EDISON

Renewi

Plotting a path for recovery and growth

Current trading, strategy and FY20 results

Industrial support services

23 July 2020

The impact of COVID-19 on current trading at the beginning of FY21 has been material but less so than previously anticipated and the underlying cash flow performance has been solid. Comfort here should allow investors to examine the strategic roadmap laid out by management targeting a significant sustainable uplift in profitability. We are reintroducing estimates, which show single-digit FY22 multiples, only partway through the business improvement programme that is underway.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
03/19	1,780.7	63.1	6.0	1.7	4.9	5.8
03/20	1,775.4	54.3	5.4**	0.5	5.4	1.7
03/21e	1,532.9	6.6	0.6	0.0	48.5	N/A
03/22e	1,691.3	42.2	3.9	0.0	7.5	N/A
03/23e	1,754.5	66.1	6.2	0.6	4.7	2.1

Note: *PBT and EPS (fully diluted) are normalised, excluding pension net finance costs, amortisation of acquired intangibles and exceptional items. FY20 is on an IFRS 16 basis. **FY20 EPS from ongoing businesses only was 5.1c.

Targeting a significant EBIT uplift

Renewi has confidently entered its next strategic business development phase despite obvious COVID-19 related trading distractions thus far in FY21. Its three-pronged approach aims to add up to €60m of incremental EBIT to group profitability within a three- to five-year framework. The contributing components in broadly equal measure are Renewi 2.0 (an internal business efficiency programme), a drive for creating more value from secondary waste streams and rebuilding dented profitability at ATM. This builds on the market-leading platform created by the Shanks/Van Gansewinkel merger at the end of FY17 and aims to capitalise on favourable long-term recycling drivers in its core markets.

Smaller than expected COVID-19 effect in Q121

The developing COVID-19 pandemic had a small effect on reported profitability at the end of FY20 and the recent Q1 update provides more detail on how this has played out in FY21 to date. Management assesses the EBIT impact to have been c €12m thus far, which is below the expected €20m previously flagged. (The high-level divisional updates are similar to those stated in May; implicitly volumes in Commercial Netherlands in particular have probably been stronger than expected.) Moreover, net debt adjusted for timing benefits from government support schemes is effectively unchanged from the year end – indicating a neutral underlying net cash flow performance – and the associated EBITDA multiple is 3.2x, well within the recently agreed covenants with lending partners.

Valuation: Looking beyond COVID-19

After absorbing initial COVID-19 market sentiment shocks, Renewi's share price has recovered from a c 18p low to settle in the 25–29p range. Looking beyond the current COVID-19 affected financial year, on our new estimates, the stock is trading on FY22e P/E and EV/EBITDA (adjusted for pensions cash) multiples of 7.5x and 4.7x, respectively. There is perhaps a wider scope for potential outcomes across all quoted companies at present, but few offer the combination of relatively resilient base markets, recovery potential and strategic impetus that Renewi does.

Price	**26.2p**
Market cap	**£210m**
	€1.11/£
Core group ongoing net debt (ex-PPP/PFI finance and IFRS 16 leases, €m) at end June 2020	413
Shares in issue	800.1m
Free float	98.8%
Code	RWI
Primary exchange	LSE
Secondary exchange	Euronext Amsterdam

Share price performance

%	1m	3m	12m
Abs	0.8	16.2	(5.4)
Rel (local)	1.4	7.2	12.8
52-week high/low		45.0p	18.1p

Business description

Renewi is a waste-to-product company with operations primarily in the Netherlands, Belgium and the UK, and was formed from the merger between Shanks Group and Van Gansewinkel Group in 2017. Its activities span the collection, processing and resale of industrial, hazardous and municipal waste.

Next events

AGM	16 July 2020

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Q121: Managing effectively through the lockdown

A trading update (7 July) noted a better first quarter trading outturn than management initially expected. Specifically, the year-on-year EBIT impact attributed to COVID-19 effects is estimated to have been c €12m, rather than the €20m originally anticipated. Moreover, the underlying cash performance (adjusting for temporary timing benefits from government scheme tax payment deferrals in the Netherlands and Belgium) has been neutral over the period, retaining significant headroom against previously announced banking facilities and covenant positions.

Within the operations, under the new divisional structure Commercial Waste volumes have improved throughout the three-month trading period (the Netherlands -6% for the quarter, Belgium's monthly run rate improving to -15% in June from -35% in April), Mineralz & Water has done slightly better than expected (albeit with slightly slower intake at ATM), while Specialities was in line. Cost reduction measures have been successful. The waste sector has largely been considered to have been an essential service during the lockdown phases. While the noted volume effects are perhaps less severe than seen elsewhere, there are pockets of Renewi's business that have had to contend with much lower inbound waste volumes than normal.

Notwithstanding the improving trends towards the end of the quarter, there is an understandable caution from management regarding the rate of further recovery. Clearly, some sectors (eg hospitality, retail) have more challenging recovery paths than others. Management is therefore monitoring other potential cost-saving actions, while at the same time pushing ahead with the implementation of its latest strategic business development phase, Renewi 2.0 (see below).

Focusing on increased value creation from waste

Summary: Renewi has entered its next phase of business development encompassing both internal and external programmes. The key components are internal business process improvement (under Renewi 2.0), accelerating revenue and profit generation from secondary materials, and delivering and enhancing the recovery of profitability at ATM as it resumes shipments of thermally treated soil.

This is not a revolutionary strategy, building as it does on Renewi's market-leading waste to products platform. It is an extension of the existing approach, with greater emphasis on creating more value from waste streams handled with increased organisational efficiency and doing so in a sustainable way.

Renewi has attached €20m EBIT targets to each of its three initiatives – with scope for some overlap here – to feed in progressively, especially from FY23 onwards. After a COVID-19 affected FY21 trading performance, our estimates (see Exhibit 11, Financial summary) show a c €57m group EBIT improvement by FY23. Specifically, for the new reporting divisions between FY21 and FY23, we expect EBIT uplifts from Commercial Waste of c €42m (to c €90m) and Mineralz & Water – incorporating ATM – by c €15m (to c €23m). Clearly, some of these improvements will arise naturally from the post-COVID-19 recovery phase, but the strategic improvements represent a substantial supplement if delivered in full. While our estimates show a very significant increase from the FY21 base year, the path by which they can be realised has been explicitly mapped out by management.

Background: The end of February 2020 marked the third anniversary of the creation of Renewi when the then Shanks Group merger with Van Gansewinkel (VGG) combined their commercial waste collection and processing networks to create the clear market leader in the core Netherlands and Belgian markets. Each party also brought specialist waste businesses into the enlarged group. On completion, the primary post-merger financial objective was to generate €40m of cost savings and synergies (with an expected cash cost of €50m) on a pro forma group EBIT base of c €63m in FY17.

The **group composition has changed and been challenged** during the three years post-merger, most obviously through the disposal of non-core operations (ie Reym and Canada Municipal, both in FY20). In addition, two business areas have faced particular headwinds, with ATM affected by industry permitting restrictions while UK Municipal has experienced contractual setbacks, which have given rise to material lifecycle onerous contract provisions. Given these effects and the change in group composition, it is difficult to ascertain true like-for-like progress. As evidence that the expected merger benefits have indeed been delivered, we note the following **Commercial Waste progress** (**from pro forma FY17 levels to FY20,** all EBIT and margin figures quoted are on an IAS 17 basis):

- **Revenue has risen by c 10%** (CAGR 3.2%), above domestic GDP growth in both the Netherlands and Belgium (+2.3% and + c 1.5% CAGRs respectively).
- **EBIT has grown by €33m** (from c €55m to c €88m).
- **EBIT margin has increased by 230p to 7.2%** (including the Netherlands +300bp to 6.9%, and Belgium +110bp to 7.6%).

One should also bear in mind that FY20 profitability was hindered by a number of exogenous factors including COVID-19 related lockdowns at the year-end (most of the €4m group hit was in Commercial Waste) and construction waste flows were interrupted by prospective industry regulation changes relating to certain chemicals. Moreover, secondary waste prices such as paper and plastics were towards their five-year low points.

Modest merger benefits have been cited in other divisions (eg Hazardous €2m, Monostreams €1m). We also note that central costs (at €26m) were similar to the initial merger pro forma level; other factors have a bearing but a stable outcome is probably the net effect of some underlying inflation and cost synergy actions, although we are unable to quantify this.

Taken together, we agree with the company that the phase one/post-merger synergy benefits have been delivered, particularly via the crucial Commercial Waste divisional development. That group profitability has not fully reflected this progress is more to do with discrete issues elsewhere in the portfolio, which could not have been foreseen at the time of the merger and have been substantially dealt with by management now.

Reinforcing and monetising competitive advantage

Having created a market-leading business platform through the merger and integration of two leading waste collection and processing companies, Renewi has entered its next phase of development led by CEO Otto De Bont (in post from April 2019, having previously been divisional MD of Commercial Waste in the Netherlands).

The updated strategy brings increased intensity to the generation of greater value from Renewi's market position based on core sustainability objectives around developing the circular economy, reducing waste and carbon emissions, and making positive community impacts. Management has mapped out a three-year business transformation strategy with the following key elements:

- **Renewi 2.0** – a business simplification and enabling strategy to improve efficiency through leaner structures and greater digitalisation.
- **Innovation** – targeting increased value generated from secondary materials through formalised, multi-pronged development processes backed by investment.
- **ATM** – managed return to the re-opened thermally treated soil market, adding value by converting disposal costs into secondary revenue streams.

We now look at each of these elements in turn:

Renewi 2.0 targets a €20m reduction in SG&A costs over a three-year period, with pooled expertise improving and standardising common best practice processes and a central administrative shared service centre function, all informed by better organisational data availability and accessibility. This

could be viewed as adapting and modernising group and divisional infrastructure to both reduce costs and provide a scalable business platform for future growth. Management has set out an explicit timeline of expected costs and benefits to implement this strategy. Exhibit 1 shows that the full annualised benefits of this programme are targeted for FY24 based on establishing this run rate by the end of FY23.

Exhibit 1: Renewi 2.0 – expected costs and benefits

€m	FY21	FY22	FY23	FY24
Net benefit	1	5	12	20
Exceptional costs	(14)	(10)	(6)	
Capex	(1)	(4)	(2)	
Net cash flow	**(14)**	**(9)**	**4**	**20**

Source: Renewi

Understandably, the fine detail of prospective changes in business structure has yet to be disclosed but will become apparent during the three-year implementation period. Some of the stated initiatives include increased digital data capture and usage at operational level (eg in collection vehicles and at depots), investment to reduce carbon emissions and more harmonised systems, implicitly with greater IT integration.

Innovation is the second prong of Renewi's business improvement strategy focused on adding value to sorted waste streams through investment in secondary processes to produce better quality saleable materials and generate additional revenue. This approach is also targeting an incremental €20m EBIT creation, with a slightly longer timeline, by FY25.

The FY20 results presentation contained an established pipeline of individual projects at varying stages of development. Some examples, where investment has already taken place, include:

- **ATM** (see below) – additional sieving equipment and storage capability, separating soil intake into constituent gravel, sand and dust/filler components to be sold and re-used as building products rather than a mixed bulk material with a disposal cost. Momentum with prospective customers following trials appears to be gathering.
- **RetourMatras** – Renewi co-invested in this mattress recycling specialist alongside an IKEA franchisee to take a 32% business stake. This company's process recycles 90% of discarded mattresses and the Commercial Waste division's collection network is able to source and supply the required inputs.
- **Bio-LNG** – having listed a transition from generating electricity from organic waste to creating bio-LNG (a low carbon fuel) as a potential subsector, Renewi's Q121 trading update announced an agreement with Shell and Nordsol in this area. No specific details of the agreement were included. Again, Renewi's Commercial Waste division (now including Orgaworld) already has access to the feedstock required.

In addition to the above, there are also other projects at earlier stages of development. Renewi's scale network position at the centre of waste flows in its markets is an obvious competitive advantage. Taking actions to further exploit latent value inherent in the streams represents an additional differentiator consistent with moving further up the waste hierarchy and the increasing onus on recycling.

At the headline, physical level, c 65% of the c 14 million tonnes of waste currently processed by Renewi is recycled and the aim is to increase this to 90% over the next five years. This has the obvious benefit of reducing incineration and landfill volumes, but also reduces any potential impact from rising regulatory costs associated with these forms of waste disposal. Compliance with industry standards (eg in consumer safety and building regulations) represents a market challenge to accepting new materials and trial phases will be good markers of progress here.

Identifying applications for secondary materials, evaluating additional process requirements and establishing market partnerships (inbound waste and outbound material) are all part of the

innovation process. Momentum in this area will be dictated by the attractiveness of returns that can be generated across individual, discrete investment projects, factoring risks associated with end market volumes and pricing.

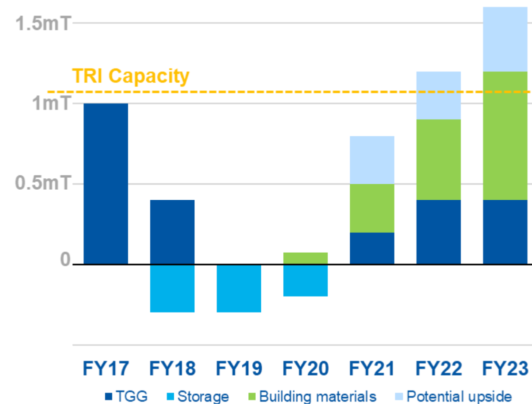
ATM: The third leg of Renewi's business transformation strategy is the recovery of annual profitability at ATM to or in excess of €20m with a likely timescale of three or more years to achieve it. An industry halt on permitting the use of thermally treated soil (TGG) has been well documented. In December 2019, after a two-year hiatus, Renewi stated that the market for shipment of TGG had re-opened, subject to local application permits being granted.

While ATM has other revenue streams, closure of the TGG market had a severe impact on profitability, reducing it to a small underlying loss-making position in FY20. At the end of that year, ATM – which has process capacity of c 1m tonnes of treated – had c 2m tonnes of soil inventory on hand, split broadly 20% untreated, 80% treated/in process. With site storage capacity full, over 1m tonnes of the treated soil was being held at third-party facilities (annualised cost c €3m). Business profitability represents the delta between inbound gate fees received and the costs of treatment and disposal of soil materials received. The envisaged recovery phases include the following:

- Resumption of TGG soil offtake/placement, reducing offsite storage costs and creating space at ATM's facility to receive new soil volumes for treatment.
- Further net reductions in TGG inventory to gradually eliminate third-party storage costs.
- Improving offtake mix in favour of revenue-generating secondary materials in place of the traditional cost to dispose model.

An illustrative progression through these phases was provided in Renewi's FY20 results presentation and we reproduce it here.

Exhibit 2: ATM outlets FY17–23e



Source: Renewi, p56 FY20 results presentation

Moving to the right, as the mix scenario evolves, the business model is transformed as treated soil moves from being a disposal cost to a revenue generator. This of course requires a growing market acceptance and penetration of secondary sorted materials (sand, gravel, dust).

We believe that ATM generated EBIT approaching €20m prior to the halt in TGG soil shipments. Market conditions (and TGG disposal costs) may have changed since then but, in principle, full capacity processing under the old business model could be capable of regaining this profit level. Management's aspiration is to meet and ultimately exceed this by a different route. There is some overlap here with the innovation strategy outlined above as building profitable secondary materials revenues is its objective also. We would suggest that the more successful ATM is in migrating its output volumes across in this way, the greater a contributor it becomes to the innovation financial target. There is, however, some incremental profit opportunity within ATM from simply restoring some or all of its previous operations.

FY20 results overview

Group revenues and EBIT for Renewi's ongoing businesses were both slightly better than we had anticipated, although reported profitability at this level was still c 6% lower year-on-year. The impact from COVID-19 lockdowns enacted in the final month of the financial year was stated to be €4m and this was effectively offset by the EBIT benefit in the year from adopting the IFRS 16 standard. Aided by the receipt of non-core disposal proceeds, core net debt reduced to €457m at the year-end (c 3x EBITDA from continuing operations). The following analysis concentrates on the performance of the ongoing businesses.

Exhibit 3: Renewi divisional splits – ongoing businesses*

€m	FY19	H120	H220	FY20	FY20 % y-o-y change	
					Reported	IAS 17
Group Revenue	**1,670.9**	**848.1**	**849.0**	**1,697.0**	**1.6%**	
Commercial Waste	1194.4	617.5	606.1	1223.6	2.4%	
Hazardous Waste*	95.4	43.0	48.7	91.7	-3.9%	
Monostreams	213.3	108.0	105.6	213.6	0.1%	
Municipal	195.2	94.3	103.0	197.2	1.1%	
Inter-company	(27.4)	(14.7)	(14.4)	(29.1)		
Group Operating Profit	**80.2**	**39.3**	**36.2**	**75.5**	**-5.8%**	**-10.2%**
Commercial Waste	86.5	46.8	43.1	89.9	3.9%	1.3%
Hazardous Waste*	1.7	2.0	(2.1)	(0.1)	N/M	N/M
Monostreams	12.9	7.6	6.9	14.5	12.4%	9.3%
Municipal	0.8	(1.5)	(1.3)	(2.8)	N/M	N/M
Central costs and services	(21.7)	(15.6)	(10.4)	(26.0)		

Source: Renewi, Edison Investment Research. Note: The FY20 EBIT figures shown are on a reported IFRS 16 basis. Favourable divisional effects were: Commercial +€2.3m, Hazardous/ATM +€1.0m, Monostreams +€0.4m, Central +€0.1m and Municipal -€0.3m. *Excludes Reym from Hazardous division; the Hazardous/ATM/group interim splits are Edison estimates.

Commercial Waste: Progressing despite market challenges

Country revenues for Renewi's largest reporting division in FY20 were split almost two-thirds in the Netherlands, and just over one-third in Belgium, which earned a slightly better margin. Management estimates that COVID-19 reduced divisional EBIT by c €4m, with the largest impact seen in Belgium.

Exhibit 4: Commercial Waste division – geographic and interim splits

€m	H119	H219	2019	H120	H220	2020
Revenue	**586.7**	**608.8**	**1,195.5**	**618.1**	**607.0**	**1,225.1**
Netherlands	375.8	388.9	**764.7**	395.2	390.8	**786.0**
Belgium	210.9	219.9	**430.8**	222.9	216.2	**439.1**
Inter-region	(0.4)	(0.7)	**(1.1)**	(0.6)	(0.9)	**(1.5)**
EBIT	**40.5**	**46.0**	**86.5**	**46.8**	**43.1**	**89.9**
Netherlands	25.3	27.9	**53.2**	29.6	26.4	**56.0**
Belgium	15.2	18.1	**33.3**	17.2	16.7	**33.9**
EBIT margins %	**6.9%**	**7.5%**	**7.2%**	**7.6%**	**7.1%**	**7.3%**
Netherlands	6.7%	7.2%	**7.0%**	7.5%	6.8%	**7.1%**
Belgium	7.2%	8.2%	**7.7%**	7.7%	7.7%	**7.7%**

Source: Renewi. Note: IFRS 16 added €1.7m to the Netherlands and €0.6m to Belgium or 20bp and 10bp respectively to EBIT/EBIT margins.

The general trends seen across the division were slightly better volumes relative to the prior year in both countries in H2 after a softer H1[1] but recyclate prices largely deteriorated in the second half, leading to a 23% drop in this income stream for the year overall. Clearly, coronavirus restrictions affected waste volumes in the final two weeks of the financial year although, as an essential service, Renewi facilities continued to operate.

[1] Core volumes year-on-year: H120 Netherlands -3%, Belgium 'lower' & FY20 Netherlands -2%, Belgium 'flat'.

Both country operations faced subsector challenges during the year with H1 incinerator capacity shortages and construction industry regulation change disrupting disposal costs and inbound volumes respectively in the Netherlands. Belgian operations incurred costs associated with the final closure of the Cetem landfill site (later requiring an exceptional provision of c €15m relating to a European Commission investigation concerning alleged state aid). To combat the effects of soft volumes, weak recyclate prices and some cost increases, Renewi was able to increase pricing for inbound waste. Together with the remaining efficiency gains from the Shanks/VGG merger, the division was able to maintain underlying margins and improve profitability year-on-year. The use of dynamic contractual pricing mechanisms to accommodate variations in recyclate prices helps to provide some revenue protection and mitigate against the full effects of weak prices. The division's main secondary material exposures are shown in Exhibit 5.

Exhibit 5: Commercial Waste division – recyclate materials exposures in FY20

Tonnes (000s)	Total	Dynamic pricing cover %	Netherlands	Belgium
Paper	**520**	**70%**	360	160
Metal	**154**	**40%**	110	44
Plastics	**91**	**60%**	64	27
Wood	**825**	**50%**	550	275

Source: Renewi

Hazardous Waste: Treated soil volumes restart at year end

Commentary here relates to the retained ATM and related businesses only and excludes Reym (a non-core industrial services company which was sold on 31 October 2019). Two-year restrictions on the sale and use of thermally treated soil (TGG) were lifted in December allowing the market to gradually restart in the final quarter of FY20. Consequently, the business was constrained for much of the year but did achieve an uplift in revenue in H2 as initial soil shipments resumed.

We have outlined the ATM business model with commentary on its recovery outlook earlier in this note, so will not repeat that here. Understandably, soil processing developments have dominated divisional newsflow but other activities have provided a business baseload sufficient to sustain profitability broadly around break-even. ATM's quayside location receives contaminated water and packaged chemicals for treatment and discharge or disposal; water volumes were slightly better year-on-year, although chemicals were slightly lower. A small satellite water treatment facility (CFS at Weert) held revenues at prior year levels.

During FY20, ATM invested in and trialled a secondary soil treatment process to produce graded constituent materials (gravel, sand and filler/dust) with a view to creating saleable product items and an associated income stream versus a historic disposal cost model. Minority interests in the development vehicle for this process (AP4 Terra, based on land adjacent to ATM) were acquired during the year and the full consolidation of which caused some drag on reported profitability. No significant revenues are thought to have been generated in the year, but momentum was noted with this project – both internally and with prospective customers – going into FY21.

In FY21, ATM and Mineralz (another soil treatment business in the Renewi portfolio) are being combined under a single management team to form the Mineralz & Water division.

Monostreams: Net gains from business turnarounds

The operating companies in this division independently process specialist segregated waste streams and generate secondary revenue streams from recovered materials. Divisional revenues were flat on a reported basis and slightly lower on an underlying basis (prior to a small acquisition by Orgaworld). EBIT recovered well from a challenged FY19 trading year and Monostreams delivered a 60bp improvement in IAS 17 profitability to 6.6% (6.8% reported). Three of the four operating companies made progress in FY20 due to sustained volume growth in the case of Orgaworld or following restructuring at both Coolrec and Maltha. These gains were partly offset by a lower contribution from Mineralz, as expected.

Orgaworld performance has improved steadily over the last couple of years and FY20 was characterised by strong inbound organic waste volumes and increased revenue from generated electricity. Rotie Organics (a collector of food waste and related de-packaging activities located near Amsterdam, acquired in May 2020) added €5.6m of revenue and €0.1m EBIT in the year.

Having exited two German sites and downsized two others in Belgium in the prior year, the ongoing electrical and electronic appliance recycling operations of **Coolrec** (including two facilities in the Netherlands and one in France) delivered improved profitability from a lower revenue base. As noted with the Commercial Waste division, notwithstanding dynamic contract pricing, adverse movements in metals and plastics recyclate prices would have provided a headwind to profit progress. **Maltha** (67%-owned with 33% minority partner and customer Owens-Illinois) closed the van Tuijl glass recycling plant during FY20, leaving eight in total (three in France, two in the Netherlands plus one each in Belgium, Portugal and Hungary). The operational performance of the main Netherlands facility at Dintelmond, south of Rotterdam, benefited most from its restructuring.

As trailed at the end of FY19, adverse regulatory rulings in the Netherlands regarding incinerator ash by-product export markets resulted in a lower profit contribution from **Mineralz**. The conversion of recycled material into building products continued to grow as a revenue stream, but this was offset by lower volumes taken to its Maasvlakte landfill site.

Overall, the EBIT improvement in this division in FY20 was all generated in the second half of the year and we believe that the turnarounds achieved by Coolrec and Maltha were primarily responsible for this. The constituent companies in this division, which are specialist in nature, are being reallocated under a new reporting structure in FY21 and a Monostreams division will no longer exist.

Municipal: Operational progress but loss reported in FY20

Renewi's P&L exposure to UK Municipal waste streams has gradually reduced in recent years due to exits from some smaller facilities and onerous contract provisions on some of the larger ones that remain. (The disposal of Canada Municipal – comprising three facilities – completed on 30 September and is not part of the discussion of ongoing operations here.) There are currently five ongoing municipal waste treatment and recycling facilities for which Renewi has had the long-term operating contract.

Exhibit 6: UK Municipal facilities, contract duration and processes

Authority/ Location	SPV Interest	Contract ends	Volume tonnes (000s) pa		MBT	MRF	AD	IVC	HWRC
ELWA	20%	2027	435		Y	Y			Y
Argyll & Bute	100%	2026	34		Y				Y
Cumbria	100%	2034	168		Y				Y
Wakefield	100%	2038	169			Y	Y	Y	Y
BDR	75%	2040	250		Y		Y		

Source: Renewi. Facilities: ELWA = East London Waste Authority, BDR = Barnsley, Doncaster & Rotherham. Recycling processes: MBT (mechanical biological treatment), MRF (materials recycling facility), AD (anaerobic digestion), IVC (in-vessel composting), HWRC (household waste recycling centre).

In most cases, Renewi also has an economic interest in the special purpose vehicle set up initially to build, commission and operate these facilities. Reported divisional revenues were stable year-on-year in FY20, with a pre IFRS 16 EBIT deterioration of €3.3m to a €2.5m EBIT loss in the period. (Note that the loss is reported after the utilisation of €12.2m onerous contract provisions made under long-term contract accounting principles in previous years.) Management reports both operational and financial improvements in most contracts, including cost control initiatives and implementation of a continuous improvement programme. Hence, the divisional profit movement relates more to non-recurring, prior-year features (including the pre-operating phase at Derby and some rates rebates) rather than an underlying shift.

That said, a structural change in ELWA's operating conditions in the final quarter of the year (namely a tax on burnable refuse-derived fuel waste exported to the Netherlands) led to a €25.9m exceptional charge, split between onerous contract provisions (€15.5m) and impairment of right of use assets (€10.4m). For the record, the original Derby contract was terminated in August 2019 following a failure by Interserve, the main contractor, to commission the facility and Renewi entered into a two-year continuity services contract at that time.

All of these UK municipal contract activities are being folded into a new Specialities division in FY21.

Net debt reduced in FY20, robust financing framework

Renewi ended FY20 with €457m core net debt pre-IFRS 16, a c €95m y-o-y reduction driven by disposal proceeds and positive underlying cash flows. IFRS 16 leases stood at c €203m at the year end. Non-recourse PFI/PPP net debt reduced by c €5m over the year to €90m.

Renewi's cash flow statement is complex due to the presence of discontinued operations, restructuring and onerous contract provision movements among other things. In this section, we have taken a broader overview than normal to provide a bigger picture view of core net debt movements. IAS 17/pre-IFRS 16 **EBITDA from ongoing businesses in FY20 was c €157.5m**[2] (this being what we believe to be the comparator for core net debt banking covenants on a frozen GAAP basis). Making **IFRS 16 adjustments to reported cash flows from operating activities** (encompassing all group activities in the year) generates a **figure of €135m:**

Exhibit 7: FY20 Cash flows from operating activities – IFRS 16 adjusted

€m	
Reported cash flows from operating activities	167.8
Less: IFRS 16 EBIT benefit	(6.2)
Less: depreciation (right of use assets)	(26.6)
Reported cash flows from operating activities (IAS 17)	**135.0**

Source: Renewi, Edison Investment Research

The difference between these two numbers is a c €23m net cash outflow at the operating level. Behind this figure, there were some fairly large line items including UK Municipal contracts/ provisioning (c €24m), synergy, integration and restructuring (c €24m) and other items (including pension deficit recovery payments) on the outflow side but also significant operating cash inflows from exited businesses (including c €39m from the discontinued Canada Municipal operations[3]). Hence, at a high level this illustrates that FY20 operating cash outflows that could be considered exceptional (although some elements are likely to recur, albeit at lower levels) were partly mitigated by some one-off/non-recurring cash inflows in the period.

Below the cash flow from operating activity level, the most notable other movements were net M&A inflows of c €81m (dominated by net cash proceeds from the disposal of Reym and Canada Municipal[4]) and net capex in excess of c €70m (of which the company considers €10m to be growth investment, with the remainder classified as replacement). For the record, cash flows related to IFRS 16 entailed a net outflow of c €6m in the year.

Cash flow outlook: Governmental COVID-19-related support for the corporate sector in the form of VAT/PAYE payment deferrals are temporary timing benefits that are likely to be substantially unwound during FY21. As part of the measures outlined to reduce costs and cash outflow in this year, capex is expected to be capped at around FY20 levels (c €35m below earlier expectations)

[2] FY20 results announcement, page 19 and reproduced in the Annual Report page 40.

[3] Annual Report FY20, note 6.4, page 195.

[4] Gross proceeds were €107m; after adjusting for cash disposed (€13.2m) and disposal costs (€5.6m), the net proceeds received for these two disposals in FY20 was €88.2m. Other net investment flows – which include the acquisition of Rotie Organics, outstanding AP4Terra minorities and a 32% stake in RetourMatras – came to c €7m.

and the absence of a final dividend payment will retain c €10m within the business. Opex cost savings are likely to be offset by restructuring costs (including Renewi 2.0). Within our estimates, we have factored in aggregate outflows of €44m relating to non-underlying items (being Renewi 2.0 restructuring of €14m, Municipal onerous contracts of €20m and ATM soil disposal costs of €10m), which individually taper down to an aggregate c €17m by FY23e. As a result, we expect core net debt to rise by €40m – broadly equivalent to the year-on-year EBIT reduction – to c €500m by the end of FY21, which would be c 4x the expected core/pre-IFRS 16 EBITDA generated in the year. Thereafter, our model has this metric declining to c 3x one year out and then c 2.5x by the end of FY23.

Core banking facilities include:

- €175m retail bonds (€100m to June 2022, €75m to July 2024);
- €25m private placement notes (to December 2023 and December 2025);
- €412.5m RCF (50% to May 2023, 50% to May 2024, both portions with extension options to May 2025); and
- €82.5m term loan (duration as for the RCF).

At the end of FY20, Renewi had drawn down c €350m (over 80%%) of its RCF, providing c €250m of liquidity on hand (c 80% in cash form) as the COVID-19 outbreak accelerated. As previously announced, Renewi has agreed a relaxation to its banking covenants with the following net debt:EBITDA limit profile: 5.5x to September 2020, increasing to 6.0x to March 2021 before reducing back to 3.5x by September 2021. The delta between the last two readings suggests that a 6x covenant is very much management's worst-case scenario that is unlikely to be tested. Given that the timing-adjusted measure (ie ignoring deferred tax/PAYE payments) for the end of June after the worst of the initial COVID-19 impact on trading was 3.2x, Renewi looks to be navigating its way well within its revised covenants and with room to spare.

Q121 trading ahead of initial management expectations

In its latest projections, the **OECD** has adopted a dual approach to its COVID-19-affected GDP estimates with single-hit (Q2) and double-hit scenarios (Q2 and Q4) and we show them for Renewi's three leading country territories in Exhibit 8.

Exhibit 8: OECD – GDP volume growth projections (Final domestic demand)

% growth, calendar y-o-y	Single outbreak scenario		Double outbreak scenario	
	2020	2021	2020	2021
Netherlands	-8.6%	7.3%	-10.7%	3.7%
Belgium	-10.6%	7.9%	-13.3%	4.6%
UK	-11.2%	8.8%	-13.6%	4.8%

Source: OECD Economic Outlook 107, June 2020

Government responses to the progression of the outbreak have varied with lockdown moves first occurring in Belgium from mid-March (starting to ease in early May) while the other two countries initiated lockdowns later in March and their initial easing was later in May. In addition, lockdown conditions in the Netherlands were less severe. Using the OECD framework, we are in the recovery phase now from the calendar Q2 hit and will be better able to judge the likelihood of a second phase as post-lockdown data and actions become apparent.

Management's initial assessment of the likely year-on-year **EBIT impact of COVID-19 on Q121** trading, which encompasses the above lockdown phases, was €20m. A trading update on 7 July revised the actual experience outcome to €12m. Moreover, adjusting for government support scheme timing benefits, the underlying cash flow performance was neutral, indicating good management control restricting potential leakage during this testing trading period.

We are now **reinstating our estimates**, which had been suspended since the end of March and are now for the three years to FY23. In broad terms, our expected 10% y-o-y revenue reduction in

FY21 is followed by a similar percentage increase in the following year. Compared to the OECD projections above, our FY20 revenue decline is similar, although the rate of recovery in FY21 is a little stronger and includes accelerating ATM top-line momentum. In profit terms, we based our FY21 EBIT expectations on management's earlier €20m Q1 EBIT effect, allowing for a similar effect for the remainder of the year as a whole on a reducing scale as it progresses. Thereafter, volume recoveries, positive effects from Renewi 2.0 restructuring and additional revenue stream development all contribute to a **substantial rebound in EBIT from the FY21 low, more than doubling by FY23**.

Exhibit 9: Renewi revised estimates

	EPS, fully diluted, normalised (p)			PBT, normalised (£m)			EBITDA (£m)		
	Old*	New	% chg.	Old*	New	% chg.	Old*	New	% chg.
FY21e	4.8	0.6	-88.4%	50.1	6.6	-86.9%	163.5	122.5	-25.1%
FY22e	5.4	3.9	-27.4%	57.0	42.2	-26.0%	171.8	159.1	-7.4%
FY23e	N/A	6.2	N/A	N/A	66.1	N/A	N/A	183.0	N/A

Source: Edison Investment Research. Note: *Our previous estimates were dated January; they were withdrawn at the end of March as COVID-19 uncertainties became apparent.

We consider that Renewi is unlikely to reinstate a dividend payment until net debt falls below 3x EBITDA. Our estimates indicate that this condition will be achieved during FY23; at this stage we assume that a final dividend will be declared in that year. We will continue to monitor this position, comparing the profile of Renewi's earnings recovery and net debt profile against our model.

Moving to a three-divisional structure

Following the disposal of non-core businesses in FY20, Renewi has adopted a revised three-division and central services reporting model. **Commercial Waste** remains the dominant revenue and profit generator in the group. Soil processing and water treatment capabilities have been brought together to form the new **Mineralz & Water** division with ATM about to enter a recovery phase, while **Specialities** comprises three separate companies, each with a distinct well-defined market focus. Some costs previously classified as central have been reallocated to the new divisions so that the old and new central cost lines are not comparable.

Exhibit 10 shows that revenue and operating profit for the ongoing businesses in FY20 were at comparable levels to those in FY18. This headline comment masks a good improvement in Commercial profitability offset by the impact of previously noted trading restrictions at ATM (now in Mineralz & Water). The businesses within Specialties have had individual challenges to overcome during the three-year period. More commentary on the new divisional structure is provided below.

Exhibit 10: New divisional structure for ongoing businesses

€m	Revenue			Operating profit			Previous divisional structure			
	2018	2019	2020	2018	2019	2020	Commercial	Hazardous	Monostreams	Municipal
	1647.1	**1670.9**	**1697.0**	**76.6**	**80.2**	**75.5**				
Commercial Waste	1176.2	1214.2	1250.2	61.6	75.0	78.6	Commercial NL & BE		Orgaworld	
Mineralz & Water	169.7	160.3	151.6	22.2	8.7	5.6		ATM	Mineralz	
Specialities	332.4	324.3	323.2	(2.6)	0.0	(1.3)			Coolrec Maltha	UK Municipal
Inter-co/central cost	(31.2)	(27.9)	(28.0)	(4.6)	(3.5)	(7.4)				

Source: Renewi

- **Commercial Waste** – this division substantially comprises the leading waste collection, reception and processing activities in the Netherlands and Belgium, supplemented and modestly expanded by the inclusion of Orgaworld (which treats organic waste, generating green energy and producing soil-enhancing composts). Orgaworld was previously part of Shanks's Dutch commercial waste activities prior to the merger with Van Gansewinkel, so the combination should be familiar.

Business model: primary revenues are generated via waste collection fees across its network and gate fees at its waste processing facilities. Profitability is determined by controlling sorting and disposal costs net of any secondary revenues earned from the sale of segregated material (or redirection to other group operations) and energy generation.

MD Netherlands: Meinderdjan Botman (from October 2019, succeeding Otto De Bont now group CEO), MD: Belgium: Wim Geens (from Shanks/VGG merger, joining with VGG).

- **Mineralz & Water** – combining ATM with Mineralz brings the former's thermal treatment plant together with the latter's washing plant network to provide a broad soil treatment service capability. Moreover, both companies have developing secondary processes to produce building products from recycled materials consistent with the group's drive to generate higher-value outputs from treated waste. (ATM's important Moerdijk wharf location, together with the smaller CFS operation at Weert, also offer specialist water, chemical and sludge processing services while Mineralz' two landfill sites round out the disposal options for both in-house treated and third-party waste, subject to local regulations.)

  Business model: these operations were created charging a gate fee for inbound contaminated materials designed to generate a profit after expected treatment and disposal costs. This model has evolved to the point where both companies have developed secondary processes to produce saleable products, thus converting what has historically been a disposal cost into a growing revenue stream, chiefly in the building materials subsector.

  MD: Theo Olijve (previously MD of Hazardous Waste from 1 June 2019).

- **Specialities** – this division now contains two niche waste stream processors and producers of recycled secondary materials, plus Renewi's UK Municipal waste processing operations. These businesses operate independently; one could observe that each operates at least partly outside the group's core Netherlands/Belgium country focus and is undertaking business improvements to improve financial performance following site consolidation.

  Business models: both Coolrec (electrical and electronic appliances, primarily white goods) and Maltha (flat and packaging glass) generate revenues through gate fees charged for receiving damaged products for reprocessing and disposal. Importantly, income is also derived from the sale of recovered materials in scrap (eg metals) and reprocessed forms (eg plastics) and this can account for two-thirds or more of total revenue. Hence, the top line here is linked to prices of recycled materials to a greater extent than elsewhere in the group. As described previously, UK Municipal operates five waste treatment and recycling facilities under long-term contracts with local authority bodies. Variances in volumes and disposal costs have created some structurally unprofitable facilities requiring accelerated loss recognition through onerous contract provisions.

  MD: James Priestley (previously MD of Municipal, from November 2016).

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Exhibit 11: Financial summary

m	2018	2018	2019	2020	2021e	2022e	2023e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS	**Sterling**	**Euros**	**Euros**	**Euros**	**Euros**	**Euros**	**Euros**
Revenue	1,565.7	1,760.3	1,780.7	1,775.4	1,532.9	1,691.3	1,754.5
Cost of Sales	(1,276.9)	(1,419.2)	(1,470.4)	(1,467.5)	(1,272.3)	(1,399.5)	(1,447.5)
Gross Profit	288.8	341.1	310.3	307.9	260.6	291.7	307.0
EBITDA	156.9	176.3	179.7	167.1	122.5	159.1	183.0
Operating Profit (before GW and except.)	69.1	82.5	85.5	87.6	41.5	76.6	99.0
Net Interest	(14.2)	(15.0)	(14.4)	(18.5)	(20.0)	(19.5)	(18.0)
Other Finance	(5.1)	(7.1)	(8.4)	(15.7)	(14.9)	(14.9)	(14.9)
JV/Associates	2.3	2.6	0.4	0.9	0.0	0.0	0.0
Intangible Amortisation	(5.8)	(6.7)	(6.4)	(6.4)	(6.4)	(6.4)	(6.4)
Non-trading & Exceptional Items	(95.7)	(108.4)	(145.1)	(107.1)	(14.0)	(10.0)	(6.0)
Profit Before Tax (Edison norm)	52.1	63.0	63.1	54.3	6.6	42.2	66.1
Pension net finance costs	(0.6)	(0.7)	(0.6)	(0.2)	(0.2)	(0.2)	(0.2)
Profit Before Tax (Renewi norm)	51.5	62.3	62.5	54.1	6.4	42.0	65.9
Profit Before Tax (statutory)	(50.0)	(52.8)	(89.0)	(59.4)	(14.0)	25.6	53.5
Tax - headline	2.6	1.4	12.4	(1.1)	(1.6)	(10.1)	(15.9)
Profit After Tax (norm)	39.1	47.2	47.5	41.0	5.0	32.0	50.2
Profit After Tax	(47.4)	(51.5)	(76.6)	(60.5)	(15.6)	15.4	37.6
Average Number of Shares Outstanding (m)	799.9	799.9	796.7	794.9	794.9	794.9	794.9
EPS - Edison norm (p/c) FD	4.9	5.9	6.0	5.4	0.6	3.9	6.2
EPS - Renewi norm (p/c) FD	4.8	5.4	6.0	5.4	0.5	3.9	6.2
EPS - (p/c)	(5.9)	(6.8)	(11.7)	(9.8)	(2.0)	1.8	4.6
Dividend per share (p/c)	3.05	3.46	1.68	0.52	0.00	0.00	0.56
Gross Margin (%)	18.4	19.4	17.4	17.3	17.0	17.3	17.5
EBITDA Margin (%)	10.0	10.0	10.1	9.4	8.0	9.4	10.4
Operating Margin (before GW and except.) (%)	4.4	4.7	4.8	4.9	2.7	4.5	5.6
BALANCE SHEET							
Fixed Assets	1,456.3	1,669.2	1,439.6	1,616.8	1,606.7	1,605.1	1,607.0
Intangible Assets	606.3	699.3	605.6	610.1	599.6	589.1	578.6
Tangible Assets (inc RoU assets)	623.0	710.8	629.1	790.9	791.3	800.2	812.6
Investments	227.0	259.1	204.9	215.8	215.8	215.8	215.8
Current Assets	366.2	418.0	533.3	503.3	436.6	364.5	407.2
Stocks	23.3	26.6	26.0	20.7	17.9	19.7	20.4
Debtors	279.0	318.4	456.9	288.1	264.1	283.1	292.0
Cash	63.9	73.0	50.4	194.5	154.6	61.6	94.8
Current Liabilities	(545.8)	(631.0)	(758.3)	(635.2)	(593.1)	(618.2)	(633.8)
Creditors	(532.9)	(616.3)	(639.6)	(618.4)	(576.3)	(601.4)	(617.0)
Short term borrowings	(12.9)	(14.7)	(118.7)	(16.8)	(16.8)	(16.8)	(16.8)
Long Term Liabilities	(894.3)	(1,019.9)	(895.1)	(1,249.6)	(1,230.5)	(1,116.3)	(1,107.7)
Long term borrowings	(489.7)	(558.9)	(483.7)	(634.9)	(634.9)	(534.9)	(534.9)
Other long-term liabilities	(404.6)	(461.0)	(411.4)	(614.7)	(595.6)	(581.4)	(572.8)
Net Assets	382.4	436.3	319.5	235.3	219.7	235.1	272.8
CASH FLOW							
Operating Cash Flow	128.4	143.6	86.8	167.8	115.5	157.0	195.2
Net Interest	(16.9)	(19.1)	(17.7)	(27.0)	(26.6)	(26.1)	(24.6)
Tax	(6.7)	(7.6)	(13.2)	(10.1)	(16.5)	(1.6)	(10.1)
Net Capex	(81.2)	(92.3)	(99.4)	(73.4)	(77.3)	(87.3)	(92.3)
Acquisitions/disposals	(4.1)	(4.8)	22.7	81.0	0.0	0.0	0.0
Equity Financing	0.6	0.6	(2.7)	0.6	0.0	0.0	0.0
Dividends	(24.4)	(27.6)	(27.4)	(8.6)	0.0	0.0	0.0
Net Cash Flow	(4.3)	(7.3)	(50.9)	130.3	(4.9)	42.0	68.2
Opening core net debt/(cash)	423.9	492.7	500.0	552.0	457.2	497.1	490.1
IFRS 16 lease capital repayments	0.0	0.0	0.0	(38.5)	(35.0)	(35.0)	(35.0)
Other	(10.5)	(0.0)	(1.1)	3.0	0.0	0.0	0.0
Closing core net debt/(cash)	438.7	500.0	552.0	457.2	497.1	490.1	456.9
Closing PPP/PFI non-recourse net debt	82.9	94.6	95.4	90.0	90.0	90.0	90.0
IFRS 16 Lease finance				202.7	204.7	206.7	208.7

Source: Company accounts, Edison Investment Research

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