

Augean

Trading update

Trading statement lowers guidance

Augean's half-year trading update has highlighted a challenging contract issue, which is reducing group profitability and weighing on the company's outlook. The problem, in the recently acquired Colt business, has resulted in a cut to our PBT forecasts for FY17 and FY18 of 10% and 13% respectively. Furthermore, we reduce our fair value per share to 67p from 80p. Management is taking decisive steps to offset the problem by instigating a £2m cost reduction programme. Despite our profit forecast reduction and the risk of further negative newsflow as contract negotiations near completion in September, we take some comfort from the fact that, despite Augean's challenges, both our forecasts and management guidance still imply a y-o-y increase in profit before tax.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	61.0	6.0	4.65	0.65	11.3	1.2
12/16	76.0	7.0	4.42	1.00	11.9	1.9
12/17e	87.5	7.3	5.23	1.20	10.0	2.3
12/18e	92.2	8.3	6.09	1.44	8.6	2.7

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

Legacy contract issue in Colt depresses outlook

A "major legacy contract" within Colt, which was acquired in 2016 and now sits in the Industry & Infrastructure (I&I) division, has been loss-making in the first half. At the time of acquisition, Colt was expected to contribute more than £1m of operating profit in FY17. We now forecast that the whole I&I unit will be loss-making in FY17 and reach break-even in FY18. Management is renegotiating the contract with the customer, expects this process to complete in September and anticipates a positive impact on I&I in the second half of 2017.

Positives and year-on-year growth remain

Our reduction in I&I profits for FY17 and FY18 is partly mitigated by new contract wins in Radioactive Waste Services (RWS), which will contribute £4m in revenues over the next two years. Several other businesses within Augean, such as the legacy I&I business, are performing strongly. Additionally, management has commenced an open-ended £2m efficiency programme. Therefore, despite our reduced forecasts, we still expect y-o-y underlying PBT to grow by 5%.

Valuation and earnings decreased

Our DCF-based fair value per share declines to 67p from 80p as a reflection of our revenue and earnings forecast reduction and an increase in the discount rate we apply to Augean's cash flows (to 9.3% from 8.7%). We view a higher cost of capital as prudent given heightened operational uncertainty.

Industrial support services

27 July 2017

Price 52.50p
Market cap £54m

Net debt (£m) at 31 December 2016	10.8
Shares in issue	102.8m
Free float	100%
Code	AUG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	6.7	5.8	43.5
Rel (local)	7.9	1.9	27.9
52-week high/low	66.00p	44.25p	

Business description

Augean manages hazardous waste through a divisional structure of five businesses: Radioactive Waste Services (3% of group revenues), Energy & Construction (37%), Industry & Infrastructure (21%), Augean Integrated Services - AIS (11%) and Augean North Sea Services - ANSS (27%).

Next events

Interim results	19 September 2017
-----------------	-------------------

Analysts

Jamie Aitkenhead	+44 (0)20 3077 5746
Roger Johnston	+44 (0)20 3077 5722

industrials@edisongroup.com

[Edison profile page](#)

**Augean is a research client of
Edison Investment Research
Limited**

Trading statement disappoints

Augean's half-year trading update was disappointing, with the Colt acquisition in particular proving to be a headwind. Despite this, profit for the first half of 2017 was in line with the previous period.

- **Energy and Construction (E&C):** profits slightly down h-o-h as the rise in air pollution control residue (APCR) revenues was more than offset by a decline in other materials. This decline is in line with our previously published forecasts for y-o-y declines in EBITDA and operating profit.
- **Radioactive Waste Services (RWS):** profit to improve in FY17 as the company begins to see the benefit from the £4m of new contracts signed. The contracts commenced at the beginning of Q217 and will last for two years, with management guiding to “typical RWS margins”, which we interpret as in excess of 50%.
- **Industry & Infrastructure (I&I):** the Colt acquisition has caused severe difficulties in the I&I unit as issues persist with one legacy contract. Management guides to contract negotiations being complete by September with an improvement expected in the second half of 2017.
- **Integrated Services:** profit flat h-o-h with waste volumes steady and the East Kent high temperature incinerator reaching break-even by the end of the second half.
- **North Sea Services:** H117 profitable versus a £0.3m loss in H116.

Financials and forecasts

We have cut our earnings forecasts principally as a result of the difficulties in I&I (Colt). This is partly offset by an increase in our RWS forecasts to reflect the new contract wins. A summary of these changes is shown in Exhibit 1.

Exhibit 1: Augean earnings forecast changes

£000s	2017e	2018e
New Energy & Construction Operating Profit	7,523	7,817
Old Energy and Construction Operating Profit	7,523	7,817
+/- New vs old	0.0%	0.0%
New Radioactive Waste Services Operating Profit	998	1,226
Old Radioactive Waste Services Operating Profit	520	1,135
+/- New vs old	91.9%	8.0%
New Industry & Infrastructure Operating Profit	(298)	23
Old Industry and Infrastructure Operating Profit	1,035	1,323
+/- New vs old	(128.7%)	(98.3%)
New Augean Integrated Services Operating Profit	638	825
Old Augean Integrated Services Operating Profit	638	825
+/- New vs old	0.0%	0.0%
New North Sea Services Operating Profit	934	964
Old North Sea Services Operating Profit	934	964
+/- New vs old	0.0%	0.0%
New Central costs	(1,420)	(1,491)
Old Central costs	(1,420)	(1,491)
+/- New vs old	0.0%	0.0%
New Operating profit (clean)	8,376	9,364
Old Operating profit (clean)	9,230	10,573
+/- New vs old	(9.3%)	(11.4%)
New PBT (clean)	7,334	8,322
Old PBT (clean)	8,188	9,531
+/- New vs old	(10.4%)	(12.7%)
DPS (pence)	1.20	1.44
DPS (pence)	1.20	1.44
+/- New vs old	0.0%	0.0%
New net debt	9,924	7,898
Old net debt	9,014	5,996
+/- New vs old	10.1%	31.7%

Source: Edison Investment Research

Fair value reduced from 80p to 67p

We reduce our PBT forecasts by 10% for FY17 and 13% for FY18, which accounts for some of the reduction in our fair value per share. The other factor is an increase in the discount rate we apply to Augean's cash flows in our DCF model. Our new post-tax WACC is 9.3% versus 8.7% previously. The uplift is a function of an increase in our assumed beta from 0.8 to 0.9 to reflect increased volatility from current difficult trading conditions. We maintain a terminal growth rate of 1%. The implied fair value per share is 67p, which offers 28% upside to the current price of 52.5p.

Exhibit 2: Financial summary

	£'000	2015	2016	2017e	2018e	2019e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		61,005	75,959	87,471	92,197	97,272
EBITDA		11,923	13,810	14,816	16,262	17,550
Operating Profit (before amort. and except.)		6,820	7,798	8,376	9,364	10,161
Intangible Amortisation		133	262	0	0	0
Exceptionals		3,508	5,719	700	0	0
Operating Profit		10,461	13,779	9,076	9,364	10,161
Associated company		0	0	0	0	0
Exceptionals		0	0	0	0	0
Net Interest		(788)	(812)	(1,042)	(1,042)	(1,042)
Profit Before Tax (norm)		6,032	6,986	7,334	8,322	9,119
Profit Before Tax (IFRS)		9,673	12,967	8,034	8,322	9,119
Tax		(1,227)	(2,464)	(1,980)	(2,080)	(2,188)
Profit After Tax (norm)		4,805	4,522	5,354	6,241	6,930
Profit After Tax (IFRS)		8,446	10,503	6,054	6,241	6,930
Average Number of Shares Outstanding (m)		102.1	102.4	102.4	102.4	102.4
EPS - normalised (p)		4.65	4.42	5.23	6.09	6.77
EPS - normalised and fully diluted (p)		4.53	4.34	5.14	5.99	6.65
EPS - (IFRS) (p)		8.22	10.25	5.91	6.09	6.77
Dividend per share (p)		0.65	1.00	1.20	1.44	1.73
EBITDA Margin (%)		19.5	18.2	16.9	17.6	18.0
Operating Margin (before GW and except.) (%)		11.2	10.3	9.6	10.2	10.4
BALANCE SHEET						
Fixed Assets		65,205	71,913	74,028	76,294	78,722
Intangible Assets		22,287	27,438	27,438	27,438	27,438
Tangible Assets		42,918	44,475	46,590	48,856	51,284
Investments		0	0	0	0	0
Current Assets		15,688	22,028	25,771	28,962	32,708
Stocks		306	379	433	448	470
Debtors		11,829	18,461	21,259	22,407	23,641
Cash		3,553	3,188	4,080	6,106	8,597
Other		0	0	0	0	0
Current Liabilities		12,857	18,071	20,505	21,195	22,208
Creditors		11,803	17,900	20,334	21,024	22,037
Short term borrowings		1,054	171	171	171	171
Long Term Liabilities		13,638	21,303	21,303	21,303	21,303
Long term borrowings		6,764	13,833	13,833	13,833	13,833
Other long term liabilities		6,874	7,470	7,470	7,470	7,470
Net Assets		107,388	133,315	141,607	147,754	154,941
CASH FLOW						
Operating Cash Flow		12,348	12,859	13,698	15,788	17,307
Net Interest		(715)	(704)	(1,042)	(1,042)	(1,042)
Tax		(1,105)	(941)	(1,980)	(2,080)	(2,188)
Capex		(7,474)	(8,335)	(8,555)	(9,164)	(9,816)
Acquisitions/disposals		(91)	(8,901)	0	0	0
Financing		460	614	0	0	0
Dividends		(511)	(665)	(1,229)	(1,475)	(1,770)
Net Cash Flow		2,912	(6,073)	892	2,027	2,491
Opening net debt/(cash)		5,712	4,265	10,816	9,924	7,898
HP finance leases initiated		0	0	0	0	0
Other		(1,465)	(478)	0	0	0
Closing net debt/(cash)		4,265	10,816	9,924	7,898	5,407

Source: Augean accounts, Edison Investment Research

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison and is not regulated by the Australian Securities and Investment Commission. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2017 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Augean and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Aus and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2017. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE data is permitted without FTSE's express written consent.