

Renewi

H119 results

Near-term trading distracting from long-term trend

Longer-term recycling trends remain favourable and the next phase of strategic development indicates greater focus in core areas to pursue growth. In the near term, we acknowledge that ATM will be a distraction until full permit authority is formally restored and is weighing on our earnings expectations, which have stepped down by c 20% this year and by a lower double-digit percentage in the following two years. In a period of stark, risk-averse market sentiment, Renewi's share price has suffered, but a 20%+ NAV discount and an 8% prospective dividend yield should be clear triggers for investors.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
03/18	1,779.1	59.1	5.5	3.5	7.8	8.1
03/19e	1,789.0	62.3	5.8	3.5	7.4	8.1
03/20e	1,823.3	83.0	7.8	3.5	5.5	8.1

Note: *PBT and EPS (fully diluted) are normalised, excluding pension net finance costs, amortisation of acquired intangibles and exceptional items.

Negotiating variable conditions, increasing focus

Robust revenue and profit performance in Commercial and recovery in Municipal were the H119 highlights, although overall group profitability was affected by lower contributions from Monostreams and Hazardous. Net debt was at comparable levels to the end-FY18 level and the interim dividend was maintained.

In terms of outlook, there are some uncertainties (eg ATM's trading position, the commissioning of a new UK Municipal facility and possible Brexit-related cross-border flows), but an intended disposal of two businesses (Reym and Municipal – Canada) will simplify the organisational structure and increase focus on strong market positions in a large part of the group, in our view. We see underlying core net debt as being stable and believe that an associated reduction in net debt would be received favourably. Extending Green financing arrangements is a further endorsement of the company's environmental credentials. We will factor in disposal effects and potential impacts from the next stage 'focus and grow' strategy as details emerge. Ahead of this, we have reduced our earnings estimates by 23%, 16% and 13% for the FY19 to FY21 years inclusive, respectively. Hazardous forms a significant proportion of this, although we have made smaller downward adjustments to Commercial and Monostreams also, based on H1 trading newsflow.

Valuation: Discount to NAV and 8.1% dividend yield

Apart from a mini rally around the middle of the year, Renewi's share price has seen a downward trend for much of 2018 and sits at just one-third of the high seen in January. Issues at ATM have perhaps reduced investor confidence in estimates, but resolution here can be a catalyst for renewed interest in our view. We note that the current share price represents a c 26% discount to the end-H119 NAV (50p or 56 euro cents). Current year valuation metrics are now a P/E of 7.4x and EV/EBITDA (adjusted for pensions cash) of 4.7x, with reductions following expected earnings growth in the subsequent two years. A maintained dividend payout (1.7x covered by our FY19 EPS estimate) prospectively yields an eye-catching 8.1%.

Industrial support services

17 December 2018

Price **38.25p**
Market cap **£306m**

£/€1.12

Net debt (€m) at end September 2018 496.1

Core group net debt (ex PPP/PFI finance)

Shares in issue 800.1m

Free float 99.5%

Code RWI

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (15.0) (39.0) (61.3)

Rel (local) (12.1) (34.0) (57.6)

52-week high/low 108.2p 37.0p

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

H119 DPS 0.95p to be paid 4 January 2019

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H119 results overview

Reporting in euros for the first time, Renewi's H119 results showed a strong turnaround in Municipal performance, a similar Commercial EBIT outturn y-o-y, offset by flagged permit issues at ATM in the Hazardous division and mixed trading among Monostreams operating companies. The cash flow and period-end net debt position were better than earlier management expectations and the interim dividend was maintained. We show the scale of each of Renewi's four divisions, together with profitability and performance relative to H118, in Exhibit 1 below.

Exhibit 1: Renewi divisional & interim splits					
€m	H1	H2	2018	H1	% chg y-o-y
Group Revenue	890.4	888.7	1,779.1	900.4	1.1%
Commercial Waste	574.6	583.6	1158.2	586.3	2.0%
Hazardous Waste	117.3	113.6	230.9	108.0	-7.9%
Monostreams	102.4	102.0	204.4	110.5	7.9%
Municipal	112.3	107.0	219.3	113.4	1.0%
Services/Interco	(16.2)	(17.6)	(33.8)	(17.8)	
Group Operating Profit	49.5	29.0	78.5	44.8	-9.6%
Commercial Waste	41.1	32.2	73.3	40.5	-1.5%
Hazardous Waste	15.7	4.2	19.9	5.9	-62.4%
Monostreams	10.8	7.4	18.2	8.8	-18.5%
Municipal	(5.6)	(5.0)	(10.6)	4.3	-177.1%
Services/Central	(12.5)	(9.8)	(22.3)	-14.7	
Source: Company					

The divisions shown above operate with different business models and have distinct market exposures. For example, Commercial Waste (continental Europe, predominantly the Netherlands and Belgium) and Municipal (UK and Canada) revenues are substantially derived from inbound local waste streams, while Monostreams is more dependent on the price/volume of processed waste sold. Hazardous shows a more even balance between activity carried out on customer premises (this is entirely Reym, we believe) and its own (a combination of Reym and ATM). These model differences are summarised in Exhibit 2.

Exhibit 2: Renewi H119 divisional split by revenue source						
€m	Commercial	Hazardous	Monostreams	Municipal	Inter-company	Total
Revenue	586.3	108.0	110.5	113.4	-17.8	900.4
Inbound	83%	45%	27%	86%	99%	72%
Outbound	12%	3%	72%	3%	1%	17%
Onsite	4%	52%	0%	0%	0%	9%
Other	0%	0%	1%	11%	0%	2%
Source: Company. Note: Inbound = fee received for treatment at Renewi facility. Outbound = sale of processed waste outputs (ie recyclates, energy). Onsite = fee received for treatment at customer's site.						

Compared to the previous corresponding six-month period, three of the four divisions experienced reductions in outbound waste income owing to weaker secondary markets – affected by China taking less paper and plastics. Monostreams was the exception, benefiting from increasing commercial arrangements for specific [high-quality] waste streams (eg closed loop vacuum recycling, digital printing). Additionally, three of the four divisions increased inbound fee income reflecting generally healthy activity levels. The high-profile exception to this was Hazardous, where a stop on selling thermally treated soil affected throughput (and also intake fees as site holding capacity filled). In the following sections, we now discuss individual divisional performance.

1. Commercial – stable sector, cost pressures

Netherlands operations account for just over 60% of this division and delivered a 3% y-o-y revenue increase and 1% in operating profit. In comparison, **Belgium** saw a flat top line and a 5% reduction in profitability. Market conditions were generally solid, with maintained to slightly better volumes and

some incremental pricing benefits coming through, although lower y-o-y received paper and plastics recyclate prices constrained revenue development to some extent. There was slight margin erosion in the period, with higher disposal costs of residual waste especially contributing to this, due to tight market incinerator capacity. Belgium started the roll out of new, integrated collection routes during the period and the Netherlands is now underway also; there were limited incremental synergy benefits in H1, but more are anticipated in H2 and beyond.

2. Hazardous – good demand levels, performance compromised by timing issues

Both **Reym** (cleaning services for industrial equipment) and **ATM** (treatment of contaminated materials) faced challenges in H1. The step down in thermally treated soil volumes at ATM began in mid-FY18 and continues, pending a re-permitting of this process; dialogue with the national regulator and a collective of regional ones (which, broadly speaking, set technical standards and issue local soil use/re-use permits respectively) is ongoing. The treatment of waste water and chemicals is not affected and activity in these streams is also understood to have been robust. Oil and gas industry activity levels – Reym's primary market – were described as good, although schedule changes leading to unrecovered overheads had a negative impact on profitability y-o-y. Reym is now considered to be non-core due to a lack of group fit and potential disposal is under active consideration

3. Monostreams – good segments outweighed by market challenges elsewhere

The companies servicing four independent waste recycling streams in this division experienced varying fortunes in H1. **Orgaworld** (processing organic waste into energy and secondary products) and **Mineralz** (incinerator bottom ash recycling and disposal) both traded well and saw good y-o-y volume progress. Waste electrical/electronic equipment recycling (**Coolrec**) and glass recycling operations (**Maltha and van Tuijl**) faced different market challenges, being inbound mix/volumes and secondary metals pricing in the former case and commercial outlets in the latter. In response to this and some operational issues, cost reduction activities have taken place in both areas. We read into this that they were the primary drag on the lower profit contribution generated from the division overall. By the same token, one would expect the actions taken to come through in improved performance in future periods.

4. Municipal – progress in both the UK and Canada

In the **UK**, a degree of change complicates a true I-f-I comparison with the prior year with exits from two facilities (Westcott Park and Cumbernauld), the then impending (now complete) exit from a third (Dumfries & Galloway), and onerous contract effects at Wakefield. Overall, reported UK revenues were maintained, which implies some improvement from ongoing facilities. Allowing for c €2m of one-off benefits from actions taken and €2m onerous contract accounting revisions explains a significant proportion of the y-o-y UK profit increase, but suggests there was underlying improvement also. We note that the full commissioning of the new Derby facility is running behind schedule and anticipate a further update on this before the year end. Operations in **Canada** are somewhat smaller than the UK, but H1 profitability was comparable and represented a turnaround from a loss-making position in H118. Each of the three facilities operated contributed to this, with a number of operational, contractual and business churn issues largely moving forward in a favourable way. The initial period of full service operation at the new Surrey biofuel facility appears to have gone well.

Core net debt edges higher, neutral underlying cash flow

Core group net debt of €496m at the end of September was in line with the level a year earlier and slightly below the €501m reported at the end of FY18. Integration and synergy generation cash costs relating to the Shanks/VGG merger were broadly in alignment with and balanced out by portfolio management activities.

Renewi's EBITDA was c €93m in the first half and below the prior year level. Working capital was effectively a neutral line item (ie less than €1m outflow) consistent with a flat top line, and together these points indicate significant core cash flow generation. After taking into account significant cash flows associated with synergy and integration of c €19m and other outflows (including pension recovery cash), Renewi generated €68m trading cash inflow overall.

Interest and tax of €15m (largely the former, with cash tax likely to be H2 weighted) and net capex (€46.5m, including €2.3m intangibles relating to IT platform investment) running slightly ahead of depreciation were the primary other normal operating cash flow items. Other net business investment overall generated proceeds of c €19m; this effectively all came from the previously announced disposal of the company's 50% stake in the Energen Biogas facility in Scotland, with other elements offsetting each other in aggregate. After paying the FY18 final dividend (c €19m) and the acquisition of shares for employee share schemes (c €1m), the core net cash inflow for H119 as a whole was c €5m.

Cash flow outlook: We expect to see a broadly similar, albeit slightly lower underlying trading cash flow performance in H2 compared to H1. This is partly seasonal and we have modelled some low-level working capital absorption in the period also. Exceptional cash costs of c €20m will be comparable to those seen in H1; half of this relates to integration/synergy activities and the other half contractually arises from the early termination of the Dumfries & Galloway agreement. Below this we have factored in higher capex levels (to over €110m for the full year, including spend on intangible assets). After all other normal line items (ie interest, tax and dividends), we project c €28m overall cash outflow in H2, which suggests an end-FY19 core net debt level of c €524m, or c 2.8x EBITDA generated in the year. As referenced earlier, two businesses (Reym and Municipal – Canada) have been earmarked for disposal, but our estimates – P&L and cash flow – will only be adjusted when any such deals are announced and/or completed. Beyond FY19, our model projects free cash inflow approaching €40m in FY20 (and c €11m at the net level after cash dividend payments), with a further step-up in FY21 with increased profitability and reduced cash exceptional spend being key contributors to this.

Total PFI/PPP (non-recourse) net debt: For the record, and excluded from the above commentary, total PFI/PPP (non-recourse) debt within Municipal special purpose vehicles stood at €90.5m at the end of H119 versus €94.5m six months earlier. The difference is explained by a €2.6m partial repayment of PFI/PPP vehicle loans and a favourable exchange rate movement (the euro strengthening against sterling). We assume neutral cash flows between the company and these vehicles in our estimates.

Currency, mix changes and estimates lowered

Following the company's change in reporting currency, we are presenting our estimates in euros for the first time. In underlying terms, we have trimmed our expectations for Commercial and made downward adjustments to Monostreams – both reflecting H1 market commentary – partly offset by improved Municipal estimates (FY19 only). For these businesses collectively, our EBIT expectations have been lowered by c 10%. In Hazardous, issues specific to ATM cause us to lower FY19 estimates in line with explicit management guidance. Beyond this, we have assumed ATM activity at c 90% of FY18 levels in FY20 and c 100% in FY21; profit recovery here should be boosted by a backlog of pre- and post-treated soil. We have also taken a more conservative stance on Reym profit development across our estimate horizon. At the group level, the above changes are slightly softened by an improved overall contribution from net finance and associate income. Taken as a whole, our group PBT/EPS forecasts have been reduced for the FY19 to FY21 years inclusive by 22%, 15% and 12% respectively. Our expectation of a DPS increase is now for FY21 (previously FY20).

Exhibit 3: Financial summary

	m's	2012	2013	2014	2015	2016	2017	2018	2018	2019e	2020e	2021e
March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS	Sterling	Sterling	Sterling	Sterling	Sterling	Sterling	Sterling	Sterling	Euros	Euros	Euros	Euros
Revenue	750.1	614.6	633.4	601.4	614.8	779.2	1,565.7	1,779.1	1,789.0	1,823.3	1,870.7	
Cost of Sales	(622.9)	(511.6)	(528.3)	(506.1)	(517.8)	(653.3)	(1,276.9)	(1,423.6)	(1,458.8)	(1,481.5)	(1,531.0)	
Gross Profit	127.2	103.0	105.1	95.3	97.0	125.9	288.8	355.5	330.1	341.8	339.7	
EBITDA	105.0	88.4	88.5	72.6	69.2	81.6	156.9	176.3	186.8	213.3	223.7	
Operating Profit (before GW and except.)	53.4	44.9	45.6	34.3	33.4	36.5	69.1	78.5	85.0	107.5	116.4	
Net Interest	(10.8)	(10.8)	(12.6)	(11.4)	(11.2)	(10.3)	(14.2)	(16.0)	(16.3)	(17.5)	(18.0)	
Other Finance	(6.4)	(3.9)	(2.9)	(1.5)	(1.6)	(2.2)	(5.1)	(6.0)	(7.0)	(7.0)	(7.0)	
JV/Associates	0.1	0.3	0.3	0.8	1.0	2.0	2.3	2.6	0.6	0.0	0.0	
Intangible Amortisation	(3.7)	(2.5)	(2.3)	(1.9)	(1.8)	(2.1)	(5.8)	(6.5)	(6.4)	(6.4)	(6.4)	
Non Trading & Exceptional Items	(2.9)	(37.8)	(20.2)	(40.3)	(21.8)	(85.0)	(95.7)	(108.6)	(30.0)	(9.0)	0.0	
Profit Before Tax (Edison norm)	36.3	30.5	30.4	22.2	21.6	26.0	52.1	59.1	62.3	83.0	91.4	
Pension net finance costs	0.2	(0.3)	(0.3)	(0.5)	(0.5)	(0.3)	(0.6)	0.0	0.0	0.0	0.0	
Profit Before Tax (Renewi norm)	36.5	30.2	30.1	21.7	21.1	25.7	51.5	59.1	62.3	83.0	91.4	
Profit Before Tax (FRS 3)	29.9	(10.1)	7.6	(20.5)	(2.5)	(61.4)	(50.0)	(56.7)	25.2	66.9	84.3	
Tax - headline	(4.2)	(1.1)	(5.8)	2.3	(1.5)	0.5	2.6	2.7	(15.6)	(20.3)	(21.9)	
Profit After Tax (norm)	26.6	22.8	23.2	20.5	19.3	20.1	39.1	44.3	46.7	62.6	69.5	
Profit After Tax (FRS 3)	25.7	(11.2)	1.8	(18.2)	(4.0)	(60.9)	(47.4)	(54.0)	9.6	46.6	62.4	
Average Number of Shares Outstanding (m)	448.0	448.3	448.9	449.1	449.5	536.3	799.9	799.9	798.7	798.7	798.7	
EPS - Edison norm (p) FD	5.9	5.1	5.1	4.5	4.3	3.7	4.9	5.5	5.8	7.8	8.7	
EPS - Renewi norm (p) FD	6.0	5.0	5.1	4.4	4.2	3.7	4.8	5.4	5.7	7.7	8.6	
EPS - FRS 3 (p)	5.7	(7.9)	(6.3)	(3.8)	(0.9)	(11.4)	(5.9)	(6.7)	1.2	5.8	7.8	
Dividend per share (p)	3.05	3.05	3.05	3.05	3.05	3.05	3.05	3.46	3.48	3.48	3.93	
Gross Margin (%)	17.0	16.8	16.6	15.9	15.8	16.2	18.4	20.0	18.5	18.7	18.2	
EBITDA Margin (%)	14.0	14.4	14.0	12.1	11.3	10.5	10.0	9.9	10.4	11.7	12.0	
Operating Margin (before GW and except.) (%)	7.1	7.3	7.2	5.7	5.4	4.7	4.4	4.4	4.8	5.9	6.2	
BALANCE SHEET												
Fixed Assets	751.6	772.1	744.4	737.3	670.4	1,420.9	1,456.3	1,661.0	1,639.6	1,645.9	1,644.6	
Intangible Assets	271.4	251.8	211.1	173.8	194.5	603.3	606.3	691.1	678.1	667.3	653.9	
Tangible Assets	390.9	375.3	322.7	282.9	297.0	587.4	623.0	710.8	714.6	729.8	741.9	
Investments	89.3	145.0	210.6	280.6	178.9	230.2	227.0	259.1	246.9	248.8	248.8	
Current Assets	233.6	247.3	265.1	224.0	177.0	348.2	366.2	418.0	418.5	404.3	416.1	
Stocks	10.5	11.0	9.4	6.9	6.8	19.9	23.3	26.6	26.0	26.3	26.9	
Debtors	163.3	160.9	151.5	156.3	135.5	253.4	279.0	318.4	315.0	319.6	325.5	
Cash	59.8	75.4	104.2	60.8	34.7	74.9	63.9	73.0	77.5	58.4	63.7	
Current Liabilities	(238.7)	(248.9)	(229.6)	(277.4)	(227.2)	(483.2)	(545.8)	(622.8)	(714.6)	(689.2)	(667.8)	
Creditors	(226.5)	(230.7)	(226.3)	(202.4)	(224.8)	(466.8)	(532.9)	(608.1)	(602.4)	(607.0)	(615.6)	
Short term borrowings	(12.2)	(18.2)	(3.3)	(75.0)	(2.4)	(16.4)	(12.9)	(14.7)	(112.2)	(82.2)	(52.2)	
Long Term Liabilities	(375.9)	(444.2)	(504.7)	(432.5)	(434.2)	(845.7)	(894.3)	(1,019.9)	(915.3)	(914.0)	(912.7)	
Long term borrowings	(253.8)	(234.5)	(253.8)	(140.8)	(224.9)	(482.4)	(489.7)	(558.9)	(489.1)	(489.1)	(489.1)	
Other long term liabilities	(122.1)	(209.7)	(250.9)	(291.7)	(209.3)	(363.3)	(404.6)	(461.0)	(426.2)	(424.9)	(423.6)	
Net Assets	370.6	326.3	275.2	251.4	186.0	440.2	382.4	436.3	428.2	447.0	480.2	
CASH FLOW												
Operating Cash Flow	109.9	67.7	78.6	55.8	72.2	27.9	128.4	143.3	129.9	190.0	215.1	
Net Interest	(13.4)	(11.5)	(13.2)	(12.8)	(12.8)	(19.0)	(16.9)	(19.3)	(18.5)	(17.5)	(18.0)	
Tax	(7.1)	1.9	(1.6)	(5.7)	(4.8)	(5.3)	(6.7)	(7.6)	(9.8)	(17.3)	(20.2)	
Net Capex	(74.8)	(50.1)	(27.1)	(37.2)	(25.8)	(41.2)	(81.2)	(92.6)	(114.1)	(116.6)	(112.3)	
Acquisitions/disposals	(19.6)	(59.2)	(54.1)	(67.3)	18.2	39.5	(4.1)	(4.7)	20.8	0.0	0.0	
Equity Financing	0.0	0.4	0.2	0.1	0.3	136.5	0.6	0.7	(0.6)	0.0	0.0	
Dividends	(13.3)	(13.7)	(13.7)	(13.7)	(13.7)	(15.1)	(24.4)	(27.8)	(27.8)	(27.8)	(29.2)	
Net Cash Flow	(18.3)	(64.5)	(30.9)	(80.8)	33.6	123.3	(4.3)	(7.9)	(20.0)	10.8	35.4	
Opening core net debt/(cash)	207.4	206.2	177.3	152.9	155.0	192.6	423.9	492.7	500.6	523.8	512.9	
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other	19.5	93.4	55.3	78.7	(71.2)	(354.6)	(10.5)	0.0	(3.2)	0.0	0.0	
Closing core net debt/(cash)	206.2	177.3	152.9	155.0	192.6	423.9	438.7	500.6	523.8	512.9	477.6	
Closing PPP/PFI non-recourse net debt	52.0	100.1	151.2	222.6	91.1	87.1	82.9	84.6	90.5	90.5	90.5	

Source: Company, Edison Investment Research. Note: *Full FY18 euro results have not been published to date – the presented P&L and cash flow statements should be taken as illustrative until that occurs.

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