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Green on a budget

Evan Lorenz writes:

TAN is the ticker for the Invesco Solar ETF, but "burn" more aptly describes the price tag. It represents 100 years' worth of current earnings of the fund's portfolio companies. We all want to do our bit for the environment, but must it cost an arm and a leg?

Not if you're willing to turn over an analytical rock or two. In preview, we're bullish on Renewi plc (RWI on the London Stock Exchange), a recycling turnaround story.

Renewi, a creation of the February 2017 merger between publicly listed Shanks Group plc and privately held Van Gansewinkel Groep B.V., is the largest waste-management company in the Benelux region, which encompasses Belgium, the Netherlands and Luxembourg. "Of the 14 million tonnes of waste we handle a year," boasts the company's website, "89% is either recycled or used for energy recovery."

Renewi divides its business into commercial waste (71% of revenues in the six months ended Sept. 30, 2020); the "Mineralz" and water unit (11%), which cleans contaminated soils, sludges, waters, bottom and fly ash; and a specialties division (18%), which processes electronic waste, recycles glass and manages municipal contracts outside of the Benelux.

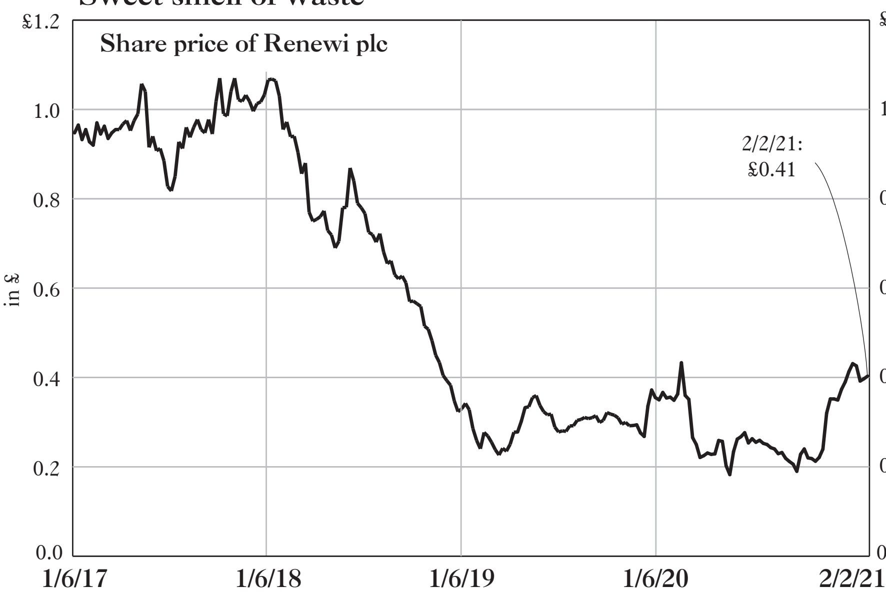
Not quite everything has gone wrong since the 2017 merger, but a stockholder may be forgiven for believing it has. In 2018, a pair of cows died near Renewi's Afvalstoffen Terminal Moerdijk plant (better known as ATM), which cleans highly contaminated soil. Regulators ordered the temporary shuttering of that facility in the Dutch city of Moerdijk. In 2019, Renewi's 50-50 partner in a waste-gasification plant in Derby, England, declared bankruptcy; poof went that business. Then, last year, Covid-19 struck, lowering the volume of waste that Renewi has to collect and process.

But bad luck can't explain every wrong turn. Listed and headquartered in London, with most of its operations in Belgium and the Netherlands, the firm seemed managerially as well as geographically distant in the face of the troubles at the ATM plant.

So a change of CEO was in order, and Otto de Bont, the former head of its Dutch operations, took the helm in April 2019. "The management team has changed from being incompetent and distant to being best in class," James Rasteh, the chief investing officer at Coast Capital Management, L.P., an investor in Renewi, tells me.

In his short tenure, de Bont has succeeded in selling a marginal Canadian organic-waste subsidiary and a Dutch industrial-cleaning business to focus the portfolio around its core Benelux waste-management unit. He has secured permission to restart the ATM soil-treatment plant and—to align the corporation more closely with its shareholders—has completed a secondary listing of stock on the Euronext Amsterdam.

Sweet smell of waste



source: The Bloomberg

Last June, de Bont divulged a plan to increase adjusted operating income by roughly €60 million over the next three to five years, from €82 million in the fiscal year ended March 31, 2020. The plan has three prongs.

The first is an efficiency program dubbed Renewi 2.0. It's both an IT overhaul (various Renewi divisions use different digital platforms) and a simplification of product and service offerings.

The second prong aims to create more value from recycled waste. For instance, instead of paying third parties to haul away processed soil, Renewi grades and separates that material and sells it as aggregates for the cement industry. Other examples: turning recycled wood into a substitute for coal, and converting bio-gas (a product of the burning organic matter) into bio-LNG.

The third initiative is to restore the once-stricken ATM plant to full operation; as of the Nov. 10, 2020 earnings call, it was running at just 30% of capacity.

De Bont has also laid out a financial target: to lower net debt to less than 2 times Ebitda, from 2.7 times as of Sept. 30, 2020. In the six months ended at that last date, adjusted operating income covered interest expense by 1.5 times. While Renewi's debt is unrated, the market's verdict seems favorable. Thus, the senior secured euro-pay 3s of 2024 change hands at €101.67 to yield 2.5%.

The issue of *Grant's* dated Nov. 13, 2020 examined the portfolio composition of funds that market themselves as compliant on environmental, social and corporate governance (ESG) grounds. We found that most resemble the Nasdaq 100 Index, with big allocations to tech darlings like Apple, Inc. and Microsoft Corp. While it's true that the creations of Steve Jobs and Bill Gates don't emit much carbon dioxide, it's also true that neither company has a big role to play in greening the planet.

Investors can have a bigger impact by following the lead of Charlotte, N.C.-based Massif Capital LLC in providing capital to firms and industries that have not yet decarbonized but are moving in that direction. We highlighted HeidelbergCement A.G., a cheap company in a dirty industry that's reducing its sizable carbon footprint. To quote hockey great Wayne Gretzky: "Skate to where the puck is going, not where it has been."

Renewi seems as if it got the message. For one, its ATM plant helps cement producers make greener concrete. For another, it's entered numerous corporate partnerships, such as with Ikea to recycle mattresses, with Royal Dutch Shell plc to turn bio-gas into LNG and with ArcelorMittal S.A. to replace coal with recycled wood in steel-making.

"From a macro perspective, the EU has regulatory mandates that say 55% of waste needs to be recycled by 2025," Chad Tappendorf, a partner at Coast Capital, tells me. "Currently it's only about 40%. So that number has to go up quite significantly over the next four or five years. And 50% of all products need to be made by recycled materials by 2030. It's less than 10% now. So, this is a business that has a huge runway for growth."

Renewi's management concurs. "[W]e see higher demand for our service," de Bont told participants on the Nov. 10, 2020 earnings call. "We are seeing a demand for higher quality of our recyclates and we also see a demand for an increased sustainability of the services that we provide. And it's not only by our customers that provide us the waste and by the customers that buy our recyclates, but also the governments that really drive a large part of how we sort and process our waste, meeting the new requirements are driving this trend. This will lead to us adding more value in the chain than we do today by adding new recycling techniques."

Neither especially cheap nor especially rich, Renewi trades at 22 times estimated fiscal 2021 earnings per share and 6.3 times enterprise value to Ebitda. But let management be seen to deliver on its operating targets, and the stock would become instantly and absolutely cheap, at 6.8 times 2023 earnings estimate and 4.9 times the analysts' best guess for 2023 Ebitda.

A tantalizing marker of potential future value: Last September, Suez S.A., the No. 2 behind Renewi in the low-country recycling industry, agreed to sell its Benelux waste-management operations to Schwarz Group for 11 times Ebitda.

In the past 12 months, insiders have sold 450,543 shares for net proceeds of £115,946. All three analysts who follow Renewi rate the company a buy. To judge from the November call, however, Renewi is nonetheless flying under the radar—not a single analyst or investor asked a question.

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