A Solid 16/17

Mark Wilson, partner, and **Robert Pearce**, head of research, at Catalyst Corporate Finance provide our annual overview of activity in the UK waste and resource management industry, and highlight the leading players from a year in which the sector has remained solid in the face of a number of external shocks

The Top 20 UK waste and resource management businesses have enjoyed another solid year, with revenues up to £7.bn (95 percent of the Top 20 companies reported FY16 or later results). The past 12 months have demonstrated that the waste management market is resilient to a range of external shocks. The sector continues to be challenged by sustained local authority austerity, a weaker sterling impacting contract pricing for refuse derived fuels (RDF) exports, and an energy from waste (EfW) project pipeline that is facing the prospect of moving forward on a subsidy-free basis. Nonetheless, we predict that the sector will continue to grow, underpinned by rising gate fees as landfill capacity shrinks, as well as technology and service model driven innovation.

The different development strategies being pursued by the "Big Five" have led to varying levels of revenue growth. Biffa had a particularly strong year, growing revenues by 6.8 percent, driven by both acquisitions and organic growth. Veolia and Suez had muted years, up one percent and 2.5 percent on the previous financial year, while Viridor and FCC's revenues contracted slightly. Cory Environmental (#7) and DS Smith Recycling (#8) also reported revenue dips. Cory divested three different assets over the past 18 months and is refocussing exclusively on its high margin EfW plant at Belvedere, rebranding itself as Cory Riverside Energy.

There were two further examples of companies undertaking rebranding exercises during the review period. Shanks (#9), which grew by 6.9 percent, and completed its acquisition of Dutch recycling firm Van Gansewinkel in February, rebranded to Renewi, a name that reflects its commitment to the circular economy. The combined entity has annual revenues of £779m. DCC Environmental (#11) is rebranding to Enva Group following its acquisition by private equity investor Exponent Private Equity in April.

To capture the growing breadth of sector participants, Catalyst has expanded its inclusion criteria to fully encompass environmental services arms of larger support services groups. This has benefited new entrants Serco Waste Management (#12) and Kier Environmental Services (#13) as well as the rise of Amey Environmental from #9 to #6. Mitie Waste & Environmental Services narrowly misses the Top 20, with revenues of £73.1m (#21).

The lower half of the Top 20 has seen strong performances from a number of parties. Reconomy, now an investment of Bregal spin out EMK Capital, has delivered a particularly impressive 34.5 percent growth rate through a combination of acquisitions, such as Cory's waste brokerage business, as well as through strong organic growth. Mick George (#18), crowned the fastest growing UK waste business last year, had another strong showing on the back of geographic and service expansion, reporting a 14.8 percent increase in revenues.

Augean, the hazardous waste specialist that closes out this year's ranking, had a more mixed year. Revenue increased 24.6 percent, largely on the back of strong air pollution control residues (APCr) volume growth. However, the integration of Colt Holdings, acquired in May 2016, is proving to be more difficult than initially anticipated. Augean reported a profit warning in July due to Colt's poor performance, that immediately saw the market capitalisation of the AIM listed business drop 15 percent.

Austerity continues to affect local authorities, with waste contracts becoming a focal point in cost-saving measures. Sheffield Council announced in January that it would be ending Veolia's 35-year waste contract 19 years early, while Viridor Laing's Greater Manchester Waste PFI contract was terminated 17 years early in May. We expect further terminations to occur in the coming year, especially where disposal logistics are sub optimal.

New Defra minister, Michael Gove, has yet to announce what Brexit will mean for the future of recycling and other waste targets. If the ban on diesel and petrol cars by 2040 is any indication, the Government does seem to acknowledge that Brexit was not a vote for reduced pollution controls, making us cautiously optimistic regarding the future of environmental legislation in this country.

The Big Five

THERE IS no change amongst the top five companies this year, with Veolia staying in the number one spot for the sector.

Veolia

Veolia's UK waste management arm has enjoyed a steady year, with revenue up slightly to £1,451m. Rising landfill tax rates have made the UK market an attractive geography for the French corporate giant. The group is investing £750m in its UK waste management operation over the next five years, aiming to further grow its largest market after France.

It has been a mixed year for contract wins, providing both opportunities and challenges. Veolia signed a revised 30-year waste partnership contract with Hertfordshire County Council last September, to the value of more than £1bn. As Veolia's Hoddesdon EfW facility will only become operational in 2020, an interim off-take for Hertfordshire Council waste will likely be a combination of nearby energy recovery facilities (ERFs).

Both the £209m South London Waste Partnership Contract, harmonising waste management services across four London boroughs, and the £338m 16-year Camden Council contract renewal, boost the company's presence in the capital, with both contracts having commenced this April. On the flipside, the £38m Rushmoor Council contract was lost to Serco, while East Cambridgeshire Council has opted take waste services in-house. Veolia's involvement in Rushmoor expired in July, while East Cambridgeshire is set to expire in April 2018. Contracts with Basingstoke & Deane and Hart councils, valued at c.£40m, are also set to expire in 2018 after Veolia indicated that the current arrangement is loss making.

Veolia is confident that the January decision by Sheffield City Council to end its £30m annual contract 19 years early can be renegotiated on favourable terms. The company operates facilities in and around the city, including the Bernard Road ERF. Sheffield is reportedly in favour of splitting the bulky £1.3bn, 35-year contract into smaller five-to-seven year tenders, bringing waste management services in-house after this period.

Renewed focus has been put on Veolia's EfW operations with a royal opening for the 8MW Battlefield ERF in Shrewsbury; further capacity increase at the biogas-fired Rose Hill Recycling facility in the Cotswolds; as well as approval for a new RDF processing facility at Mansfield. Separately, a £10m closed-loop glass recycling facility in St Helens is set to boost Veolia's commitment to a circular economy.

Veolia made a single UK acquisition this year, Energy Performance Contract (EPC) specialist Cynergin. Acquired in January, Cynergin aims to minimise a client's energy-related maintenance and carbon-footprint, promoting Veolia's carbon-efficient energy generation credentials with current and future clients.

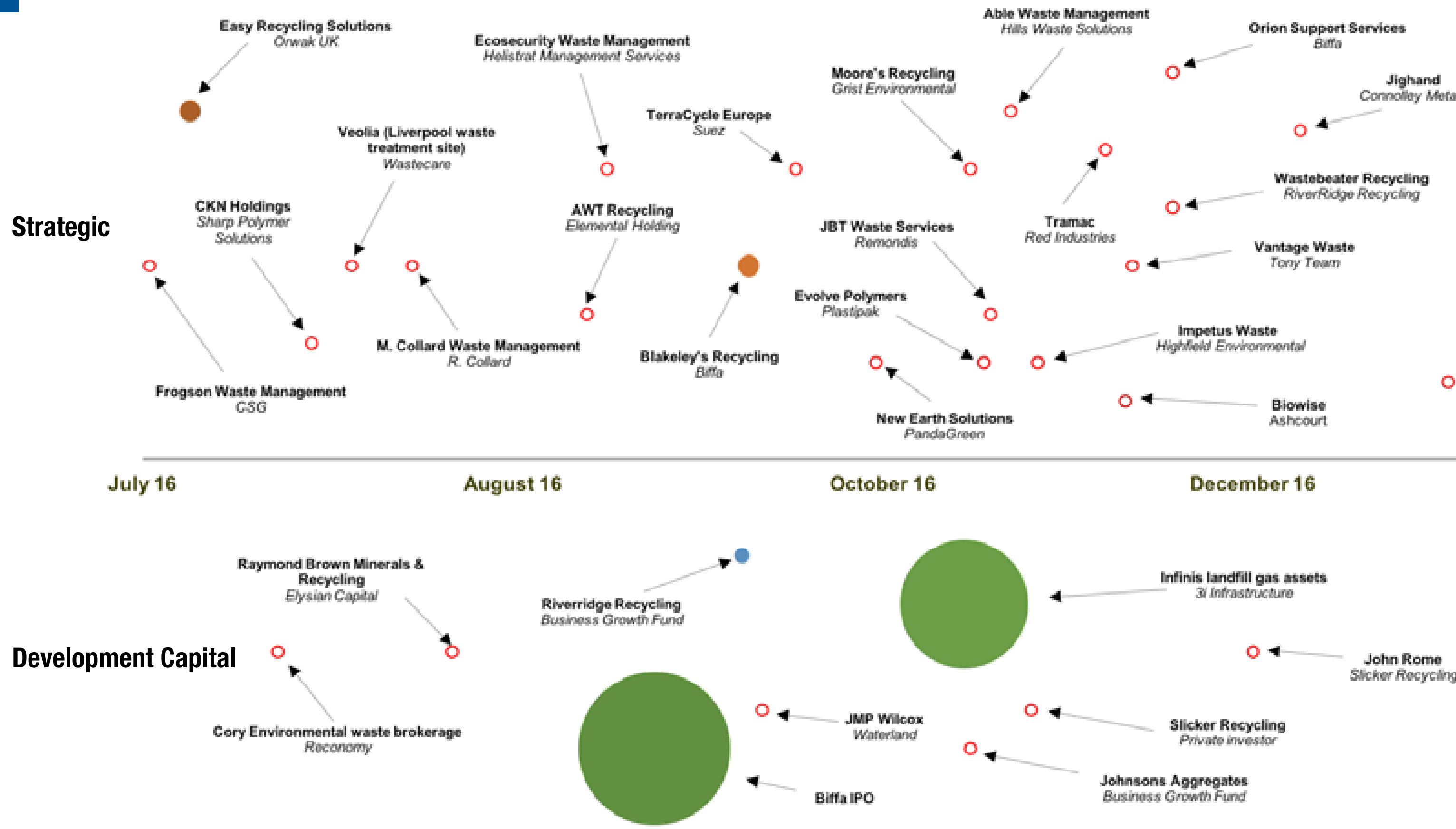
	Company	Revenue £m	Ownership
1	Veolia Environmental Services	1451.0	Foreign listed
2	Biffa Group	990.4	UK listed
3	Suez Environment UK	854.9	Foreign listed
4	Viridor (Pennon)	793.5	UK listed
5	FCC Environment (FCC)	662.0	Foreign listed
6	Cory Environmental	260.1	Private equity
7	DS Smith Recycling	259.7	UK listed
8	Renewi (Shanks)	174.8	UK listed
9	SRCL (Stericycle)	166.0	Foreign listed
10	AmeyCespa (Ferrovial)	153.7	Foreign listed
11	Enva Group (DCC)	140.6	Private equity
12	Serco Waste Management	140.0	UK listed
13	Kier Environmental Services	132.5	UK listed
14	Reconomy	110.8	Private equity
15	Grundon Waste Management	108.5	Private
16	Hills UK	101.0	Private
17	Tradebe Environmental Services	93.1	Foreign private
18	Mick George	87.2	Private
19	Saica Natur UK	79.2	Foreign private
20	Augean	76.0	UK listed

Biffa

Biffa had a strong year following its return to the public markets in October 2016. A 6.8 percent increase in revenues, along with an 18.1 percent jump in operating profit to £73.8m, has been rewarded by the market, with Biffa shares up c.25 percent on its initial public offering.

A development strategy focused on both organic

The Criteria: This table was compiled using audited financial statements filed at Companies House, participants' relevant stock exchange or submitted directly by the company to Catalyst Corporate Finance. To be considered for inclusion, participants' revenues are required to be consolidated and relate to waste management activities undertaken in the UK, revenues generated outside the UK have been extracted. The compiled list allows for companies domiciled outside of the UK to be considered, providing entities report separate accounting information for UK activities.



An illustration of merger and acquisition activity from July 2016 to July 2017 – target name in bold, acquiror in italics. Bubble size represents size of transaction. Blank bubble represent transactions where consideration was not disclosed.

growth, including winning new clients such as John Lewis and Coca-Cola, and an acquisition approach that aims to successfully integrate half a dozen targets a year, is paying off. Commercial and industrial (C&I) revenue is up £42.9m, partly due to strong cyclical growth, but also thanks to a string of smaller acquisitions in trade waste collection, such as O'Brien Waste Recycling Solutions, which added a further 3,600 customers in the North East. With five acquisitions over the past year, we foresee that this strategy will continue to augment Biffa's growth.

Following the integration of Cory's municipal waste collection business, which increased the group's presence in Cornwall and Rutland, Biffa now serves 2.5m households through 41 different local governments. Municipal contracts have stayed steady, with every contract in need of renegotiation being renewed and the win of the £7m North Somerset contract bringing the total from 36 to 37.

As direct-to-household waste management services become more common, larger market players – which have the infrastructure to provide specialised services, such as food or green waste collection – are set to benefit from a market shift towards more complex outsourcing strategies. Biffa is developing three new food waste transfer stations to feed the Poplars anaerobic digestion plant to stay on top of market trends like these.

Suez Environnement

A steady year of growth has seen Suez's revenues increase by 2.5 percent to £854.9m. With no majority-control acquisitions in the past financial year, Suez's growth is entirely organic and attributable to increases in waste collection and energy recovery volumes, new contract wins and a number of new facilities coming online.

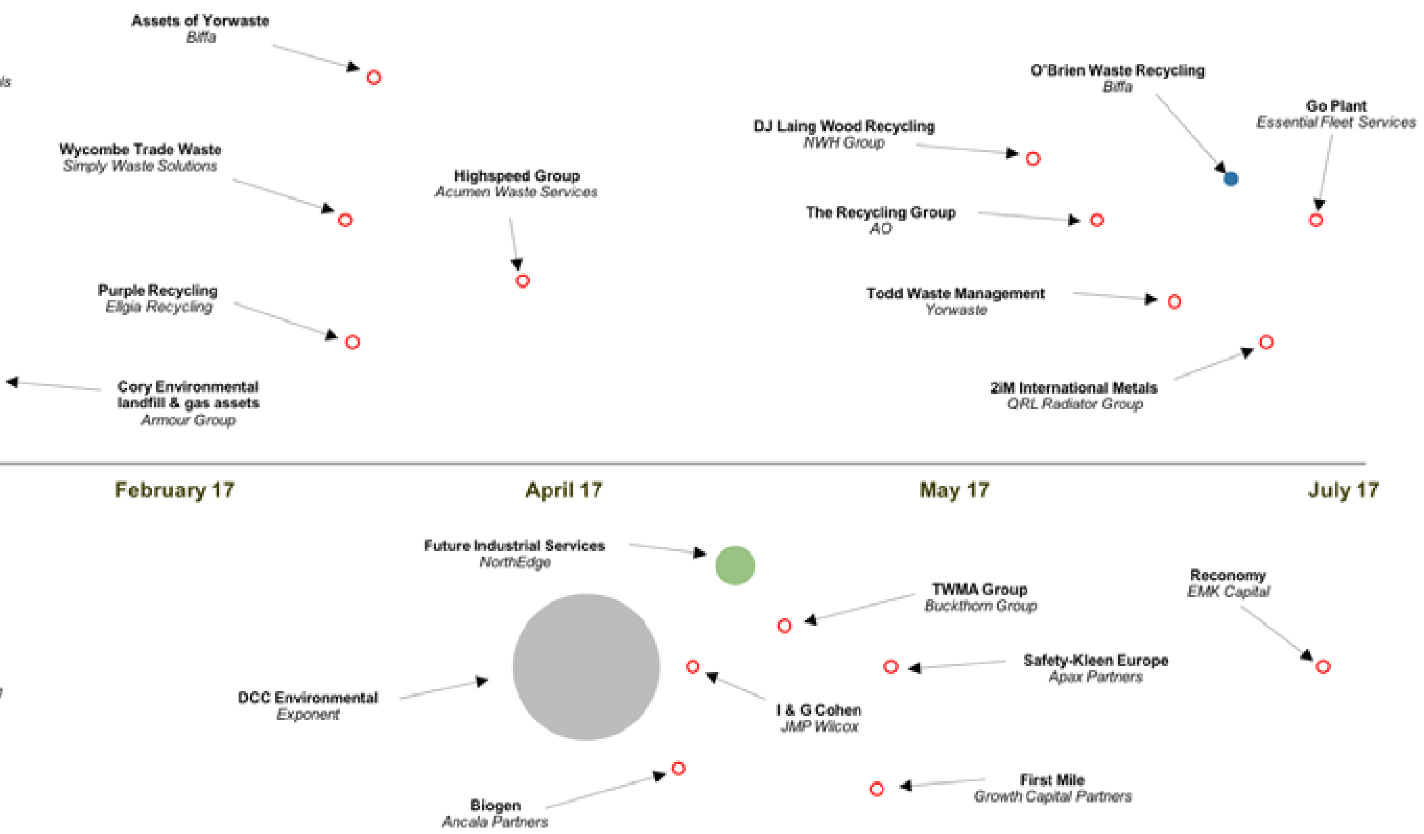
With the completion and start of operations in December 2016 of the £244m, 400 ktpa capacity Severnside ERF, also encompassing a bottom ash processor and two Greater London transfer stations, West London residual waste will now reach a 96 percent diversion rate away from landfill. Further north, a new £27m municipal and C&I waste recycling facility, which will output recoverable metals and RDF, opened this summer in Aberdeen, adding a further 40 jobs to Suez's Scottish operations.

Innovation investment has increased this year. Suez took a 30 percent stake in Terracycle Europe, a provider of recycling programmes aimed at managing hard-to-recycle waste such as cigarettes and aerosol cans. Suez's French parent company has also announced a partnership and minority investment in Rubicon Global, an American technology-driven waste services provider akin to Uber, backed by Leonardo DiCaprio. Both investments highlight Suez's continued interest in potentially market disrupting technologies.

Suez won the five-year £25m renewal contract for Devon County Council, which commenced in April. A fall in landfill volumes has also been more than off-set by increased waste and energy recovery levels at Suez's EfW plants at Teesside and St Dennis. After initial delays to the railhead in Kirkby, the second Teesside incinerator should be up and running this year at Wilton as well. Wilton 11 will treat 444ktpa of residual waste coming from the Merseyside Waste Disposal Authority.

Viridor

Viridor reported a second year of decreasing revenues, down 1.6 percent from £806.2m to £793.5m, however the picture is much rosier when taking into account margin growth. Strong EBITDA performance, growing 18.7 percent to £138.4m, further



validates the group's long term strategy to diversify away from landfill in favour of EfW by 2020/2021. Viridor continues to invest in new facilities, with capital investment up £12.2m to £195m, and a further £252m for the ERF at Avonmouth, which has been approved for construction.

When Avonmouth becomes operational towards the end of 2020, Viridor will have 12 ERF facilities, up from eight, bringing

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total energy output to 276MW, capturing 20 percent of the UK EfW market. The Dunbar and Beddington ERFs will both be operational in 2018, while Glasgow has run into further construction difficulties. Previous Glasgow ERF construction contractor, Interserve, announced it would be leaving the EfW sector in February after repeatedly failing to meet deadlines. Doosan Babcock has been chosen by Viridor to finish the construction of the project. As of August, no commissioning date has been announced.

A potential issue for the company is the decision by the Government to back the construction of Heathrow's third runway, which will require the relocation of Lakeside ERF, a joint Viridor/Grundon operation. Further problems will likely be caused by the Greater Manchester Waste Disposal Authority's termination and renegotiation in April of the £3.2bn 25-year Greater Manchester PFI deal, 17 years early. Viridor Laing, the joint venture between Viridor and John Laing Group that operates the contract, is seeking compensation.

New MD, Phil Piddington, has had a good start to his tenure with the September 2016 win of the £127m 10-year South Lanarkshire contract. Dunbar ERF will handle the 80ktpa waste arisings of the council once operational early next year. Previously chief operating officer of Viridor's Energy division, the move further underscores Viridor's focus on the energy recovery side of the company.

FCC Environment

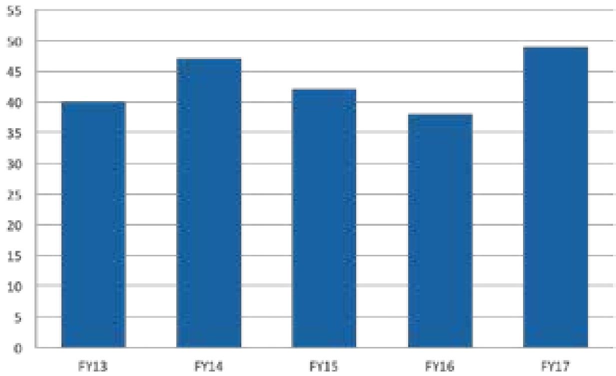
FCC Environment saw revenues drop by three percent to £662m. The Carlos Slim majority-owned business will be hoping to use its recent contract wins as a platform for future growth.

The Wiltshire Council contract, which was initially thought to be won by Hills Waste Management, was instead announced to be split between Hills and FCC in August. Hills will continue to provide collection services for the Council, while FCC has been contracted to operate the household recycling centres, commencing in October.

The £2.5m per year Barrow Council contract, won in December 2016 and coming into force last April, is being let for a period of seven years prior to opportunities for extension. FCC has pledged to invest £2m to improve current services in the 33,500-household council.

Another win, the £450m, 25-year Edinburgh and Midlothian contract, signed in October 2016, will come into force once the 11MW Millerhill EfW and recycling facility becomes operational, expected to happen in the first half of 2019. The £142m Millerhill ERF, which received £28m of debt funding from the now Macquarie-owned Green Investment Bank, will handle 155,000 tonnes of non-recyclable household and C&I waste, supporting the Council's goals in achieving Scotland's Zero Waste Plan targets of 70 percent recycling and 95 percent landfill diversion by 2025.

A new hazardous soil treatment facility in Sandwell is expanding FCC's hazardous waste treatment capacity in the West Midlands, while the Northwich joint venture with Dong Energy to supply the UK's first bioliquid fuel producer has also commenced. The facility started its commissioning in February. The group's ninth – a 15.5MW – EfW plant at Hartlebury has also become fully operational, having taken in waste since October 2016 as part of commissioning trials.



Merger and acquisition deal volume (NB year runs from July to June)

M&A Activity

M&A ACTIVITY continued to grow, despite the uncertainties caused by Brexit and elections in both the UK and continental Europe. Over the last 12 months we have seen particularly strong private equity (PE) interest, who, with significant capital to deploy, are taking greater interest in a sector they have historically viewed as too capital intensive

In April, Exponent outbid corporate acquirors and other PE firms to acquire DCC Environmental, paying £219m for the group that includes William Tracey in Scotland and Enva in Ireland. £170m of debt was raised for this transaction from Lloyds Bank, including £130m of term loan, £20m of CAPEX/acquisition facilities and £20m of revolving credit facilities.

PE activity is not limited to the upper mid-market. Smaller scale businesses with attractive business models or a strong presence within a particular niche, such as First Mile's flexible C&I waste collection model and Future Industrial Services' specialist hazardous waste services, have attracted private equity investments.

A favourable exchange rate due to the EU referendum-induced drop in Sterling, along with a market resilient to external shocks, is boosting interest from overseas buyers. Corporates with limited or no presence in the UK, which have easy distribution channels into or out of the country through, for example, waste treatment capacity in Ireland or the Benelux, are showing their interest. Combined with traditional consolidators like Biffa and Veolia, the waste management buyer market is looking more crowded than ever, driving up valuations.

Shanks' £416m acquisition of Van Gansewinkel, which completed in February, makes the combined group the largest recycling player in the Benelux. Renewi, as the group is known post-merger, will continue to be led by its current CEO and CFO, and it will retain its London Stock Exchange listing despite UK revenues contributing less than a quarter of the group's total.

Cory continues to dispose of non-core assets, with the divestment of its landfill and gas portfolio in January to reinsurance provider Armour Group. Comprising of 12 sites that together produce 60 MW of electricity through landfill gas power, the divestment is Cory's third in under 18 months. In addition, in March the group refinanced the debt of its Belvedere EfW facility to the value of £520m.

Project investment in EfW and related biomass projects totalled c.£2.2bn (Clean Energy pipeline) for 2016. Although slightly down on the previous period, it shows that EfW is still considered a lower risk investment in comparison to the volatility being experienced in the solar and onshore wind sectors.

There is potential for the sector to see a surplus in EfW feedstock. Exchange rate volatility and the possibility of a hard-line Government position on Brexit are driving concerns around the future of RDF export to continental Europe. Further project investment to boost EfW capacity is therefore paramount to avoid a treatment capacity gap caused by decreasing exports as well as the planned closures of landfill sites.

The Government sale of the Green Investment Bank to the Macquarie Group for £2.3bn in April caused consternation amongst some politicians, who questioned Macquarie's commitment to green energy projects and accused the Australian infrastructure fund of asset-stripping practices. However, with Macquarie pledging to invest £3bn in projects over the next three years, compared to a Government figure of £3.4bn over the past four-and-a-half years, investment is set to be going in the right direction. With biomass and CHP "by far the front runner" for renewable asset financing firms, like Lombard, waste-related feedstock energy facilities should be able to take a sizeable chunk out of that budget.

Bulgarian EfW plant constructer, Ebioss Energy, announced in November 2016 that it has signed a deal with Energy China and Catfoss to build two new EfW plants in Newcastle and Hull for a total capacity of 32MW, and an investment value of £146m. A majority of the equity – 51 percent – will be provided by China Energy and other Chinese investors, underlining that the post-Brexit EfW market is still very much of interest to overseas investors. ■

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