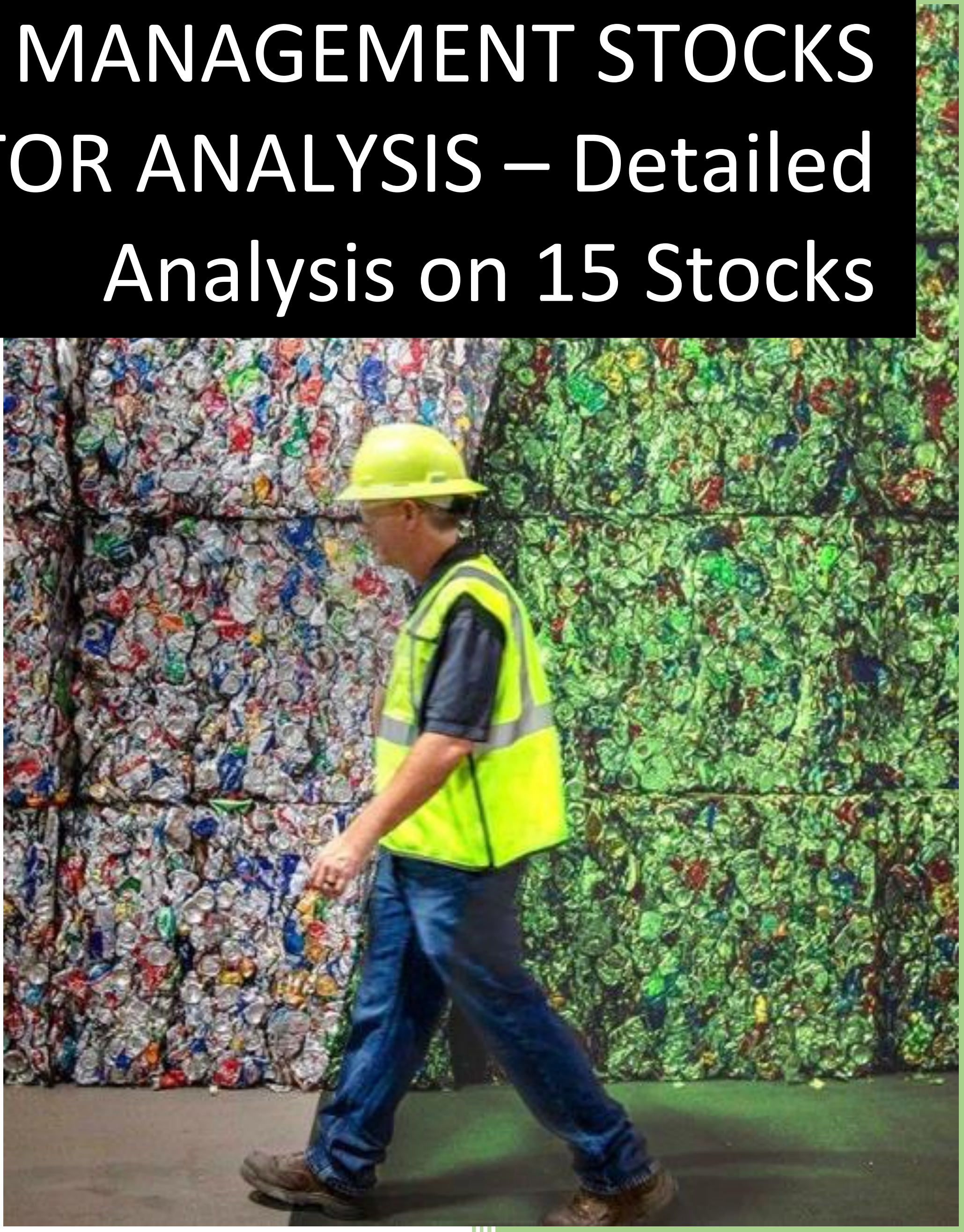
2020

WASTE MANAGEMENT STOCKS SECTOR ANALYSIS – Detailed Analysis on 15 Stocks



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Stock Market Research Platform

1/1/2020

Waste Management Stocks Global Sector Investment Analysis by Sven Carlin Ph.D. – Stock Market Research Platform.

This report starts with a general overview of the industry, what are the key factors to look at when it comes to investing, the global trends and concludes with an analysis of 15 waste management stocks from developed markets. Here is the Waste Management Stocks Google Sheets List for the 15 developed markets waste management stocks. The analysis of waste management stocks from emerging markets is coming…

Table of Contents:

Introduction to investing into the Waste Management Stocks industry

This is a short summary of my initial thoughts and findings on Waste Management.

Did you know, the average American throws away 2.01 kg (4.43lb) of rubbish every day, or, that the total volume of Municipal Solid Waste (MSW) produced in the US, each year, is equal to the weight of 5,600 Nimitz Class aircraft carriers, 247,000 space shuttles, or 2.3m Boeing 747 jumbo jets. And, if all of the solid waste collected in the US was put in a line of average sized waste disposal trucks, that line would extend from NYC to Los Angeles, over 100 times. Also, 40% of all food in the US goes uneaten and is thrown away. (Source: Bank of America Merrill Lynch - Waste)

Well, stick with me and 'fun' statistics like these will be at your fingertips. Over the last few weeks, I have had to read through them all. So, I'm going to inflict a few on you. With this report, amaze and fascinate your family and friends. In fact, don't buy them presents (too much waste) email them this report instead, as a gift!

But, for you as a value investor, let's have another 'fun fact' and this time a special question. According to the World Bank, commercial fees for collecting MSW range from about $35 per year in low-income countries to $300 in high-income countries (see, fascinating). The question - Do you know why this is important and how it will make you money?

No.

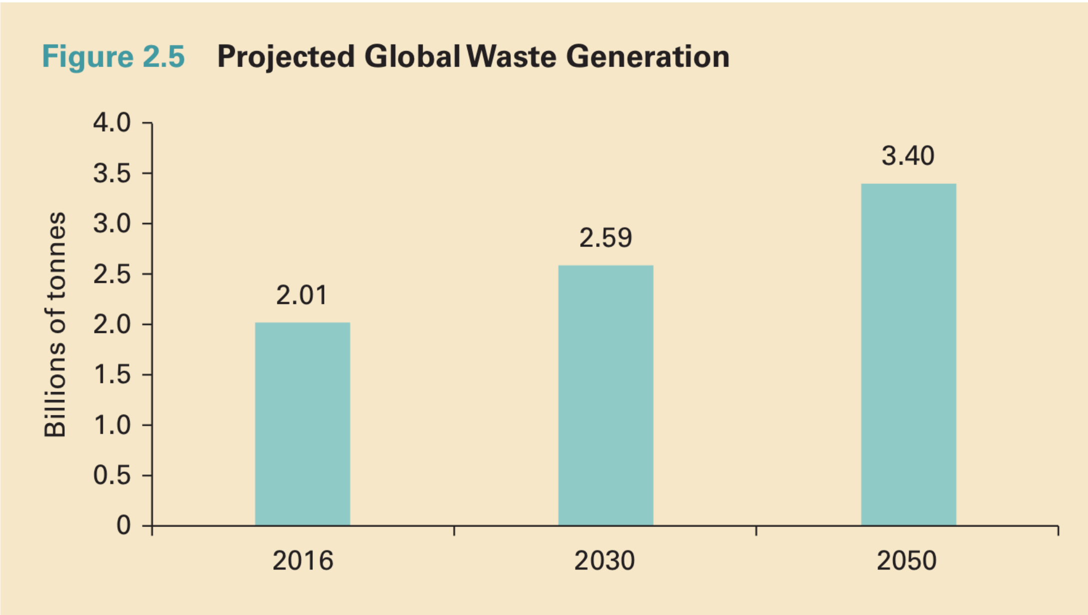
Well, congratulations, your about to find out.

Let's start off by explaining there are many areas to waste management, recycling, circular energy production etc. Here, I am predominantly going to be talking about traditional good old-fashioned waste, rubbish, garbage, call it what you will. You know what I mean. The dirty stuff.

Why? Because, I am old fashioned and I like my rubbish old fashioned, plus, globally, only 25 percent of this type of waste is currently recovered or recycled. In other words, it's a growth area. How do we know this?

Waste Management - Prospects for Global Growth

According to The World Bank, an estimated 2.01 billion tonnes of municipal solid waste was generated in 2016, this number is expected to grow to 3.40 billion tonnes by 2050 (under a business-as-usual scenario).



Source: World Bank

The total quantity of waste generated in low-income countries is expected to increase more than three times by 2050. Currently, the East Asia and Pacific region is generating most of the world's waste, at 23 percent, and the Middle East and North Africa region is producing the least in absolute terms, at 6 percent. By 2050, however, waste generation in Sub-Saharan

Africa, South Asia, and the Middle East, North Africa regions, is expected to approximately triple, double, and double, respectively.

Current estimates for the MSW market alone are USD $410-433 billion per year. Estimates for the total global waste management market are as high as USD $1 trillion given it's larger range (for example, industrial waste, wastewater and sewage, sustainable packaging, and e-waste).

So, lots of rubbish is being generated and needs to be dealt with. But more importantly, the world population, as a whole, is growing, increasingly it is moving into towns and cities, it is also becoming richer. The impact of this is illustrated in the next few charts:

Table 3: Top 10 megacities 2011-2025 (population in millions)

City	Country	Population – 2011	City	Country	Population – 2025
Tokyo	Japan	37.2	Tokyo	Japan	38.7
Delhi	India	22.7	Delhi	India	32.9
Mexico City	Mexico	20.4	Shanghai	China	28.4
NYC	USA	20.4	Mumbai	India	26.6
Shanghai	China	20.2	Mexico City	Mexico	24.6
São Paulo	Brazil	19.9	NYC	USA	23.6
Mumbai	India	19.7	São Paulo	Brazil	23.2
Beijing	China	15.6	Dhaka	Bangladesh	22.9
Dhaka	Bangladesh	15.4	Beijing	China	22.6
Kolkata	India	14.4	Karachi	Pakistan	20.2

Source: UN Population Division, BofA Merrill Lynch Global research

Costs of Waste Management by Income Group

Country Income Group	2010 Cost	2025 Cost
Low Income Countries	$1.5 billion	$7.7 billion
Lower Middle Income Countries	$20.1 billion	$84.1 billion
Upper Middle Income Countries	$24.5 billion	$63.5 billion
High Income Countries	$159.3 billion	$220.2 billion
Total Global Cost (US$)	$205.4 billion	$375 billion

Source: World Bank

Average Fees per Individual Household/Company

Table 5.5 Waste Management User Fees by Income Level

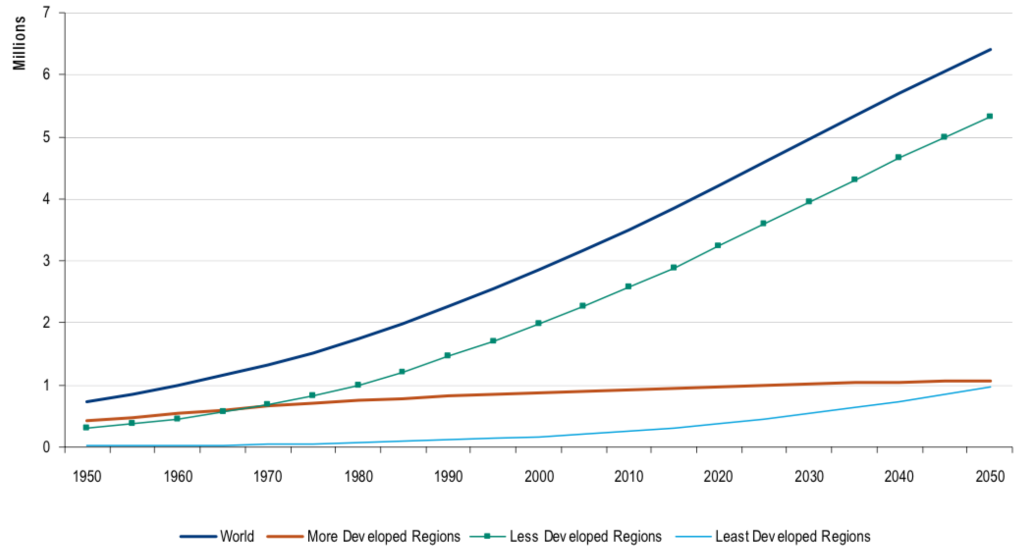
	Average fees, US$ per year	
Income group	Household	Commercial
High income	$168	$314
Upper-middle income	$52	$235
Lower-middle income	$47	$173
Low income	$37	$155

Note: All currency amounts are in US$.

What do these charts explain. In basic terms, amounts of waste are largely determined by: i) population size; and ii) consumption patterns, these factors are controlled by GDP per capita growth. In other words, as a population grows, so does the amount of waste it creates. As that population becomes richer, consumption also increases, again creating more waste (a 1 percent increase in national income generates a 0.69 percent rise in MSW).

Similarly, as a population becomes richer, they, in general, move into towns and cities for work. As a result, waste collection becomes more of a priority, due to space and health concerns. These same concerns usually force governments and local councils to spend more cash on waste management. Cash which they collect from the same newly rich residents. Residents who do not want to live in slums, watching their children die of disease, like in the good old days.

Chart 8: Global urban population 1950-2050 (bn people)



Source: Unpopulation

These governments introduce health laws and regulations about waste disposal, to comply with global standards. These laws and regulations create barriers to business entry and allow monopolies to develop for those waste management firms who have obtained contracts from those same governments and councils.

What Do Waste Management Trends Mean To a Value Investor?

Well, perhaps rather than focus on companies, like Amazon, who stuff products into boxes and deliver them around the world, we should be concentrating on what happens to that box once we throw it in the bin. Waste disposal means:

- We have a market which is growing in size;
- We have a market with steady, predictable, long term revenue streams, created through city waste management contracts;

- And, we have a market which will never go out of fashion (everyone has got to eat etc etc)

But, importantly, for investors, as we have already mentioned, when people become richer, they move to cities and spend more per family, they produce more waste. However, this new waste is different. It is more expensive. Those empty IPhone boxes and foil wrappers are more valuable and can be recycled. And, perhaps more importantly, because we live in cities and put out our rubbish for disposal, waste becomes easier to collect, things can be done more efficiently, economies of scale kick in, larger companies take over responsibility, it's easier to get customers to pay up as they have bank accounts and best of all, as they are richer you can force them to pay more for their waste collection.

Waste management, done well, can create a business environment with a large moat, that has constant demand for its products and the ability to charge customers higher prices for the same thing year in year out.

The Downside of investing into Waste Management Stocks

That all sounds great, a licence to print money. But there is always a downside or a voice of caution. Here are a few issues:

- In reality, waste management is closely linked to economic cycles, the market is largely driven by a combination of industrial output, revenue growth, and domestic consumption. For example, the MSW industry was, likely everyone else, hit by the Great Recession, with the EU most affected in terms of industrial production and GDP forecasts. A recession can mean pricing pressure, a decrease in treated waste volumes and landfill, plus emerging markets can be hit by currency and inflation fluctuations. This is especially true when local governments, in search of greater returns have exposed themselves to sovereign debt investments or issued local bonds.

- MSW is often one of the largest single budget items for many cities. If EM municipal government finances are strained, how likely are they to move away to more expensive waste management?
- Currently, globally, about 37 percent of waste is disposed of in some type of landfill, 33 percent is openly dumped, 19 percent undergoes material recovery through recycling and composting, and 11 percent is treated through modern incineration. Waste disposal or treatment using controlled landfills is almost exclusively the domain of high- and upper-middle-income countries. Lower-income countries generally rely on open dumping, 93 percent of waste is dumped in low-income countries and only 2 percent in high-income countries. With no money and large areas of cheap, empty land mass available, will this change significantly in some EM countries?
- The adoption of new billing systems in developed markets, for instance, the pay-per-weight system in France, is considered, by analysts, to mean downward short-term pricing pressure, as they are designed to push customers to consume less and/or recycle more. Although, longer term, it could also enable large and innovative players to gain market share and improve their collection businesses (fixed services paid for by the customers). Short term, these changes could affect profit margins.
- Many companies within waste management are becoming sizeable materials and energy suppliers, due secondary raw materials recovery, waste-to-energy processes etc. As a result, they are increasingly exposed to volatility in commodity prices, a process that has to be managed. Some companies have a significant sensitivity to an industry metric, adjusted operating cash flow to recycled materials price fluctuations. Companies need to be more sophisticated around hedging strategy.
- Finally, for retail investing purposes, most publicly listed waste disposal companies are based in developed markets. Global waste management is still, generally, locally based

small family firms or perhaps run in house by the state or municipal government. Many of the changes mentioned in this report have yet to happen on a sufficiently large enough scale. It is still early days for investors and hard for the general public to gain exposure to the global market fully at this time.

Waste Management stocks sector analysis conclusion - The Future Reality

Going forward, in line with many other sectors we have previously researched, analysts anticipate a two-tier growth story within MSW:

Many developed markets, particularly in Europe, face structural changes in the waste business coupled with lower waste volumes and a shift, in what is called, 'the waste treatment mix' (more recycling, less landfilling/incineration). These changes will hit margins.

The EM MSW market is expanding fastest on the back of: a sense of urgency due to climate change and population growth, the need for a waste solution and profit opportunities created from increased regulation, increasing barriers to market entry, caused by economies of scale, new regulations etc. But in many places these changes have yet to take place, at least in a way that global retail investors can exploit. That said, analysts consider Asia and Latin America to be the most attractive regions, with China and Brazil the biggest growth markets.

So, I have been doing some searching through all the rubbish (I couldn't resist that joke) and I have researched through a number of companies, around 30 or so. A large number belong in developed markets and are a US or European listed company. They are mostly the largest waste managers globally. Some feature in one of the few ETFs specifically designed to cover waste investing, or, were uncovered, in the natural cause of events, by myself, whilst carrying out my research. All are considered, by analysts, to have a high exposure to the waste management sector. What follows is the analysis of 15 waste management stocks from developed markets.

Waste Management Stocks List and Analysis

Here is the full Waste Management Stocks Google Sheets List with financials and analyses for businesses from developed markets. When going into a specific stock analysis, I'll derive the financials form this sheet.

Advanced Disposal Services Stock Analysis NYSE ADSW

Advanced Disposal Services was recently acquired by Waste Management (NYSE: WM) for $33.15 per share. This is important because it shows how economies of scale are the key in the waste management business and consequently that bigger players will look for scale and growth through consolidating smaller players.

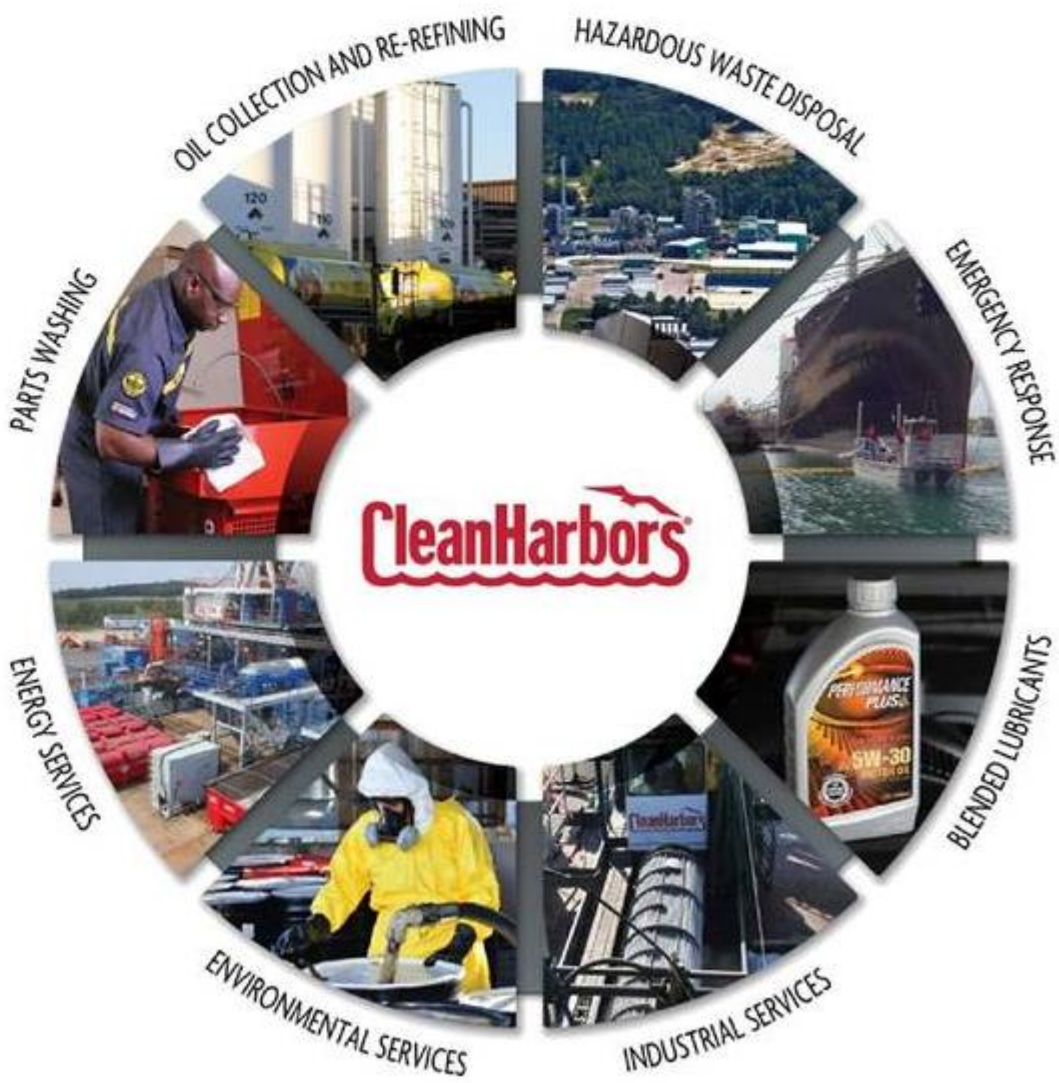
Advanced Disposal Services stock price

This has two benefits for investors; one is the growth that the large players will create while the other is the benefit you immediately receive when the business you own is take over at a 30% or higher premium to current stock prices.

ADSW was purchased for $33.1 in cash while investors expecting a 10% investment return from ADSW's business, should not had paid more than $20 per share, including the value of the assets. So, to fully take advantage of investing in the sector, you want to buy when the actual business is delivering a satisfactory yield, be it 10% or 15% if you are like me, and then sell when the market decides to pay full value, where a 5% return is satisfactory for companies like Waste Management. Sounds strange? Well, if you can borrow at 4% and get a 5% return on your investment, you get rich quickly, plus if there are synergies even faster.

Clean Harbors Stock Analysis, Inc NYSE CLH

Clean Harbors, Inc. is a provider of environmental, energy and industrial services, including hazardous waste disposal for companies, including Fortune 500 companies, small waste generators and federal, state, provincial and local governments.



Clean Harbors business - Source: [Clean Harbors Investor Relations]

CLH is highly exposed to business activity in the US, consequently a slowdown would be very detrimental and in addition, what you are looking at now from an investing perspective is probably the best the company can deliver as business in the late part of the economic cycle is as good as it gets.

Clean Harbors stock investment analysis – leave it to pension and index funds

Therefore, a PE ratio of 26 is a bit high for the current environment the company is operating in. 2019 expected free cash flows are $200 million which leads to a lower than 4.5% FCF yield on investment as Clean Harbors' market capitalization is above $4.5 billion.

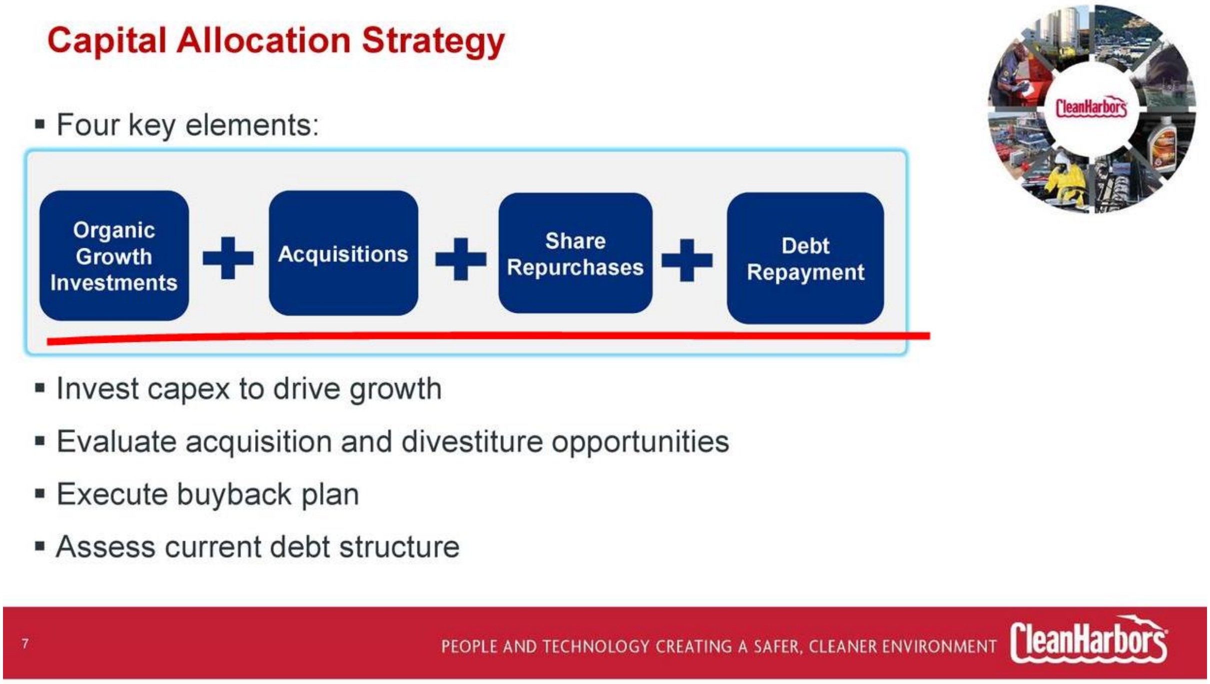
Clean Harbors stock price almost doubled during 2019 showing how it was definitely a much better buy 12 months ago when the FCF yield was closer to 10% and PE ratio in the teens.

Clean Harbors stock price

Going forward anything can happen, but investing is about risk and reward and I simply don't like the current risk and reward of Clean Harbors stock. If we have a recession, the stock could easily fall to December 2018 levels while the upside is limited given the single digit business yield and single digit growth in a strong economic environment. I would conclude by saying that Clean Harbors stock is exuberantly priced at the moment. The net present value for the stock targeting a 10% business return from the investment gives that Clean Harbors stock is a buy at a price of $41.4.

On top of everything, Clean Harbors' balance sheet is highly leveraged. Having almost a billion in goodwill, $2 billion in liabilities on $1.2 billion in equity could lead to very tricky situations if interest rates increase or business activity slows down. Thus, the risk of investing in Clean Harbors stock is simply to high.

Of course, the fact that there are risks doesn't have to mean anything in the short term or if the risks don't ever materialize. If the management continues to efficiently create value by delivering growth, be it organic or through acquisitions, increases share repurchases and lowers debt, the stock can keep going up.



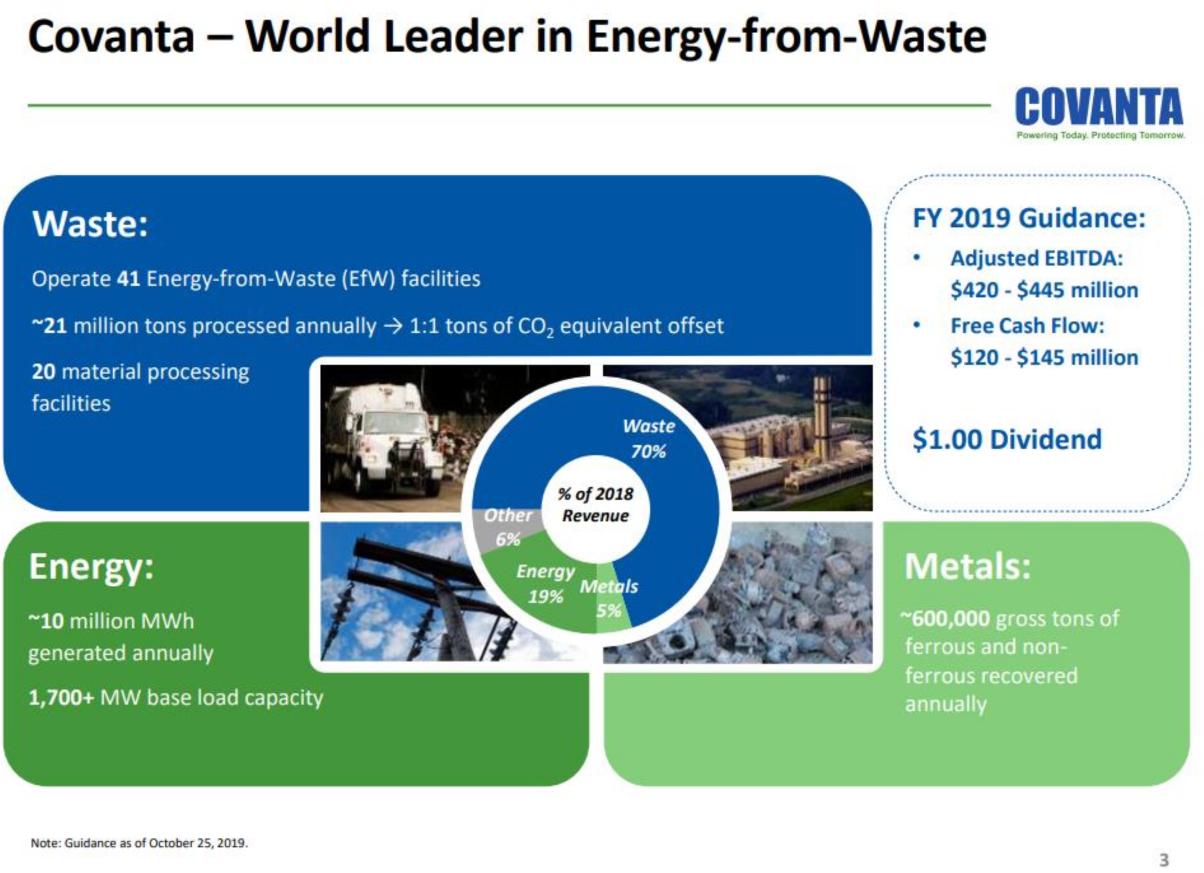
Clean Harbors Strategy - Source: Clean Harbors Investor Relations

But, if you speculate on what the management can do and how that compares to other stocks in the market, you are a relative and not an absolute investor. Relative investors look at what the company does and compare it to others out there in the sector or in the general market. Absolute investors focus on what is the business yield of compared to the stock price. Clean Harbors' stock offers a current FCF yield of 4.5%, alongside relatively high risk and future expected growth in line with the US economy.

I think we can find better.

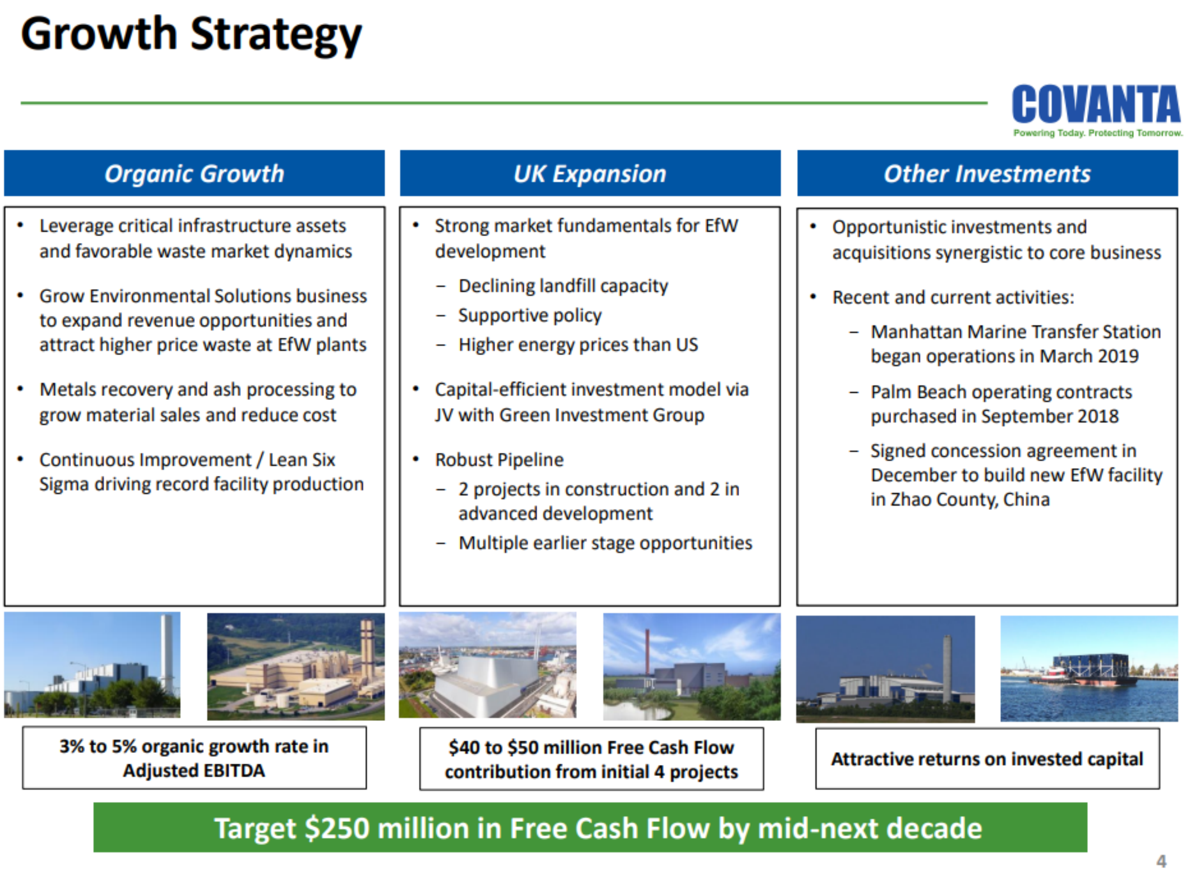
Covanta Holding Corporation Stock Analysis NYSE CVA – Dividend cut and bankruptcy risk is too high

Covanta is a large global corporation that provides a variety of waste-management and incineration services. 70% of revenue comes from waste management while the rest comes from recycling and energy production.



Covanta's business Source: Covanta Stock Investor Deck

The company expects to grow both organically and through acquisitions and is focusing on the 'energy from waste' sector.



Covanta stock growth strategy Source: Covanta Stock Investor Deck

It has 75% of the waste to energy market in the US and it plans to expand in the UK thanks to a joint venture operation with Green Investment Group.

Covanta stock price and financials

The situation for Covanta' stock price hasn't been great over the past years.

Covanta's stock didn't givenany return to shareholders for the past 14 years except for the dividend. But before discussing the significant dividend let's discuss Covanta's financials.

Covanta Holding Corp CVA

Financials

Export Ascending

	2009-12	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	TTM
Revenue USD Mil	1,550	1,582	1,650	1,644	1,630	1,682	1,645	1,699	1,752	1,868	1,885
Gross Margin %	39.0	32.8	33.0	—	—	—	—	—	—	—	—
Operating Income USD Mil	244	227	249	236	239	215	152	129	103	149	108
Operating Margin %	15.8	14.3	15.1	14.4	14.7	12.8	9.2	7.6	5.9	8.0	5.7
Net Income USD Mil	102	62	219	114	-7	-2	68	-4	57	152	7
Earnings Per Share USD	0.66	0.40	1.54	0.87	-0.07	-0.01	0.51	-0.03	0.44	1.15	0.04
Dividends USD	—	—	0.30	0.75	0.66	0.86	1.00	1.00	1.00	1.00	1.00
Payout Ratio % *	—	—	46.9	86.2	184.2	407.8	—	204.1	—	47.4	—
Shares Mil	155	154	142	133	130	130	133	129	131	132	131
Book Value Per Share * USD	8.93	7.52	7.96	7.94	6.95	6.06	4.60	3.85	2.56	3.85	2.87
Operating Cash Flow USD Mil	397	431	361	342	316	341	249	282	243	238	203
Cap Spending USD Mil	-74	-133	-126	-127	-188	-216	-376	-359	-277	-206	-169
Free Cash Flow USD Mil	324	298	235	215	128	125	-127	-77	-34	32	34
Free Cash Flow Per Share * USD	2.09	1.93	1.71	1.62	1.31	0.88	-0.77	-1.15	-0.38	0.58	—
Working Capital USD Mil	540	412	285	328	-119	242	331	126	119	56	—

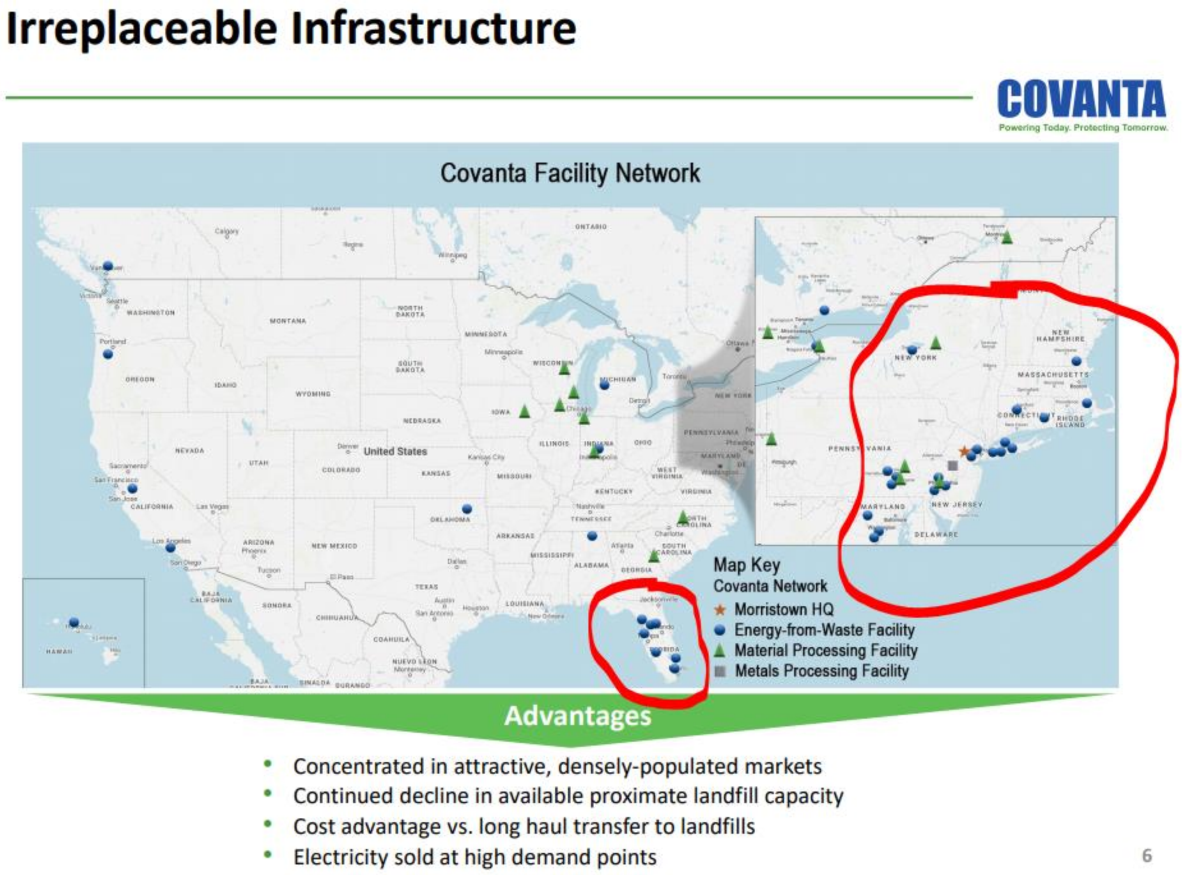
* Indicates calendar year-end data information

Covanta stock financials – Source: Morningstar

Revenues have been flat for the past 10 years, while operating income, net income, book value per share and cash flows all significantly declined. When all the important financial metrics are in a downward trend but the company keeps paying a big dividend, debt usually goes up. Covanta's debt to equity ratio is 0.87 where total liabilities are $3.35 billion while total assets are $3.85 billion. This tells us that operations are pretty leveraged while there is no growth. But, before dismissing Covanta's stock as an investment, we have to look at its outlook, business model and main possible issues like debt, contracted energy prices and dividend sustainability.

Covanta Stock dividend sustainability

Let’s start discussing the issues. Covanta says it operates in markets with high barriers to entry.



Legacy markets can be costly to maintain. Source: [Covanta Investor Relations]

Would you like to have an ‘energy from waste’ facility in your backyard? Of course not. Therefore, it is costly for the company to maintain those as you have to change filters, improve disposals and you never know when you’ll get a lawsuit or lose your license. Operating in such a difficult environment leads to high cash outflows, increased debt and deteriorating book values over time. Plus, the energy sector doesn’t look attractive from a price perspective.

Energy Update

COVANTA
Powering Today. Protecting Tomorrow.

- **Q3 2019 revenue drivers vs. Q3 2018:**
  - Same store energy revenue:
    - Price down $4 million (5%)
    - Volume up $2 million (2%)
- **Trends and outlook:**
  - Energy prices remain muted
  - Hedge activity:
    - 0.3 million MWh remain exposed in 2019
    - 2.2 million MWh already hedged for 2020
  - No meaningful contract transitions until 2024

(in millions, except price)	Q3 2019	Q3 2018	(Unaudited) 2019E
Energy Revenue:			
Energy Sales	$66	$67	$265 - $275
Capacity	9	13	45
Other [1]	6	-	10
Total	**$81**	**$81**	**$320 - $330**
MWh Sold:			
Contracted	0.6	0.5	2.1
Hedged [2]	0.8	0.8	3.0
Market	0.4	0.3	1.3 - 1.4
Total	**1.7**	**1.6**	**6.4 - 6.5**
Revenue per MWh: [3]			
Contracted	$62.77	$65.41	~$65
Hedged [2]	$28.69	$28.24	~$34
Market	$25.36	$33.66	~$25
Average	**$39.08**	**$41.48**	**~$42**

Covanta stock - 2024 will come fast - Source: Covanta Investor Relations

Market energy prices are much lower than Covanta's contracted energy prices. In 2024 when the new contract transitions come, it will be difficult for Covanta to get new contracts above market rates as it currently has. So, from 2024, on top of the current cash tight situation, there will be even less money coming from the energy business.

Therefore, the cash situation of the company looks stretched. What kind of company pays out a dividend and the securitizes its receivables to get cash upfront?

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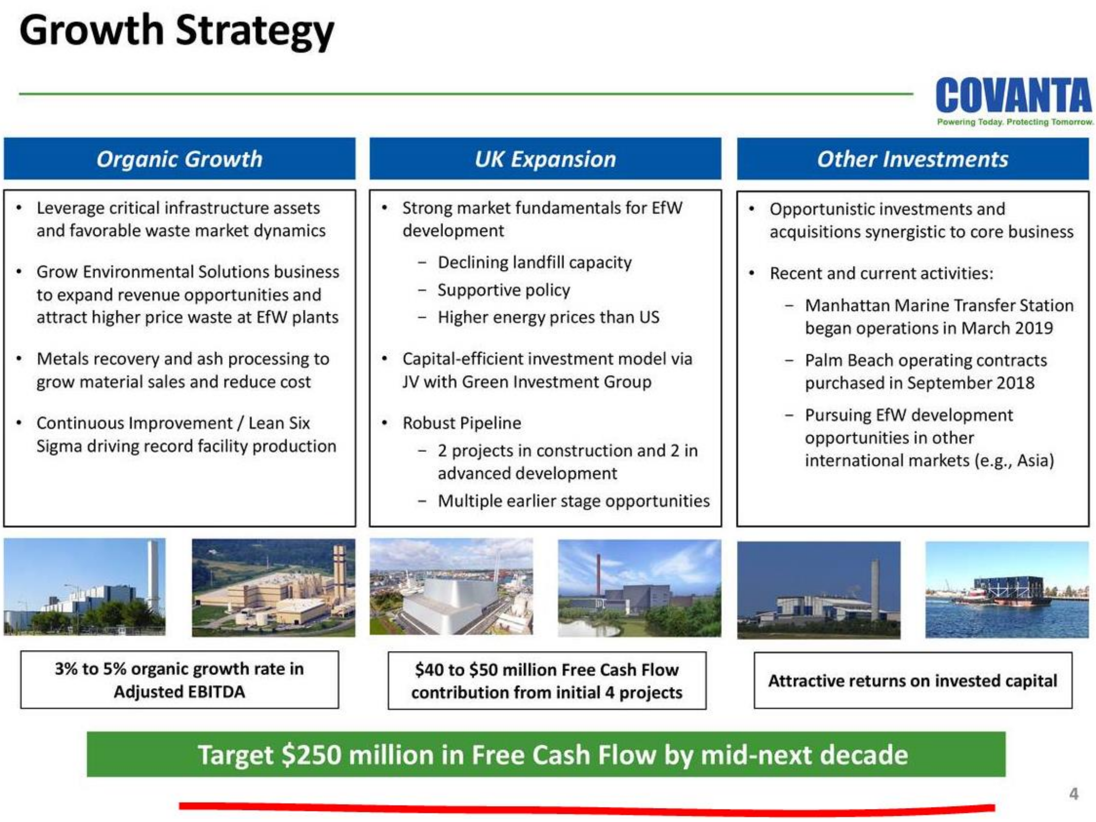
Covanta's receivables securitization – Source: Covanta News

Such behaviour is unsustainable because at some point you can't borrow anymore. When that happens, debt investors panic and retreat, the company is not able to refinance and goes bust.

To conclude, given C02 emissions, the focus on less waste, Covanta is not in a good position. It could be that the dividend is the only thing keeping the stock price up and on a $2 billion market cap, there are plenty of individual dividend investors and ETFs, or even better waste management environmental index funds that hold this and keep Covanta's stock price up. Al always, anything can happen but the risk is simply to high in relation to the reward. The company needs to be paying you a $1 dividend for the next 14 years just to give you your money back while we don't know whether the company will be around in 5 years.

On the other hand, the company targets $250 million in free cash flow by 2025.



Covanta's stock outlook – Source: Covanta Investor Relations

If that happens, the stock will be rerated and probably trading around $4 billion. However, the risk of zero is too high when compared to the $4 billion upside. Investing in companies that have debt levels above their market capitalizations is extremely risky. Plus, with the cumulative cash flows over the last 4 years being a negative $170 million, where are they going to find the money to keep paying the dividend or even, to survive?

Donaldson Co Inc Stock Analysis NYSE DCI – Safe, sound and boring can be a bad investment

Donaldson Company, Inc. is a vertically integrated filtration company engaged in the production and marketing of air filters used in a variety of industry sectors, including commercial/industrial, aerospace, chemical, alternative energy and pharmaceuticals.

Donaldson stock performed extremely well over the past 3 decades but has been volatile as of lately and is especially volatile during economic downturns.

Donaldson stock price chart

The volatility is probably due to the relatively high price to earnings ratio of 28.5. The company didn't grow as fast as the stock price did in the last 10 years. Revenues increased just 33%, earnings not even 20% since 2012 while the only thing growing was the dividend.

Donaldson Co Inc DCI | ★★

Financials

Export | Ascending

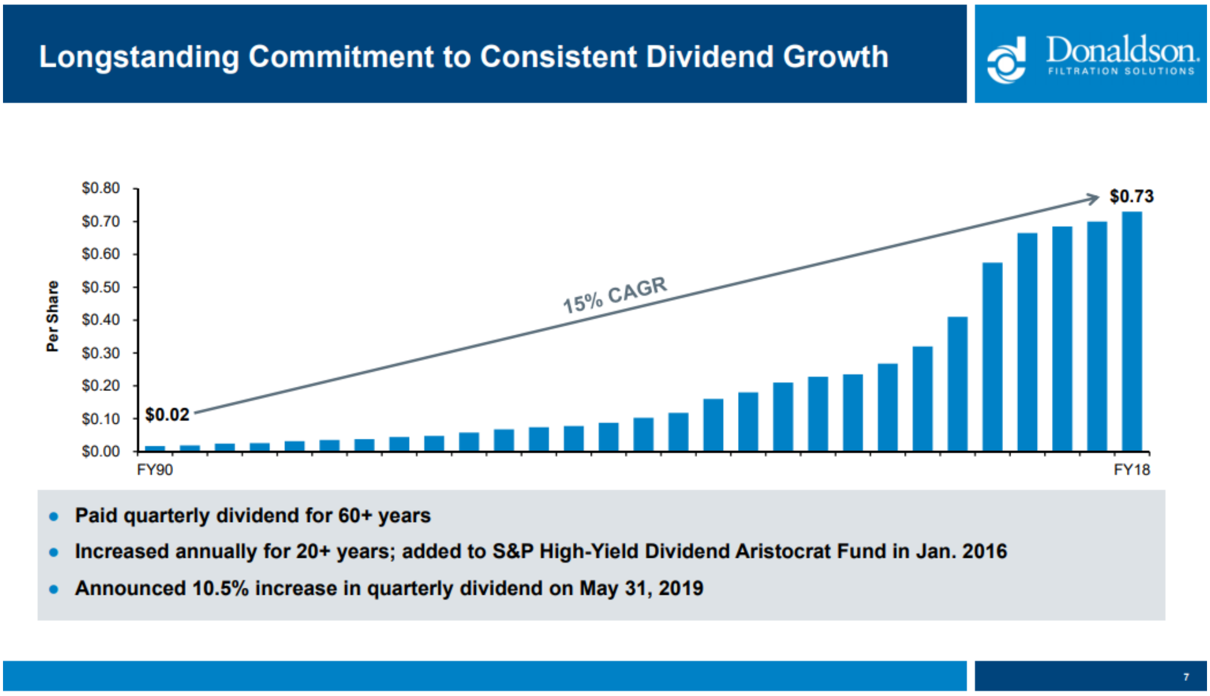
	2010-07	2011-07	2012-07	2013-07	2014-07	2015-07	2016-07	2017-07	2018-07	2019-07	TTM
Revenue USD Mil	1,877	2,294	2,493	2,437	2,473	2,371	2,220	2,372	2,734	2,845	2,816
Gross Margin %	35.1	35.5	35.0	34.8	35.5	34.1	34.0	34.7	34.2	33.3	33.4
Operating Income USD Mil	238	315	363	343	356	288	274	329	380	388	378
Operating Margin %	12.7	13.7	14.6	14.1	14.4	12.2	12.3	13.9	13.9	13.6	13.4
Net Income USD Mil	166	225	264	247	260	208	191	233	180	267	258
Earnings Per Share USD	1.05	1.43	1.73	1.64	1.76	1.49	1.42	1.74	1.36	2.05	2.00
Dividends USD	0.23	0.27	0.32	0.41	0.57	0.67	0.69	0.70	0.73	0.78	0.80
Payout Ratio % *	26.6	18.8	18.5	22.7	31.0	41.8	49.3	41.7	65.0	32.1	40.0
Shares Mil	158	157	153	150	147	139	135	134	132	130	129
Book Value Per Share * USD	5.05	6.33	6.16	7.40	8.02	6.30	6.02	6.11	6.46	7.38	7.20
Operating Cash Flow USD Mil	203	246	260	316	318	213	286	310	262	346	369
Cap Spending USD Mil	-43	-61	-78	-95	-97	-94	-73	-66	-98	-150	-159
Free Cash Flow USD Mil	160	185	182	221	221	119	213	244	165	195	209
Free Cash Flow Per Share * USD	1.15	1.04	1.19	1.36	1.59	1.03	1.28	1.88	1.06	1.46	—
Working Capital USD Mil	471	570	587	579	616	470	465	666	656	640	—

* Indicates calendar year-end data information

Source: Donaldson stock financials - Morningstar

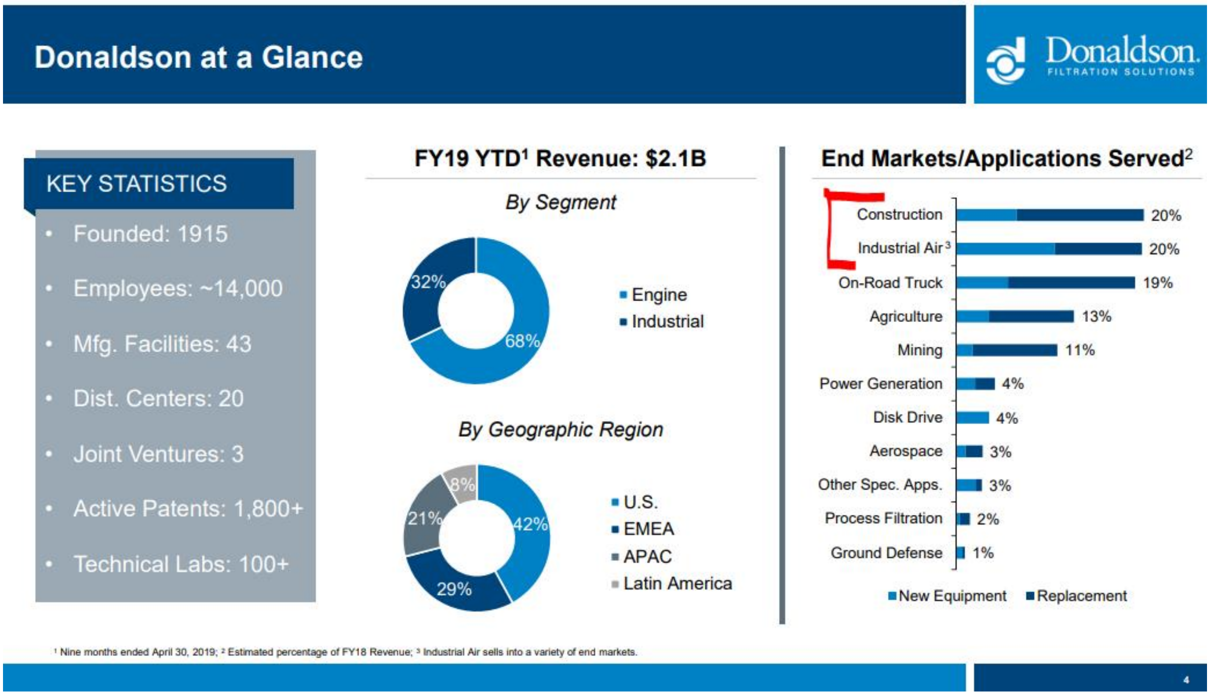
Given the past performance, I find it unlikely that the company will grow faster in the future and therefore it is not an attractive investment for me. I understand investors that see it as a safe investment that will compound over the long-term as the return on invested capital has constantly been above 15% over the past decade and Donaldson has a strong balance sheet, but apart from safe and sound, there is not much to it.

Donaldson's dividend has been increasing for the last 20 years but I don't see that as enough of a sign to invest in it at any price.



Donaldson's dividend - Source: Donaldson's Investor Relations

Plus, the company is exposed to risky and cyclical sectors like construction and industry that you never know when will turn into a slump.



Donaldson's dividend - Source: Donaldson's Investor Relations

The slump might not be big, but at a valuation close to 30, it could be big for investors, as it was the case in 2016 and 2009!

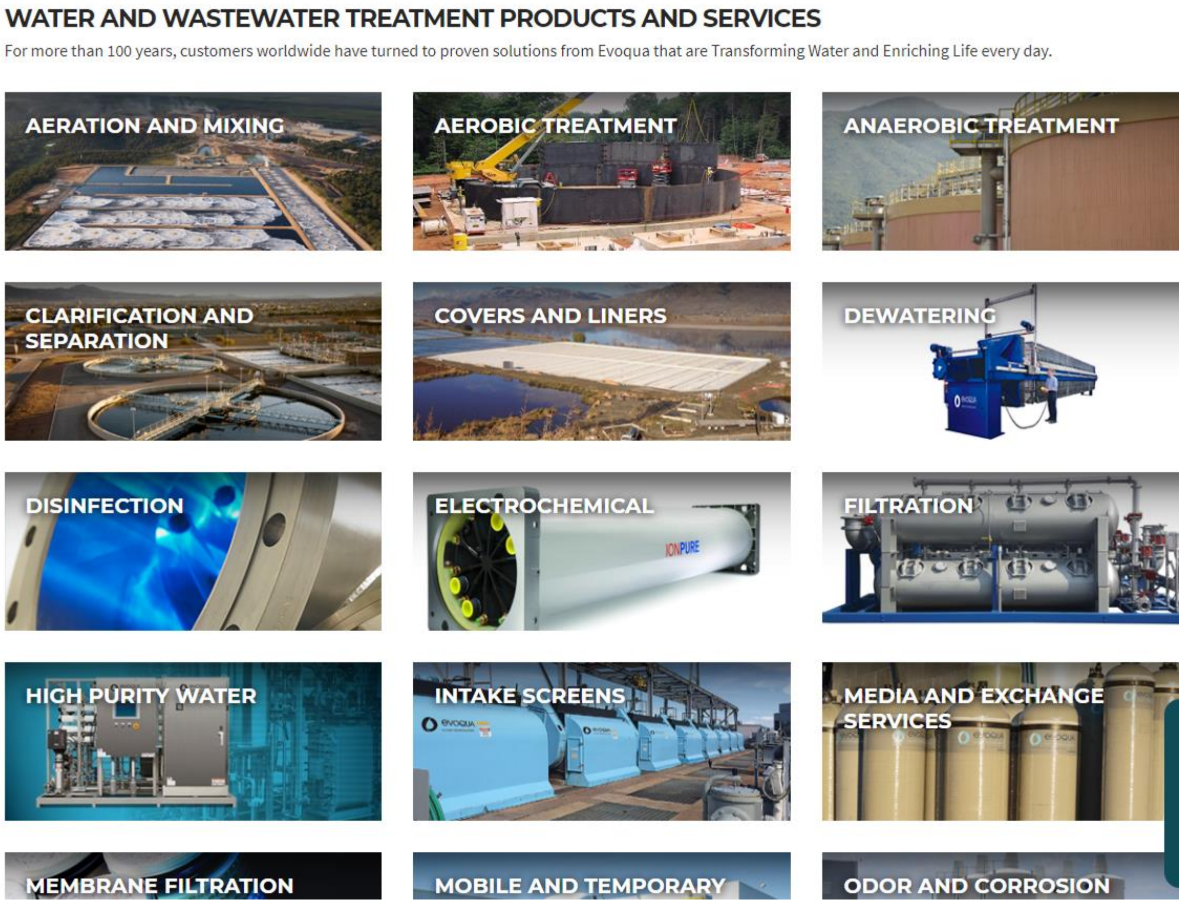
Donaldson stock price volatility

As the company makes air filters, vehicle electrification poses a risk but that is still pretty far away from happening.

All in all, this could be an interesting investment to make during an economic downturn as you need their products no matter what.

Evoqua Water Technologies Stock Analysis NYSE AQUA

Evoqua Water Technologies provides water treatment equipment and services; like filter press, intake rebuilds, and electrocatalytic services, as well as sludge dryers, digester covers, captivator systems, and other related technologies to the industrial, commercial, and municipal water infrastructures.

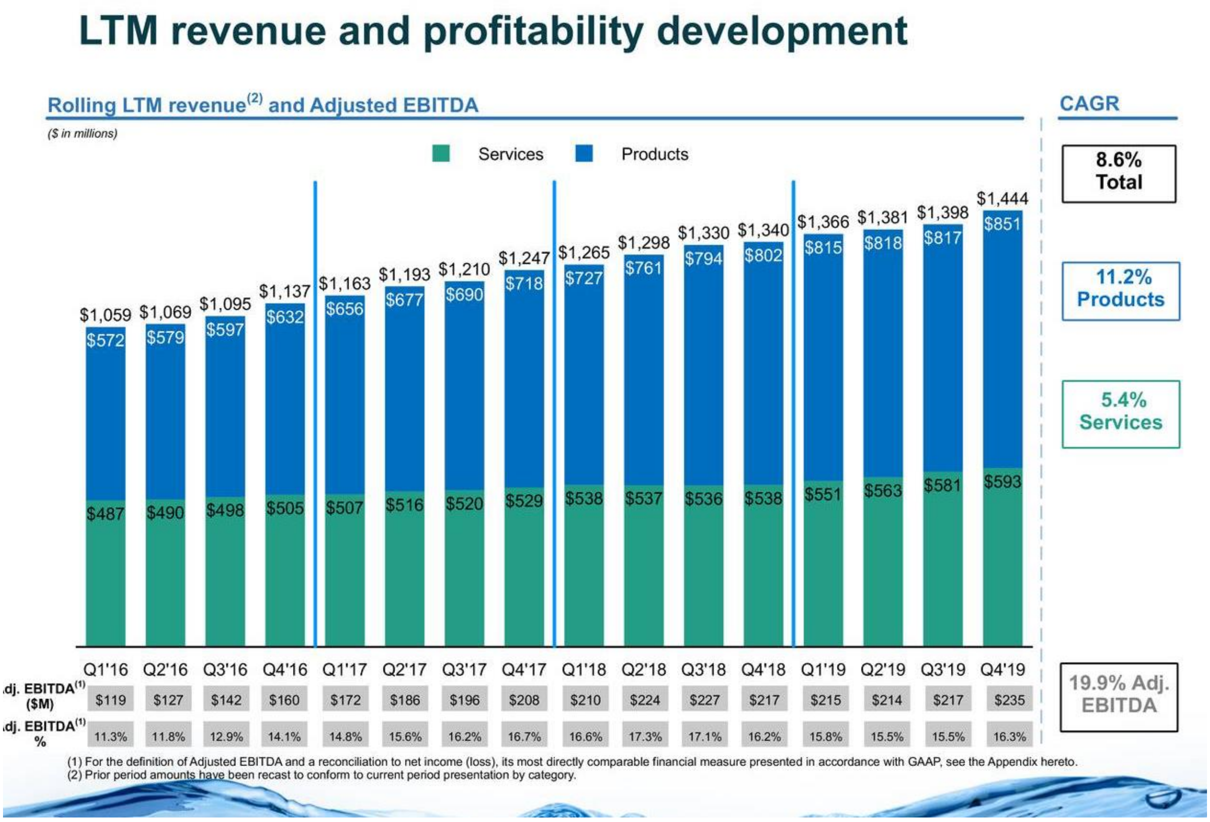


AQUA stock is a recent IPO and it behaved as many recent IPOs do. First it goes down and then back up.

AQUA stock price

AQUA stock business overview

AQUA's business is a two-tier business, including both services and products. Growth has been steady and stable over the past years. Expected growth for 2020 is between 1% and 5%.



AQUA stock revenues – Source: [Evoqua investor relations]

Growth in revenues for AQUA hasn't been stellar but the company became free cash flow positive, which is always good.

Evoqua Water Technologies Corp AQUA

Financials

Export | Ascending

	2010-09	2011-09	2012-09	2013-09	2014-09	2015-09	2016-09	2017-09	2018-09	2019-09	TTM
Revenue USD Mil	—	—	—	—	—	1,061	1,137	1,247	1,340	1,444	1,444
Gross Margin %	—	—	—	—	—	27.6	29.3	32.0	30.2	29.5	29.5
Operating Income USD Mil	—	—	—	—	—	-6	37	69	67	60	60
Operating Margin %	—	—	—	—	—	-0.5	3.3	5.5	5.0	4.1	4.1
Net Income USD Mil	—	—	—	—	—	-86	12	2	6	-10	-10
Earnings Per Share USD	—	—	—	—	—	-0.82	0.11	0.02	0.05	-0.08	-0.08
Dividends USD	—	—	—	—	—	—	—	—	—	—	—
Payout Ratio % *	—	—	—	—	—	—	—	—	—	—	—
Shares Mil	—	—	—	—	—	105	105	113	120	115	115
Book Value Per Share * USD	—	—	—	—	—	—	—	—	3.15	3.15	3.17
Operating Cash Flow USD Mil	—	—	—	—	—	42	32	29	81	125	125
Cap Spending USD Mil	—	—	—	—	—	-49	-48	-63	-83	-95	-95
Free Cash Flow USD Mil	—	—	—	—	—	-7	-16	-34	-2	30	30
Free Cash Flow Per Share * USD	—	—	—	—	—	—	—	—	-0.22	0.03	—
Working Capital USD Mil	—	—	—	—	—	232	133	220	281	315	—

* Indicates calendar year-end data information

AQUA stock financials – Source: [AQUA Morningstar]

AQUA's management forecasts future growth to be between 3% and 5% but given the number of acquisitions they make, growth might even be faster. In 2019 the company acquired ProAct, IsH20TOP, PureWater and 60% of Frontier water systems.

The company delivered $90 million of free cash flows in 2019 but also $34 million in restructuring costs, $20 million in share compensation to management plus $20 million in other losses and expenses.

AQUA looks like something that could be a good business, but the management is making a mess of their financials. Everything is adjusted, from EBITDA, earnings to cash flows and they do that year by year. This makes me think they are not really there to reward shareholders as much they are there to reward themselves.

Free cash flow / Adjusted net income / EPS

($ in millions)	Q4'18	Q4'19	FY'18	FY'19
Operating Cash Flow	**$ 44.2**	**$ 70.8**	**$ 81.0**	**$ 125.2**
(+) EBITDA adjustments, excluding share-based compensation and gain on sale of property, net of tax[1]	13.1	14.3	43.9	42.6
(-) Capital Expenditures	(26.1)	(24.9)	(80.7)	(88.9)
(+) Financing related to growth capital expenditures	2.2	22.4	5.7	38.4
(+) Financing related to property acquisition	—	—	1.9	—
(-) Purchases of intangibles (e.g., software licenses)	(0.5)	(1.6)	(2.0)	(6.4)
Free Cash Flow	**$ 32.9**	**$ 81.0**	**$ 49.8**	**$ 110.9**
Operating Profit	**$ 16.4**	**$ 27.5**	**$ 66.8**	**$ 59.7**
Interest expense	(17.2)	(14.8)	(57.6)	(58.6)
Income tax (expense) benefit	(2.3)	(10.8)	(1.4)	(9.6)
Net (loss) income	**$ (3.1)**	**$ 1.9**	**$ 7.9**	**$ (8.5)**
Adjustments, net of tax[1][2]	18.3	18.5	54.2	57.1
Adjusted Net Income	**$ 15.2**	**$ 20.4**	**$ 62.1**	**$ 48.6**
(Loss) Earnings Per Share				
Basic EPS	$ (0.03)	$ 0.01	$ 0.05	$ (0.08)
Diluted EPS	$ (0.03)	$ 0.01	$ 0.05	$ (0.08)
Adjusted Basic EPS[1]	$ 0.13	$ 0.18	$ 0.53	$ 0.41
Adjusted Diluted EPS[1]	$ 0.13	$ 0.17	$ 0.50	$ 0.41
Memo items:				
Blended statutory tax rate	26.0%	26.0%	26.0%	26.0%
Foreign currency loss (gain) primarily on intercompany loans	$ 0.8	$ 6.7	$ 5.9	$ 10.5
Basic # of shares (in millions)	113.9	114.7	113.9	114.7
Diluted # of shares (in millions)	113.9	120.2	120.2	114.7

AQUA stock revenues – Source: Evoqua investor relations

However, if they do well, keep growing and improve margins, the market might rerate this like it has been the case with other similar stocks like Waste Management, but it is too much of a long-shot for me.

Another issue is the frightening debt levels where the debt is higher than the tangible assets. Tangible assets are $1 billion while total debt is $1.3 billion. Actually, AQUA's stock tangible book value is negative.

Hitachi Zosen Corporation Stock Analysis TYO 7004 – Margins Are Just Going to Increase – yeah right!

Hitachi Zosen Corporation produces waste treatment plants, industrial plants, precision machinery, industrial machinery, steel mill process equipment, steel structures, construction machinery, tunneling machines, and power plants.

Hitachi Zosen business – Source: Investor Relations

Hitachi Zosen stock analysis

Hitachi Zosen Stock is a different stock than Covanta stock or Clean Harbors stock that we already analysed. Clean Harbors being and expensive play in an exuberant market, Covanta being a high risk dividend payer, Hitachi stock shows how this is a difficult environment to operate it. The company forecasts profits of just 1 billion Yen on 395 billion in revenues.

However, if we discount Hitachi's future cash flows at a 10% discount rate, we get to a present value that is similar to the current stock price. Given the price to cash flow rate of 12.94, expected future growth, the company is likely to deliver 10% returns.

As a typical Japanese company, they have a short term and a long-term 2030 management plan. And, as a typical Japanese company, they don't mention rewarding shareholders within their plan.

Evaluation of Management Targets and Actions

Hitz
Hitachi Zosen

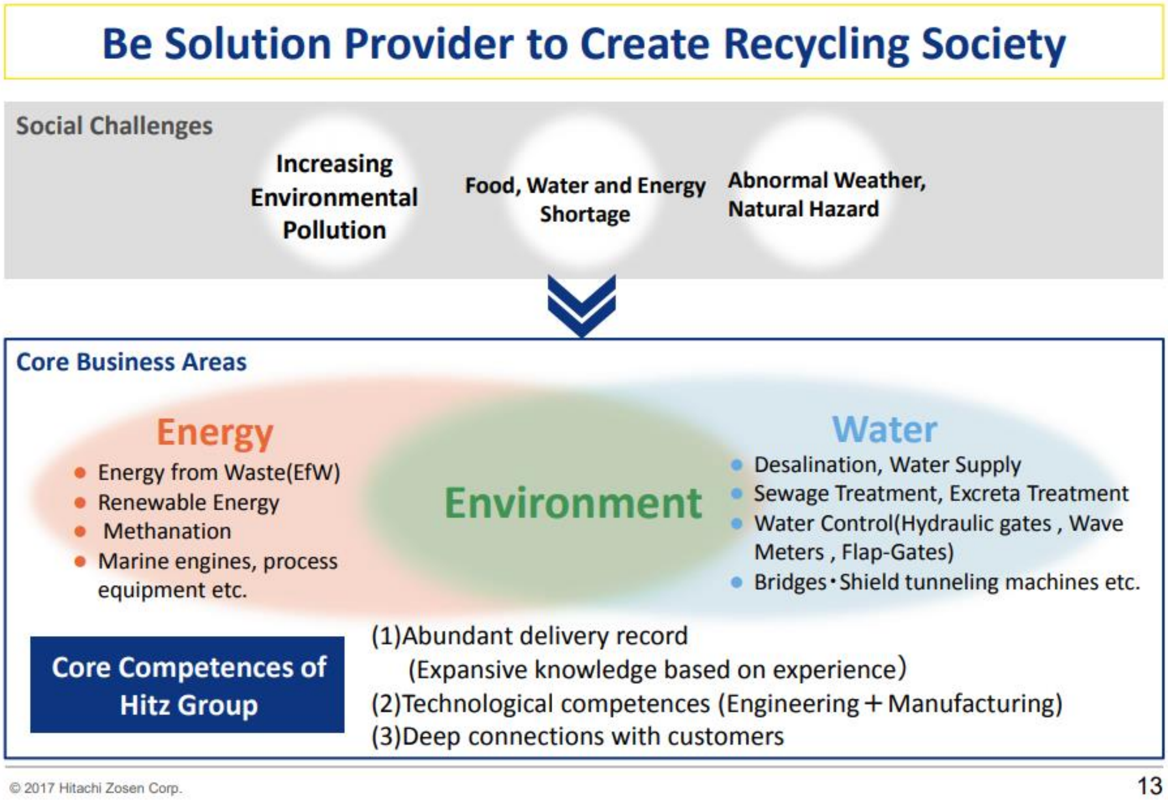
No.	Management Targets	Evaluation
1	**Strengthen profitability** ● Each business and product to achieve No. 1 profitability in its area	● Engineering：AOM leads growth of engineering ● Manufacturing ： Continuing slump Troubles of marine diesel engines and systematic machinery. Projects troubles and technical problem related to overseas
2	**Expand business scale** ● Expand to Yen 500 billion company with public recognition	● INOVA, NAC and large-scale desalination project contribute increase of overseas net sales to approximately JPY 500 billion
3	**Fortify financial structure** ● Achieve and maintain at least 30% shareholders' equity ratio, and secure a stable financial position	● Shareholder's equity ratio is 29% ● Increase endurance to financial risk by subordinated loan

AOM: After service, Operation and Maintenance

5

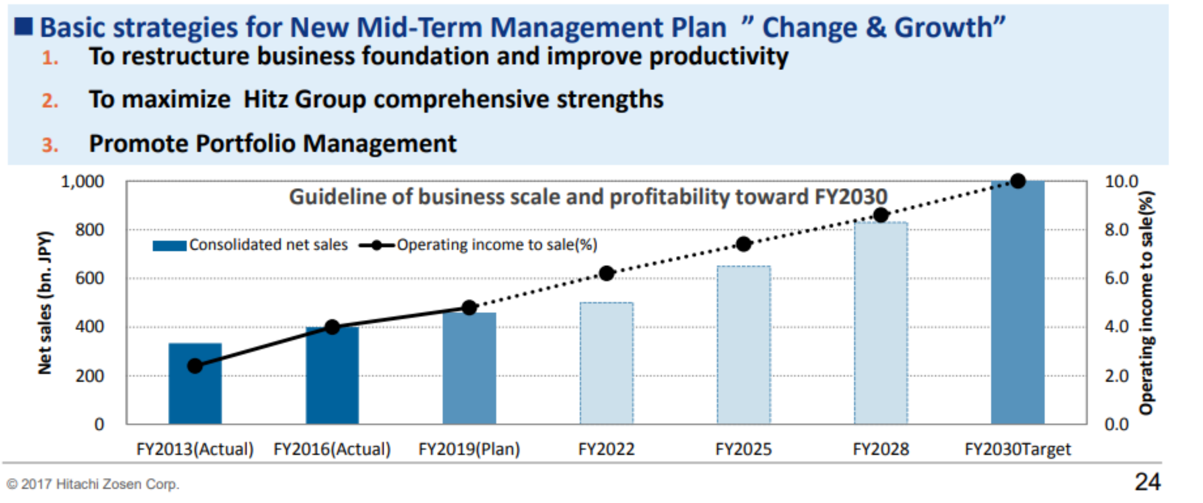
Hitachi plan - Source: Hitachi

They are really banking on hot environmental topics, but this doesn't mean the stock will be a great investment.



Hitachi plan - Source: Hitachi

Their plan is to grow revenues to 1 trillion Yen and to increase operating margins to 10%.



Hitachi plan - Source: Hitachi

If they do that, the stock will probably quintuple over the next decade, but I don't see how will they get to higher margins in 10 years if they don't have them now. Now, business is great globally, so why should it be better in 10 years with more competition?

Plus, they expected sales of 430 billion Yen for 2019 while actual sales are 390 billion.

Numerical Forecast (Consolidated)

Hitz Hitachi Zosen

(Unit: Billion Yen)

	Hitz Vision Ⅱ (Actual)				Change & Growth (Plan)			
	FY2014	FY2015	FY2016	3 years total	FY2017	FY2018	FY2019	3 years total
Order intake	452.7	435.4	398.9	1,287	400	430	460	1,290
Net sales	359.3	387	399.3	1,145.6	360	400	430	1,190
Operating income (Ratio)	12.8 (3.6%)	15.1 (3.9%)	14.9 (3.7%)	42,8 (3.8%)	12.5 (3.5%)	16.5 (4.1%)	20.5 (4.8%)	49.5 (4.2%)
Ordinary income (Ratio)	7.5 (2.1%)	12.2 (3.2%)	11.2 (2.8%)	30,9 (2.7%)	10 (2.8%)	14 (3.5%)	18 (4.2%)	42 (3.5%)
Net income	5.1	5.8	5.8	16.7	6.5	8	10	24.5
Interest-bearing debt	119	105.1	109.2	–	110	105	100	–
Shareholder's equity ratio (incl. subordinated loan)	26.6%	28.4%	29.4%	–	30.0% (32.4%)	30.5% (32.7%)	31.0% (33.3%)	–
ROE	4.9%	5.2%	5.1%	–	5.5%	6.5%	7.7%	–

Hitachi plan - Source: Hitachi

To add to the above, they talk about data, artificial intelligence etc. Bullshit words I heard already and everyone is using them. Give me margins, not words. I don't see from where will their competitive advantage come ???? A look at Hitachi Zosen's stock price tells us the market doesn't really believe them too.


Hitachi Zosen Corp
TYO: 7004
Follow
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1 day
5 days
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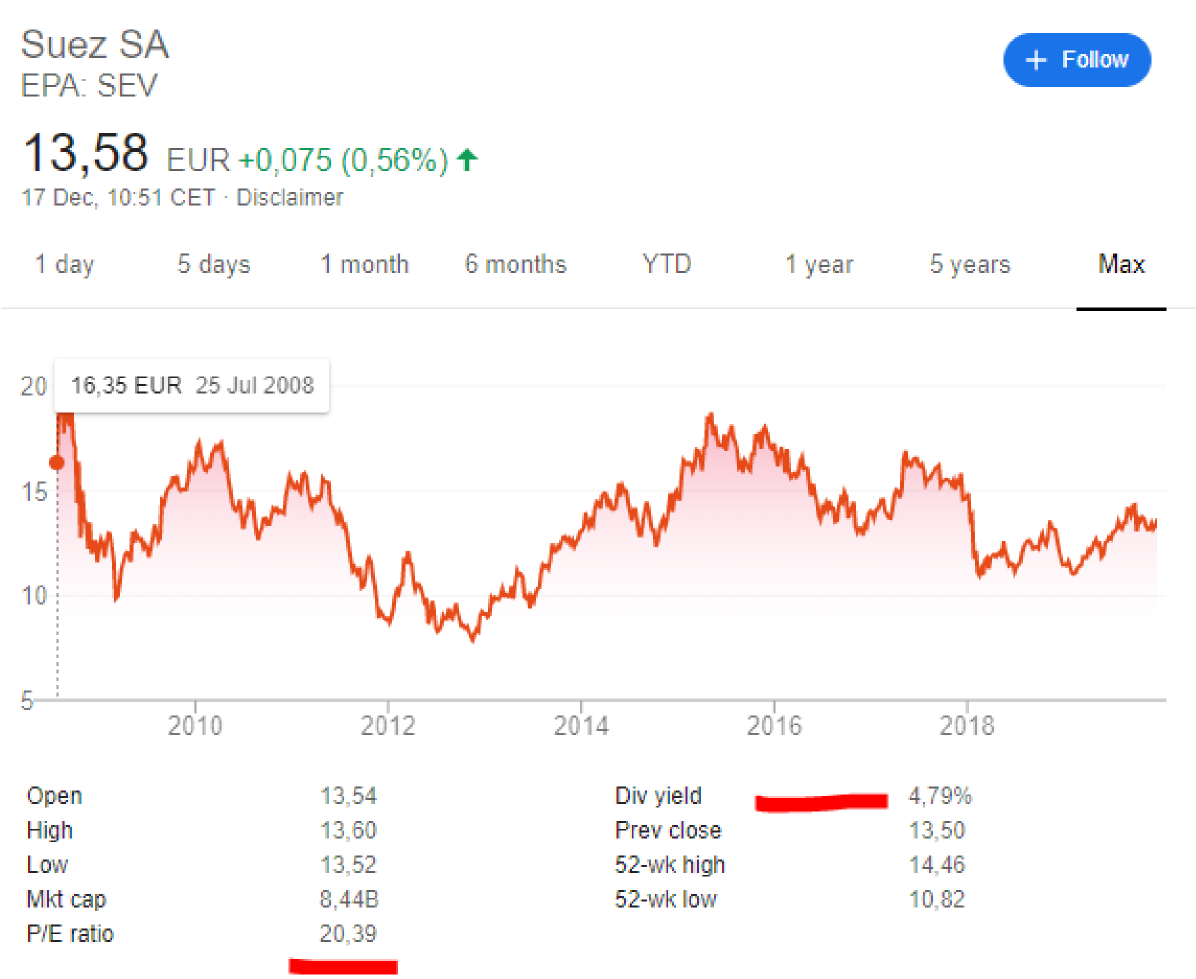
Suez Environment S.A EPA SEV – Free ECB Money Allows Suez to Dream

Suez SA is a French-based utility company which operates largely in the water treatment and waste management sectors.

Suez stock didn't do any miracles over the past decade but the dividend is significant at 4.79%.



Suez SA stock price

The management recently published Suez SA plan for 2030. If I scroll through it, I see many empty words. The stock didn't go anywhere for a reason. The reason is that fancy, but empty words don't make for a competitive advantage.

Suez SA change plans – Source: Suez SA 2030 Strategy

The last decade has been a decade of renegotiating water contracts in France, the same is about to happen in Spain, while the waste management business is highly dependent on industrial activity. In Europe, industrial activity is a big risk as we are already seeing within the automotive industry.

They are trying to expand into emerging markets, but you don't have a moat in this business and you need to be the lowest bidder to win business.

Suez SA change plans – Source: Suez SA 2030 Strategy

It is likely that they will not see improved margins from international expansion, plus, it is not going to come for free. Another risk is cheap European money, if that source dries up for whatever reason, companies like Suez immediately become much less competitive globally.

Suez SA Stock financials

Over the last decade, the company did grow revenues, but it did so at the cost of declining operating margins.

Suez SA SEV | ★★★

Financials

Export Ascending

	2009-12	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	TTM
Revenue EUR Mil	12,296	13,869	14,830	15,102	14,643	14,324	15,135	15,322	15,871	17,331	17,637
Gross Margin %	76.5	74.2	76.8	76.9	79.7	80.2	80.5	80.4	80.5	78.9	79.4
Operating Income EUR Mil	1,012	1,389	1,201	1,170	1,199	1,046	1,127	1,145	1,101	1,145	1,178
Operating Margin %	8.2	10.0	8.1	7.7	8.2	7.3	7.4	7.5	6.9	6.6	6.7
Net Income EUR Mil	515	720	550	251	352	417	408	420	302	334	456
Earnings Per Share EUR	0.81	1.13	0.59	0.44	0.63	0.68	0.67	0.69	0.45	0.47	0.66
Dividends EUR	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.65	0.65
Payout Ratio % *	79.2	56.5	82.3	144.4	106.6	70.7	144.4	85.5	141.1	125.0	98.5
Shares Mil	496	496	496	516	520	543	557	555	593	618	624
Book Value Per Share * EUR	7.41	9.65	9.29	9.46	8.97	9.13	10.14	8.74	9.99	9.92	10.11
Operating Cash Flow EUR Mil	1,606	1,889	1,902	2,357	1,823	1,973	1,992	1,913	1,962	1,973	2,201
Cap Spending EUR Mil	-1,083	-1,346	-1,410	-1,222	-1,138	-1,076	-1,277	-1,086	-1,177	-1,343	-1,470
Free Cash Flow EUR Mil	522	544	492	1,135	686	897	715	827	785	631	732
Free Cash Flow Per Share * EUR	1.05	1.10	0.91	2.20	1.76	1.42	1.69	1.09	1.46	1.24	—
Working Capital EUR Mil	-826	-887	-1,212	-723	-1,577	-1,222	-1,231	-951	-297	-792	—

* Indicates calendar year-end data information

Suez SA stock financials – Source: [Morningstar]

With a price to earnings ratio of 20, where all the earnings are paid out in the form of dividends (the pay-out ratio was above 100% for 5 years in the last 10 years), it is unlikely you will see something spectacular coming out of this investment. The exposure to industrial activity in Europe makes it extremely risky above book value. If you buy Suez SA stock, you do that with a huge margin of safety below book value and when earnings are negative in a recession or slowdown like it was the case in 2012 when earnings fell 50% and Suez SA stock price was closer to EUR 5.

Veolia Environment S.A EPA VIE

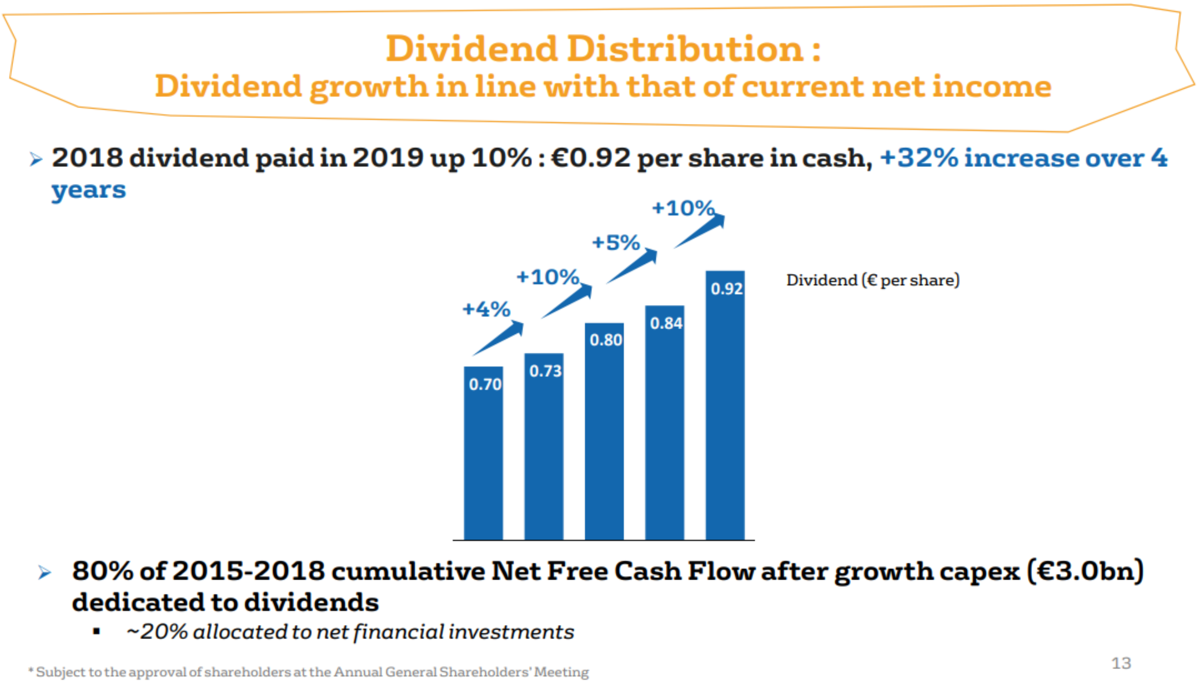
Veolia Environnement S.A., branded as Veolia, is a French transnational company with activities in three main service and utility areas traditionally managed by public authorities – water management, waste management and energy services.

Veolia's stock price tells us that the situation hasn't been the best there over the long-term. However, since 2009 the returns have been ok, but it also means you need to time your investment very well as the stock is extremely volatile in relation to cycles. A thing common to all the waste management stocks we analysed by now.

Veolia stock price chart

Veolia's stock market capitalization is EUR 13 billion, its debt is 10 billion and year finance costs of 400 million. This means the company is highly leveraged, its business requires constant capex investments in a highly competitive environment. Given the leverage, high investments necessary, policy related issues etc. it is another high risk investment and we can see that by taking a look at the stock performance over the last 20 years.

However, if you time your investment well and you invest when the trend turns positive, you can do really good by taking advantage of those dividend increases.



Veolia stock dividend – Source: Veolia Investor Relations

This is another typical waste management company with high leverage and dependent on the economy, contracts and consumption. It looks like these are sustainable, recycling, waste management companies oriented to the future, but it is mostly utilities in a highly competitive environment.

Waste Management Inc. NYSE WM – Moat and Scale, but Easily Down 50% in Next Downturn

Waste Management stock is the leader of the waste management industry with a stock market capitalization of $47 billion. Up to 2012 the stock didn't look like anything spectacular but since then it has really boomed.

Waste Management stock price

What is the difference between Waste Management and the other waste management stocks we discussed up till now?

Well, scale and moats!

Waste management managed to increase margins thanks to its integrated business and moat, as you can't build new competitive landfills. Not in my back yard (NIMBY) might be something familiar to you😊.

Waste Management stock financials

Waste Management Inc WM | ★

Financials

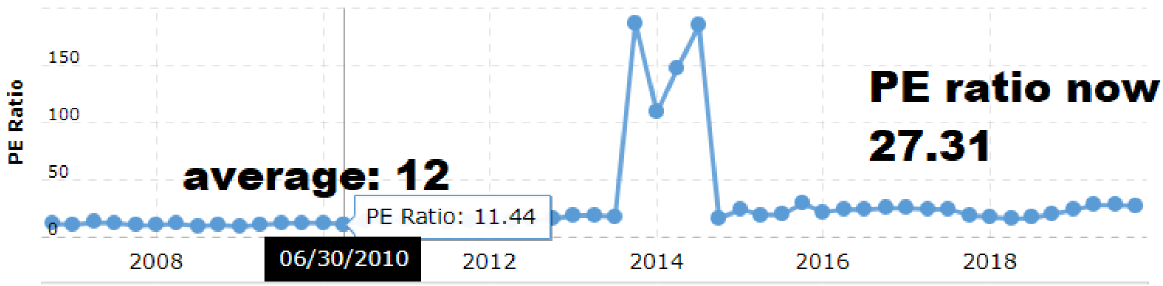
Export | Ascending

	2009-12	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	TTM
Revenue USD Mil	11,791	12,515	13,378	13,649	13,983	13,996	12,961	13,609	14,485	14,914	15,451
Gross Margin %	38.6	37.5	36.2	34.9	34.8	35.7	36.5	37.6	37.7	38.0	38.1
Operating Income USD Mil	2,020	2,036	2,057	2,001	2,070	2,221	2,142	2,412	2,620	2,735	2,785
Operating Margin %	17.1	16.3	15.4	14.7	14.8	15.9	16.5	17.7	18.1	18.3	18.0
Net Income USD Mil	994	953	961	817	98	1,298	753	1,182	1,949	1,925	1,754
Earnings Per Share USD	2.01	1.98	2.04	1.76	0.21	2.79	1.65	2.65	4.41	4.45	4.09
Dividends USD	1.16	1.26	1.36	1.42	1.46	1.50	1.54	1.64	1.70	1.86	2.00
Payout Ratio % *	57.7	63.6	65.1	80.7	73.2	647.8	66.0	64.8	54.0	34.5	49.0
Shares Mil	494	482	471	464	470	466	455	447	441	432	428
Book Value Per Share * USD	12.93	13.18	12.92	13.69	14.45	11.70	11.71	12.20	12.18	14.72	15.99
Operating Cash Flow USD Mil	2,362	2,275	2,469	2,295	2,455	2,331	2,498	2,960	3,180	3,570	3,764
Cap Spending USD Mil	-1,179	-1,104	-1,324	-1,510	-1,271	-1,151	-1,233	-1,339	-1,509	-1,694	-1,986
Free Cash Flow USD Mil	1,183	1,171	1,145	785	1,184	1,180	1,265	1,621	1,671	1,876	1,778
Free Cash Flow Per Share * USD	2.40	2.43	2.28	1.69	2.63	2.52	2.74	3.13	3.92	3.87	—
Working Capital USD Mil	109	-3	-689	-613	-515	156	-165	-418	-638	-463	—

* Indicates calendar year-end data information

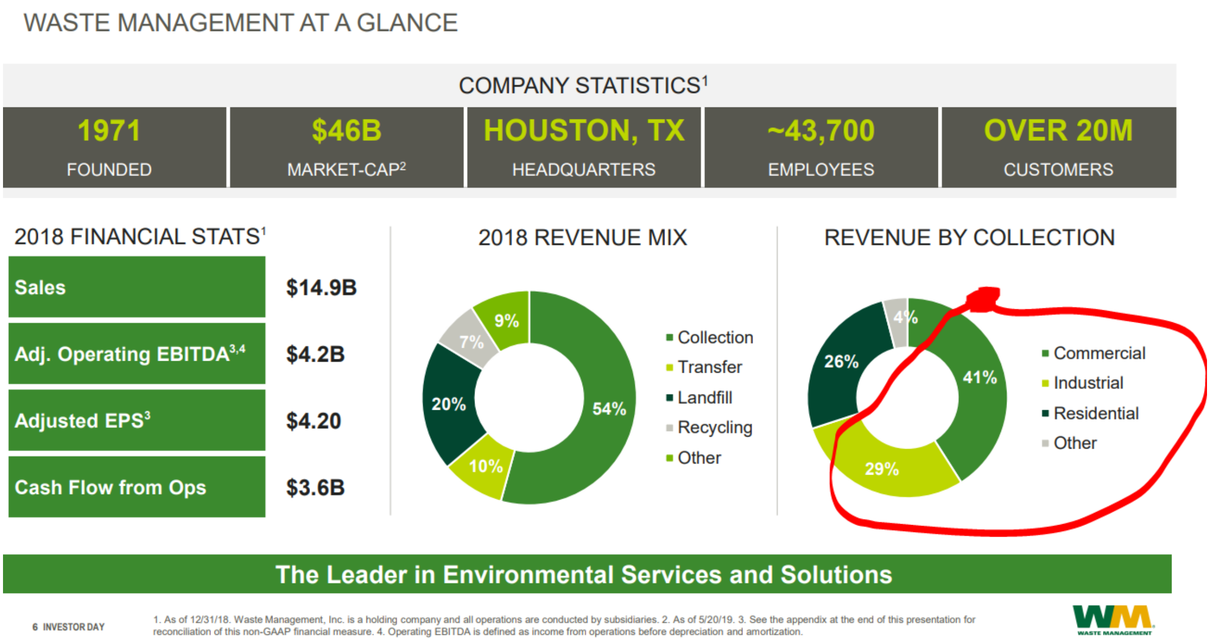
Source: Waste Management - Morningstar

As the business numbers improved, so di Waste Management’s stock price to earnings ratio improve. From an average PE ratio in the low teens, the valuation expanded to the current 27.31 which is a huge valuation for a company that hasn’t been really growing much.



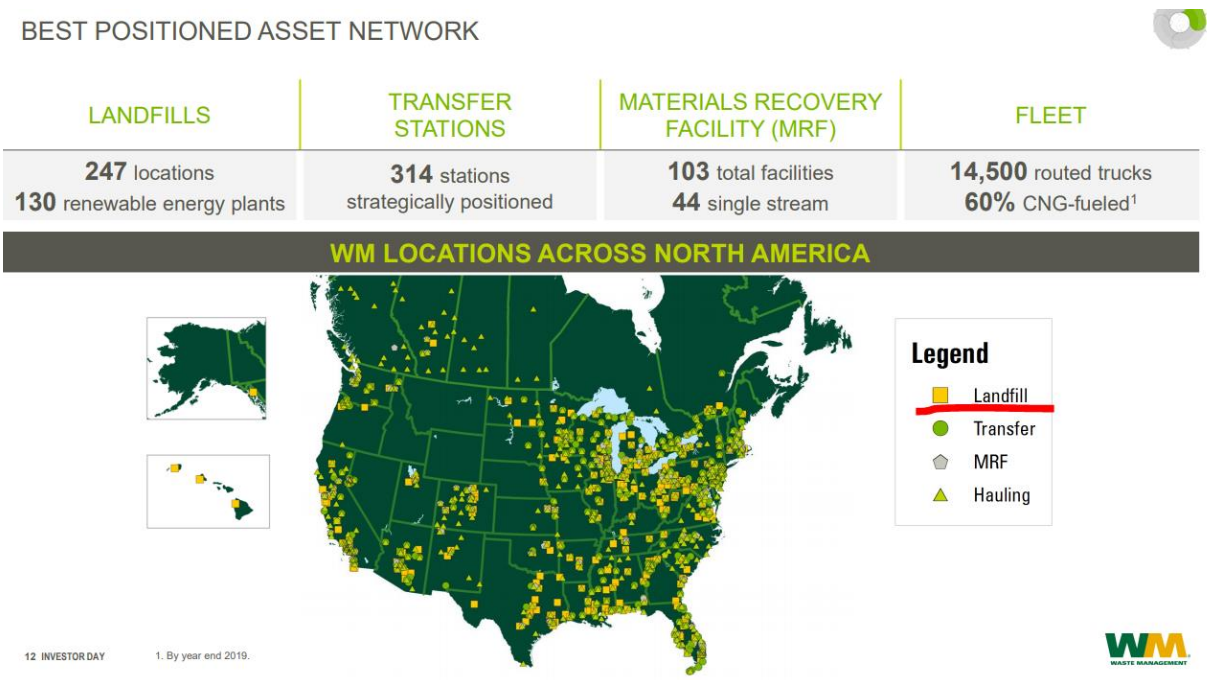
Waste Management stock price to earnings ratio – Source: WM Macrotrends

So, the company got rerated by the market but I still see risks, especially as the company is dependent on the economic cycle as 70% of revenue comes from industrial and commercial clients.



Waste Management revenue distribution – Source: [Waste Management investor relations](#)

The impressive network of landfills and short haul routes that gives it a competitive advantage is what makes the company a great business.



Waste Management network – Source: [Waste Management investor relations](#)

Waste Management stock – future investment returns

But, when it comes to future investment returns, given the price to earnings ratio of 28, there must be significant growth ahead to justify such a high valuation and a dividend yield of 1.83% seems a bit high. If I compare it to [Visa stock, that I recently analysed](#). Visa has a price to earnings ratio of 33 but is growing at 15%, compared to WM's expected growth of 4% in a very positive economic environment.

Given that there will not be an amazing population growth rate in the US, we can't expect WM do grow much. Therefore, I see it as an expensive investment where the stock is being pushed up by buybacks and increased dividends. In case of a recession you can easily see this down 50%.

Now, you might wonder why do I analyse stocks like Waste Management that are clearly overvalued when you look at the stock price or price to earnings ratio?

Well, finding out what worked in developed markets will give me great insight when I'll look into emerging markets. If I find a company that can build a moat there, offer similar economies of scale, grow also thanks to population growth and economic development, I could be looking at a big winner, similarly to what was the case with Waste Management over the past decades, up 30 times not including dividends.

It is unlikely that WM stock repeats the performance over the next 3 decades, but I might find a business somewhere else in the world that will do something similar.

Republic Services, Inc NYSE RSG – Valuations are too high for significant long-term investing returns

Republic Services stock performed similarly to Waste Management's stock since 2012.

Republic Services stock price

Even the dividend and the price to earnings ratio are equal to Waste Management. The finances of Republic Services are also similar and there is practically no growth in revenues, only margin expansion.

Republic Services Inc Class A RSG | ★

Financials

Export Ascending

	2009-12	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	TTM
Revenue USD Mil	8,199	8,107	8,192	8,118	8,417	8,788	9,115	9,388	10,042	10,040	10,253
Gross Margin %	40.9	41.2	40.6	38.3	37.8	36.0	39.5	38.6	38.1	38.8	38.7
Operating Income USD Mil	1,516	1,569	1,580	1,282	1,176	1,217	1,519	1,532	1,616	1,717	1,765
Operating Margin %	18.5	19.4	19.3	15.8	14.0	13.8	16.7	16.3	16.1	17.1	17.2
Net Income USD Mil	495	507	589	571	588	548	749	613	1,278	1,037	1,085
Earnings Per Share USD	1.30	1.32	1.56	1.55	1.62	1.53	2.13	1.78	3.77	3.16	3.36
Dividends USD	0.76	0.78	0.84	0.91	0.99	1.08	1.16	1.24	1.33	1.44	1.53
Payout Ratio % *	58.5	59.1	57.3	58.7	73.1	52.0	64.0	70.9	55.3	33.7	45.5
Shares Mil	381	385	378	368	363	358	351	344	339	328	323
Book Value Per Share * USD	19.86	20.45	20.58	21.33	21.47	22.48	22.57	22.50	23.13	24.56	24.99
Operating Cash Flow USD Mil	1,397	1,434	1,767	1,513	1,548	1,529	1,680	1,847	1,911	2,243	2,283
Cap Spending USD Mil	-826	-795	-937	-904	-880	-863	-946	-927	-989	-1,071	-1,159
Free Cash Flow USD Mil	570	639	830	610	667	667	734	920	920	1,171	1,123
Free Cash Flow Per Share * USD	1.50	1.66	2.20	1.66	1.95	1.77	2.38	2.20	2.68	3.73	—
Working Capital USD Mil	-1,283	-1,430	-631	-463	-295	-435	-605	-528	-1,198	-1,154	—

* Indicates calendar year-end data information

Republic Services stock financials – Source: Morningstar

Arcadis AMS – ARCAD – good project company but nothing special, no competitive advantage

Arcadis NV is a global design, engineering and management consulting company based in the Zuidas, Amsterdam, Netherlands. It was founded in 1888. The company is a member of the Next 150 index. Arcadis has over 350 offices, in forty countries.

Arcadis stock price chart tells us the company did great in the 2000s, but has failed to reward shareholders since then, except those who traded. Nevertheless, the stock chart's volatility tells me that either the company is extremely leveraged or it promises a lot but it has failed to deliver when expected which can create and interesting investment opportunity.

Arcadis stock analysis

Arcadis is a business that projects infrastructure, so the current low interest environment benefits it very much.

Arcadis NV ARCAD

Financials

Export Ascending

	2009-12	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	TTM
Revenue EUR Mil	1,786	2,003	2,017	2,544	2,516	2,635	3,419	3,329	3,219	3,256	3,377
Gross Margin %	68.2	68.6	71.5	73.8	75.2	76.5	75.9	74.1	75.7	74.9	74.4
Operating Income EUR Mil	113	129	126	150	149	146	156	124	129	133	146
Operating Margin %	6.3	6.5	6.2	5.9	5.9	5.5	4.5	3.7	4.0	4.1	4.3
Net Income EUR Mil	73	74	80	89	99	94	101	66	71	-27	-26
Earnings Per Share EUR	1.13	1.08	1.17	1.23	1.29	1.18	1.15	0.76	0.81	-0.31	-0.31
Dividends EUR	0.44	0.44	0.46	0.91	0.51	0.55	0.58	0.61	0.42	0.46	0.47
Payout Ratio % *	38.7	40.5	38.4	74.3	38.9	41.7	56.6	53.7	61.5	55.7	—
Shares Mil	64	68	68	72	75	78	86	85	88	87	88
Book Value Per Share * EUR	5.29	5.95	5.48	7.27	7.40	7.16	11.30	11.30	10.95	11.18	11.07
Operating Cash Flow EUR Mil	152	92	80	158	140	139	171	139	151	214	259
Cap Spending EUR Mil	-26	-36	-35	-35	-32	-38	-53	-65	-59	-69	-63
Free Cash Flow EUR Mil	126	56	44	123	108	101	118	75	92	145	196
Free Cash Flow Per Share * EUR	1.97	0.82	0.53	1.70	1.20	2.07	1.01	0.97	1.27	1.31	—
Working Capital EUR Mil	258	223	255	171	271	280	474	520	342	233	—

* Indicates calendar year-end data information

Arcadis stock financials – Source: Morningstar

Earnings have been volatile in the past and so has been the dividend. Unfortunately, despite revenue growth, net income didn't really grow and cash flows also remained stable. It is an interesting play on increased infrastructure spending, but a long-shot bet for me.

The number of shares outstanding increased significantly over the past 10 years while the business metrics didn't improve much – a red flag for me. Also, the company doesn't really have a moat and operating margins are around 5%.

Waste Connections Inc NYSE WCN – Moat but expensive to invest in

Same story as with Waste Management, only the stock price spiked even more and the valuation is even higher.

Waste Connections stock price

The difference is that the company did more acquisitions by issuing equity that allowed it to grow faster. Therefore the better stock performance, but growth ahead is similar to what the other two moat stocks have, Waste Management and Republic Services.

Steris Plc Stock Analysis NASDAQ STE – A good business but overvalued

Steris Plc operates as a provider of infection prevention and other procedural products and services. The Company offers sterilizers and washers, surgical tables, lights and equipment management systems, and endoscopy accessories.

Steris Plc Business – Source: [Steris Investor Relations](#)

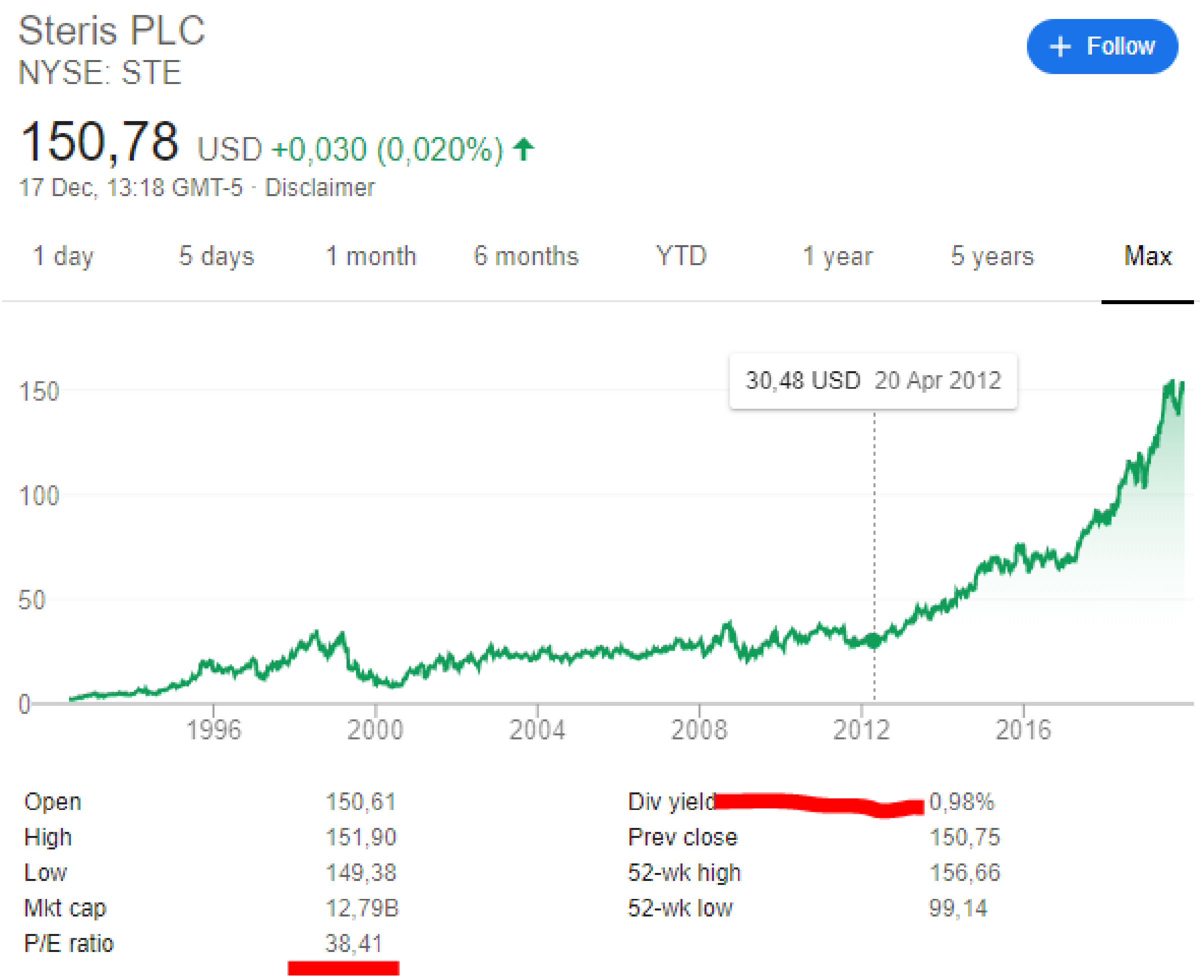
It is not a pure waste management business, but it can be included in a waste management ETF as it is the case with this list.

It is an interesting business because 75% of revenue is recurring as you have to sterilize the equipment the company sold to you.

Steris Plc Business – Source: Steris Investor Relations

Steris stock analysis

Healthcare is definitively a growing business with expected growth rates around 5%. Their revenues should grow in line even if that hasn't been the case over the last years. However, a price to earnings ratio in the high 30s, makes this another good business that is overvalued.



Steris stock price chart

If the company grows earnings at 5% per year, it will take a long time before there is a significant return to shareholders in the form of higher dividends and lower valuations. Perhaps we are in a similar situation to the 1990s. It took the stock more than 20 years to return to previous highs. Given the exuberance surrounding the sector, it is likely to be the case again.

What is interesting about Steris is that before 2013, it was on nobody's radar. The market cap was below $2 billion, before the merger with Synergy Health in 2015 and the stock didn't do much since 1999. However, revenues were growing, the dividend had been increased and all was looking better.

Steris PLC STE | ★★★

Financials

Export | Ascending

	2010-03	2011-03	2012-03	2013-03	2014-03	2015-03	2016-03	2017-03	2018-03	2019-03	TTM
Revenue USD Mil	1,258	1,207	1,407	1,502	1,622	1,850	2,239	2,613	2,620	2,782	2,898
Gross Margin %	42.9	37.0	40.4	41.4	40.0	41.8	40.0	39.3	41.8	42.2	43.0
Operating Income USD Mil	209	86	223	242	220	227	212	286	404	442	479
Operating Margin %	16.6	7.2	15.8	16.1	13.6	12.3	9.5	11.0	15.4	15.9	16.5
Net Income USD Mil	128	51	136	160	129	135	111	110	291	304	336
Earnings Per Share USD	2.16	0.85	2.31	2.72	2.17	2.25	1.56	1.28	3.39	3.56	3.93
Dividends USD	0.44	0.56	0.66	0.74	0.82	0.90	0.98	1.09	1.21	1.33	1.39
Payout Ratio % *	20.4	65.9	29.0	25.9	36.0	39.8	64.4	61.3	41.5	41.4	35.4
Shares Mil	59	60	59	59	60	60	71	86	86	85	86
Book Value Per Share * USD	12.73	13.32	13.50	15.64	17.09	18.00	34.63	32.47	36.66	36.73	38.08
Operating Cash Flow USD Mil	225	118	149	228	210	246	255	424	458	—	540
Cap Spending USD Mil	-44	-77	-67	-87	-86	-85	-126	-173	-165	—	-190
Free Cash Flow USD Mil	181	40	83	140	123	161	128	251	292	—	350
Free Cash Flow Per Share * USD	3.04	0.67	1.21	2.41	1.69	2.58	1.16	3.28	3.36	3.80	—
Working Capital USD Mil	379	361	373	395	420	437	572	636	591	589	—

* Indicates calendar year-end data information

Steris Plc Financials – Source: [Morningstar](#)

So, this is another indication of what to look for. Plus, in 2012 the price to earnings ratio was around 14, not bad for a stock that doubled revenues and earnings going forward.

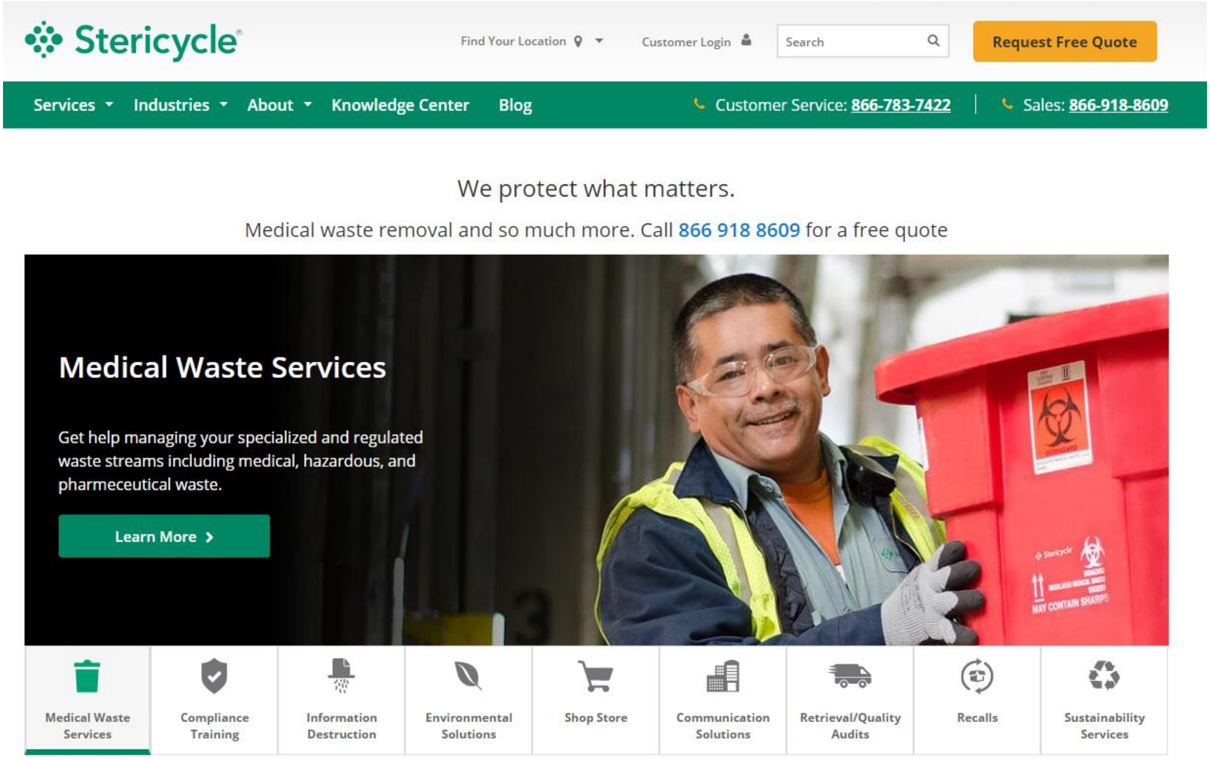
Stericycle Inc NASDAQ SRCL – the stock has already turned around

Sterycycle is a perfect example of what happens to a stock when the growth expectations aren't met. Something that hasn't happened to Steris Stock that we analysed too, but it shows the risk and reward of investing in such growth stocks. Thus, a very concerning risk for many other exuberantly priced waste management stocks.

Stericycle stock price

Stericycle business

Stericycle is a compliance company that specializes in collecting and disposing regulated substances, such as medical waste and sharps, pharmaceuticals, hazardous waste, and providing services for recalled and expired goods. It also provides related education and training services, and patient communication services.



Stericycle business

Everything was going very well both for the company and the stock up to 2015. From amazing revenue growth, revenue started declining, net income turned into big losses and free cash flows fell to zero.

Stericycle Inc SRCL | ★★★

Financials

Export Ascending

	2009-12	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	TTM
Revenue USD Mil	1,178	1,439	1,676	1,913	2,143	2,556	2,986	3,562	3,580	3,486	3,361
Gross Margin %	46.9	46.4	47.8	44.8	45.0	42.8	42.4	42.2	40.8	39.5	36.4
Operating Income USD Mil	325	391	424	469	536	556	488	434	-7	197	91
Operating Margin %	27.6	27.2	25.3	24.5	25.0	21.8	16.3	12.2	-0.2	5.7	2.7
Net Income USD Mil	176	208	235	268	311	326	267	206	42	-244	-445
Earnings Per Share USD	2.03	2.39	2.69	3.08	3.56	3.79	2.98	2.08	0.27	-2.91	-5.07
Dividends USD	—	—	—	—	—	—	—	—	—	—	—
Payout Ratio % *	—	—	—	—	—	—	—	—	—	—	—
Shares Mil	87	87	87	87	87	86	86	85	85	87	91
Book Value Per Share * USD	9.98	12.30	13.96	17.93	19.95	21.87	32.01	33.44	32.83	32.21	27.15
Operating Cash Flow USD Mil	277	326	306	387	403	449	390	547	509	165	277
Cap Spending USD Mil	-40	-48	-53	-65	-73	-86	-115	-136	-143	-131	-195
Free Cash Flow USD Mil	237	277	253	322	330	362	276	411	366	34	82
Free Cash Flow Per Share * USD	2.74	3.19	3.27	3.70	4.32	3.79	3.53	4.33	4.63	0.68	—
Working Capital USD Mil	26	60	64	110	124	119	174	231	-156	14	—

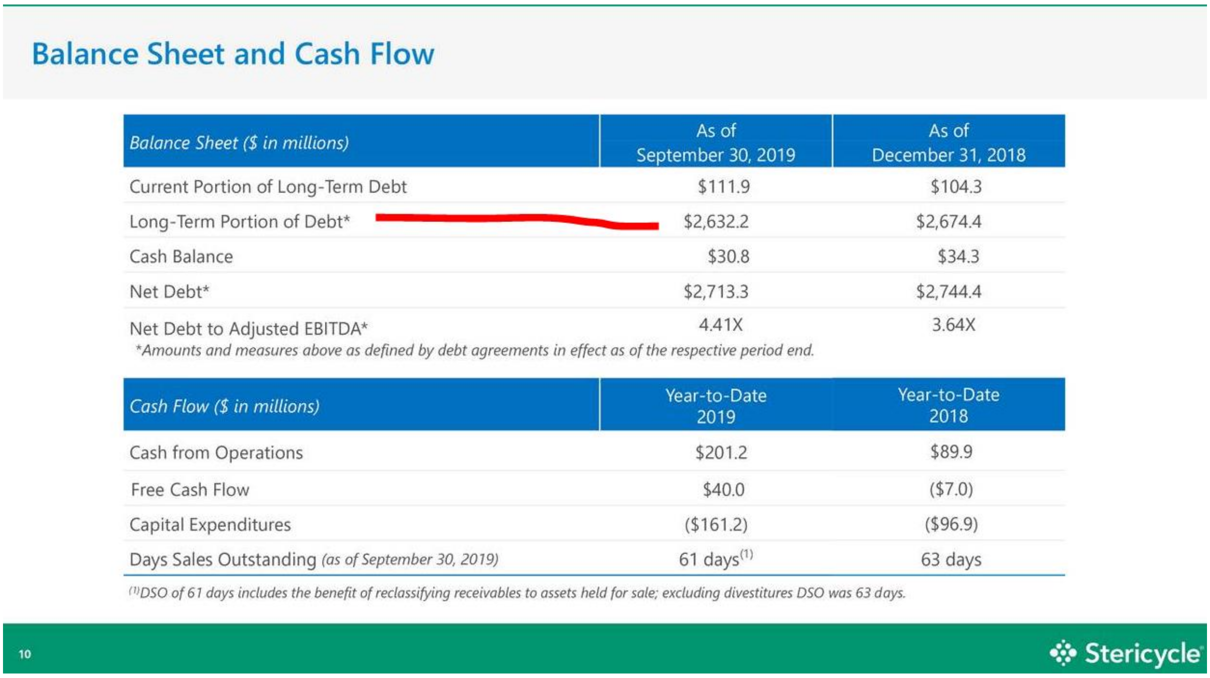
* Indicates calendar year-end data information

Stericycle stock financials

Combine the decline in fundamentals to a price to earnings ratio above 30 in 2015 and it is logical for the stock price to fall more than 50%.

Stericycle stock price decline

The thing is that too much debt is never good. Having $ 2.8 billion in debt on revenues of less than $4 billion is a difficult thing to manage. They made some bad acquisitions and the growth story came to a halt.



Balance Sheet and Cash Flow

Balance Sheet ($ in millions)	As of September 30, 2019	As of December 31, 2018
Current Portion of Long-Term Debt	$111.9	$104.3
Long-Term Portion of Debt*	$2,632.2	$2,674.4
Cash Balance	$30.8	$34.3
Net Debt*	$2,713.3	$2,744.4
Net Debt to Adjusted EBITDA*	4.41X	3.64X

**Amounts and measures above as defined by debt agreements in effect as of the respective period end.*

Cash Flow ($ in millions)	Year-to-Date 2019	Year-to-Date 2018
Cash from Operations	$201.2	$89.9
Free Cash Flow	$40.0	($7.0)
Capital Expenditures	($161.2)	($96.9)
Days Sales Outstanding *(as of September 30, 2019)*	61 days[1]	63 days

[1] DSO of 61 days includes the benefit of reclassifying receivables to assets held for sale; excluding divestitures DSO was 63 days.

10 Stericycle

Can Stericycle stock rebound?

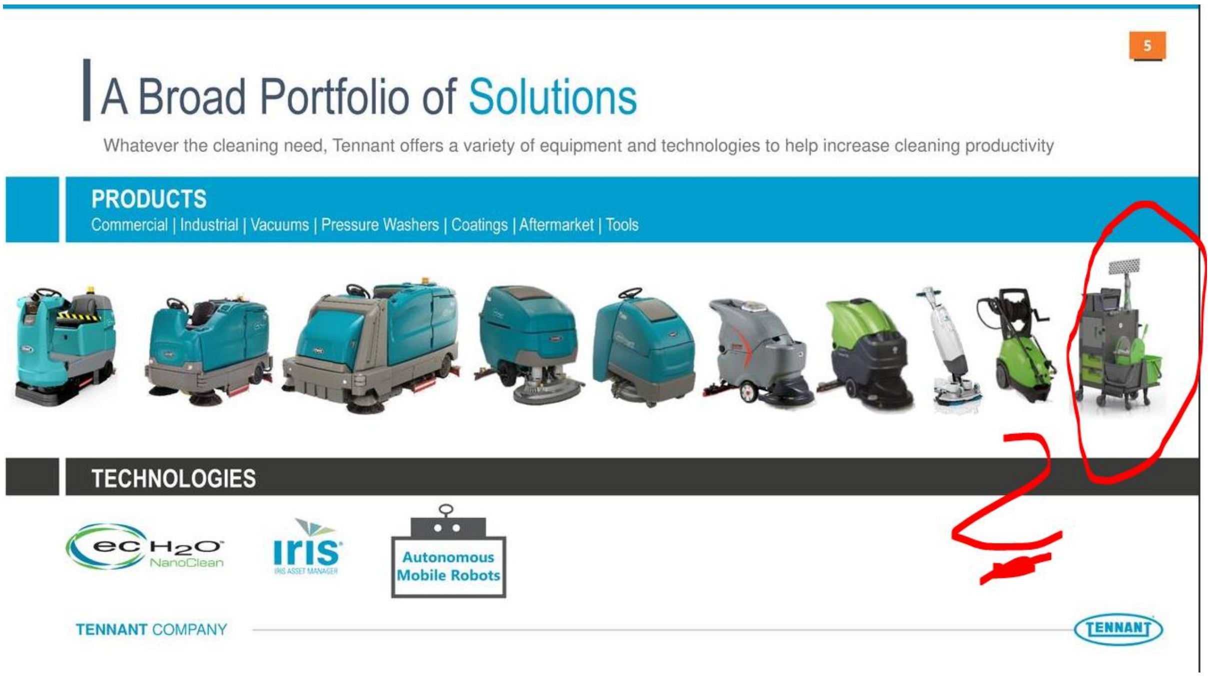
Of course it can, but what I usually do is compare the current stock price with the earnings capacity the stock had and then see whether it is something I should dig deeper into. Stericycle's best EPS was in 2014 with $3.79 while cash flows often surpassed $4.

If I wish for a 15% investing return, I would need the stock to be to be around $26 on the $4 per share in free cash flow. The 52week low was $34 that shows how you can find investments that should give you double digit returns over the long-term, you just have to be patient. However, Stericycle is in full turnaround mode and that is always an uncertain thing. Given the stock is at $60, not at $26, nor even at $35 anymore, I will not spend too much time as whether it can go to $100 or not is not of an interest to me. Hoping the stock can get valued in a similar way to other waste management stocks with PE ratios above 30, that in case of a good turnaround could push the stock above $120 is not what value investors do. We invest in absolute returns, business returns, not stock market returns, relative returns.

Tennant Co NYSE TNC

Tennant is an interesting business that has been delivering to shareholders.

But, the company depends on business customers buying products, more real estate and more retail premises coming in the future. It is an option as Asia grows, but the company has only 9% of sales coming from Asia. Thus, there is no competitive advantage as anybody can make a cleaning machine today.



At a PE ratio of 30? No thank you!

Conclusion on Investing in Developed Markets Waste Management Stocks

I am not going to follow any of the stocks mentioned in the article. This might make you wonder why I spent the time to research each company and also analyze the whole sector?

Well, I believe investing knowledge compounds in the same way as investment returns. I now know pretty well the waste management industry from the inside, as a practitioner, not just from a numerical perspective as an investor. I know how the competition in the sector works, how you can establish a moat and keep pricing power which is of utmost importance when it comes to investing. PE ratios for the companies mentioned above are all above 30 usually on the good companies and lower on the bad utilities with legacy issues, but I am very curious to what is my accumulated knowledge going to lead me when I analyze emerging markets waste management stocks that have much better valuations and growth opportunities thanks to demographics and economic growth.

The Emerging Market Waste Management Report will be published on the Sven Carlin Stock Market Research Platform alongside many other stock analyses and sector reports.