Silverdell

Deal closes and interim results

Edison investment research

Deal closes – placing completed

Support services

The £20.6m acquisition of Euro Dismantling Services (EDS), completed 20 June, doubles Silverdell's revenues. EDS's business is complementary, expands Silverdell's geographic horizons and provides significant opportunities for cross-selling. The challenge is for management to exploit the opportunities successfully and manage the step up in size and its attendant potential. The current valuation does not recognise this potential.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/10	56.7	2.6	0.9	0.0	15.1	N/A
09/11	59.7	3.0	1.3	0.0	10.5	N/A
09/12e	80.5	5.3	1.4	0.2	9.7	1.7
09/13e	130.3	11.5	2.2	0.3	6.2	2.5

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

A well targeted acquisition

The deal to buy EDS, completed 20 June, provides Silverdell with global reach, a more attractive ratio of revenues to cost base and opportunities to cross-sell its services into the global blue chip customer base of EDS. This is a truly complementary business, with a large pipeline of orders (£209m for the combined company) and earnings accretion.

No more big acquisitions anticipated

Management recognises the need to bed down EDS before embarking on any further substantial acquisitions, although there may be a call for selected acquisitions to open up potential opportunities such as the German nuclear decommissioning market. Management would also consider small consultancy businesses in the fields of water testing, soil testing or legionella detection.

Forecasts updated

We update our forecasts to reflect both the recently completed reorganisation of the two existing UK businesses (Silverdell UK and Kitsons) and the acquisition. In 2013 we forecast £130m of revenues, including £60m from EDS. Thereafter we assume underlying growth of 2.5% falling to 2%. With this scale and a return to the dividend list the company should appear on the radar of many new investors.

Valuation: Good value despite recent run

Following the share price run post deal, Silverdell trades on a September 2013 P/E multiple of 6.2x. This appears modest in the context of its expanded market opportunity. Our updated DCF suggests a fair value of 25p/share – twice the current share price.

4 July 2012

Price	13.62p
Market cap	£43m

Shares in issue	313.2m
Free float	82%
Code	SID
Primary exchange	AIM
Other exchanges	N/A

Share price performance

%	1m	3m	12m
Abs	22.5	31.3	19.8
Rel (local)	13.4	35.1	26.6
52-week high/low		14.1p	8.2p

Business description

Silverdell provides industrial services in hazardous or regulated environments. Its core offerings are asbestos removal and decommissioning of plant for global corporations. It also provides testing services on a consultancy basis.

Next events

Final results	December 2012

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Bigger, broader and better

Silverdell has completed the £8.8m placing to fund the purchase of EDS, which we detailed in our May 2012 note. Now the deal has closed we have updated our forecasts to incorporate the acquisition, restructuring and interim results. EDS contributes approximately £60m of revenues and £6m of EBITDA, which are of similar magnitude to Silverdell pre acquisition. We consider this earnings-accretive acquisition as a positive move for Silverdell.

Silverdell goes international

The purchase of EDS propels what has traditionally been a UK company into the international arena. EDS was chosen for nine out of the last 11 oil refinery decommissionings globally since 1994. It has offices and a strong customer base in Canada and Australia, thus Silverdell can build on the experience and infrastructure of EDS to seek work outside the UK. Management recognises that the scale and opportunity carries a risk of overstretching so it will approach this expansion cautiously.

Silverdell gains scale

Buying EDS roughly doubles the size of Silverdell from a £65m revenue company to a forecast £130m of sales. Central costs are not expected to grow significantly, estimated to rise from c £15m to c £21m. The blend of resources between the two companies also improves: Silverdell historically has generated its revenue with very low capex, but with 900 staff. By contrast EDS generates similar revenues with just 200 people but on higher capex. EDS has also historically managed to negotiate cash payments early in a contract while Silverdell's business tends to be working capital intensive as it pays its staff weekly, but gets paid on 30-90 day terms.

As a pure asbestos removal company and decommissioning company, the enlarged Silverdell is now a clear leader in terms of scale globally. However, it continues to compete against companies that are often many times its size, but are neither specialist in these two areas, nor often able to offer the full range of services that Silverdell can.

Silverdell now has another skill to offer

Possibly the greatest potential value of the acquisition lies in the complementary offering that EDS adds to Silverdell's portfolio. Silverdell has firmly moved away from its heritage as an asbestos removal contractor to become a broad-based specialist environmental support services provider. Like Silverdell, EDS has a good brand name. EDS also has a global blue-chip customer base, which offers cross-selling opportunities to Silverdell, arguably more than the other way round. The two companies are culturally similar and have worked together in the past. Indeed for the current Magnox framework contract the two companies were asked to bid together to provide the wide spectrum of services required by the client.

Growth opportunities

We believe that the biggest opportunities for growth will come from the decommissioning side of the business, where EDS was previously limited in its expansion by the strategy of the previous owner. In Germany alone there is considerable opportunity. In 2011 the German Bundestag voted to phase out its 17 nuclear plants (nine of which are active) by 2022. The four operators of nuclear power stations have set aside €32.5bn for the decommissioning. Although neither Silverdell nor EDS have existing operations in Germany, a small acquisition or an investment in people and plant could establish the base and credibility to win bids. However, the potential rewards would make such an investment worthwhile.

Management

It is a credit to the existing management that it has done exactly what it said it would. Silverdell has always worked on a buy-and-build strategy with the ideal acquisition being one that would be complementary in services and equivalent in size. EDS is just that. Silverdell will retain continuity of management by taking on the existing managing director of EDS, Darren Palin. Given the importance of relationships in this industry such staff retention is key.

Financials and forecasts

Forecasts

Our forecasts have changed substantially to reflect the restructuring of the legacy business, as well as the impact of the acquisition of EDS. We have assumed a three-month contribution to the year ending September 2012. In 2013 the revenue contributions from Silverdell and EDS are roughly equal, but we assume a 1% higher EBITDA margin at EDS (11%) than at Silverdell (10%).

Exhibit 1: 2012 and 2013 forecast changes

	Old	New	Change
2012 revenue (£m)	64.5	80.5	24.8%
2012 EBITDA (£m)	5.3	6.6	24.5%
2012 EPS (p)	1.4	1.4	-
2013 revenue (£m)	66.0	130.3	97.4%
2013 EBITDA (£m)	5.4	13.8	155.5%
2013 EPS (p)	1.6	2.2	37.5%

Source: Edison Investment Research

Silverdell has paid £18.6m for EDS, consisting of £8.5m cash up front, £5.75m of shares up front, a £0.75m loan note payable in three years with an 8.5% coupon and £3.6m of cash to be paid as an earn-out depending on performance over the coming two years. Debt of up to £2m will be taken on, taking the total maximum deal cost to £20.6m. As the table above shows, we estimate the deal to be 38% EPS accretive on our 2013 figures.

Cash

Both Silverdell and EDS are cash generating companies. In 2013 we forecast that the combined company will generate £5.9m of cash after paying dividends and the £1.8m earn-out for the EDS acquisition. This will take Silverdell from a £5.5m net debt position at the start of 2013 to a £0.4m net cash position at the end of the year.

We expect the working capital position of the company to take its new shape (ie reflecting the incorporation of EDS) by the end of 2012, with little change between the end of 2012 and the end of 2013. Capex is likely to change though, with a tripling of spend to about £1.5m pa as the more asset intensive business of EDS draws on cash resources.

We are not forecasting any further acquisitions or disposals, but we do factor in a £1.8m spend in each of 2013 and 2014 as the earn-out payment for the EDS purchase.

Dividend

Silverdell has confirmed that it plans to pay a final dividend for this year ending September 2012. We estimate a 0.22p/share dividend, equating to a 25% payout ratio and giving a 1.7% dividend yield. We forecast a 2013 total payout of 0.32p/share, giving a 2.5% yield.

New banking facilities

Normally a change of bank is not a point we would note. However, EDS had a strong relationship with HSBC Bank, and Silverdell has used this global relationship to establish new banking facilities for the enlarged group. Silverdell has secured facilities for a three-year term on improved rates and less restrictive covenants than it had with Barclays. Perhaps most significantly it leaves behind the relationship with Barclays Bank that was so challenging just three or four years ago.

The investment arm of Barclays Bank still holds warrants representing 3.7% of the company's shares. Each warrant can be exercised at 5p until June 2017. With the issue of shares for the placing to fund the EDS acquisition we can take comfort that the warrant overhang is now a much smaller concern (down from a 7.5% overhang) than it was.

Interim results

On 13 June Silverdell announced its interim results.

Exhibit 2: H1 results

	H112 forecast	H112 actual	Difference
Revenues (£m)	30.8	31.4	1.9%
EBITDA (£m)	1.9	1.6	(16%)
EBITDA margin	6.2%	5.1%	(1.1%)

Source: Edison Investment Research, Silverdell

At the level of gross margin numbers were fine (GM steady at 28%). The company has invested in senior operational management (to develop the scaffolding side of the business), merged two of the UK operations (Silverdell and Kitsons) and invested in scaffolding assets to support the expansion of this business. This had an impact on EBITDA and operating profit in H1. The effect of the restructuring will be annual savings of c £1.4m pa and will feed through fully into H2.

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Exhibit 3: Financial summary

£ 000s	2009	2010	2011	2012e	2013e	2014e
Year end 30 September	IAS	IAS	IAS	IAS	IAS	IAS
PROFIT & LOSS						
Revenue	**59,509**	**56,674**	**59,696**	**80,500**	**130,335**	**133,704**
Cost of Sales	(44,897)	(41,974)	(43,364)	(58,075)	(95,576)	(97,907)
Gross Profit	14,612	14,700	16,332	22,425	34,759	35,798
EBITDA	**2,272**	**3,936**	**4,086**	**6,625**	**13,759**	**14,255**
Operating Profit (before GW, except & int amortisation.)	**1,480**	**3,235**	**3,561**	**5,725**	**11,709**	**11,955**
Goodwill Amortisation	(6,544)	(601)	(30)	(100)	(400)	(400)
IFRS 2 charges	(613)	(130)	(555)	(1,474)	(1,000)	(1,026)
Operating Profit	**(5,677)**	**2,504**	**2,976**	**4,151**	**10,309**	**10,529**
Net Interest	(1,190)	(672)	(514)	(450)	(220)	9
Profit Before Tax (norm)	**290**	**2,563**	**3,047**	**5,275**	**11,489**	**11,963**
Profit Before Tax (FRS 3)	**(6,867)**	**1,832**	**2,462**	**3,701**	**10,089**	**10,537**
Tax	826	(1,095)	(779)	(1,855)	(3,853)	(3,991)
Profit After Tax (norm)	**1,116**	**1,468**	**2,268**	**3,420**	**7,637**	**7,972**
Profit After Tax (FRS 3)	**(6,041)**	**737**	**1,683**	**1,846**	**6,237**	**6,546**
Average Number of Shares Outstanding (m)	83.1	151.7	155.7	213.9	313.2	313.2
EPS - normalised (p)	1.3	1.0	1.5	1.6	2.4	2.5
EPS - normalised fully diluted (p)	1.2	0.9	1.3	1.4	2.2	2.3
EPS - FRS 3 (p)	(7.3)	0.5	1.1	0.9	2.0	2.1
Dividend per share (p)	0.0	0.0	0.0	0.2	0.3	1.7
Gross Margin (%)	24.6	25.9	27.4	27.9	26.7	26.8
EBITDA Margin (%)	**3.8**	**6.9**	**6.8**	**8.2**	**10.6**	**10.7**
Operating Margin (before GW and except.) (%)	2.5	5.7	6.0	7.1	9.0	8.9
BALANCE SHEET						
Fixed Assets	**20,221**	**19,156**	**21,867**	**39,367**	**40,217**	**40,921**
Intangible Assets	601	0	453	3,453	3,453	3,453
Tangible Assets	2,343	1,999	2,652	10,252	11,502	12,606
Goodwill	16,156	16,156	17,761	24,661	24,261	23,861
Other	1,121	1,001	1,001	1,001	1,001	1,001
Current Assets	**17,578**	**17,398**	**22,936**	**24,338**	**30,264**	**36,504**
Stocks	1,624	998	3,064	4,000	4,000	5,348
Receivables	12,691	12,774	17,305	18,000	18,000	17,382
Cash	2,885	3,626	2,567	2,338	8,264	13,774
Other	378	0	0	0	0	0
Current Liabilities	**(13,917)**	**(11,808)**	**(15,763)**	**(17,899)**	**(17,899)**	**(18,269)**
Trade & Payables	(10,912)	(8,620)	(11,613)	(13,749)	(13,749)	(14,119)
Short term borrowings	(2,848)	(3,117)	(3,793)	(3,793)	(3,793)	(3,793)
Other creditors	(157)	(71)	(357)	(357)	(357)	(357)
Long Term Liabilities	**(5,858)**	**(5,793)**	**(5,369)**	**(5,831)**	**(6,367)**	**(10,606)**
Long term borrowings	(4,700)	(4,777)	(4,038)	(4,038)	(4,038)	(4,038)
Other long term liabilities	(1,158)	(1,016)	(1,331)	(1,793)	(2,329)	(6,568)
Net Assets	**18,024**	**18,953**	**23,671**	**39,976**	**46,214**	**48,549**
CASH FLOW						
Operating Cash Flow	**7,486**	**1,937**	**235**	**7,130**	**13,759**	**13,896**
Net Interest	(1,199)	(869)	(492)	(450)	(220)	9
Tax	(457)	(269)	(628)	(1,855)	(3,853)	(3,991)
Capex	(339)	(288)	(639)	(1,500)	(1,500)	(1,604)
Acquisitions/disposals	(334)	0	(1,348)	(17,000)	(1,800)	(1,800)
Financing	5,264	0	1,823	13,446	0	0
Dividends	0	0	0	0	(462)	(998)
Net Cash Flow	10,421	511	(1,049)	(229)	5,926	5,511
Opening net debt/(cash)	**14,394**	**4,663**	**4,268**	**5,264**	**5,493**	**(433)**
HP finance leases initiated	0	0	0	0	0	0
Other	(690)	(116)	53	0	0	0
Closing net debt/(cash)	**4,663**	**4,268**	**5,264**	**5,493**	**(433)**	**(5,943)**

Source: Edison Investment Research

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