Ophorst
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Quarterly report Q2 2024

Sentiment improved in the second quarter and prices climbed sharply, especially in May. The growing realisation among investors that the UK is a promising market caused equity prices to rise across a broad front. Company-specific news pushed up the prices of a few individual names, but the recovery was widely supported. Despite the general optimism on the markets, once again there were examples of former market darlings suddenly receiving severe blows. Investors who some time ago put money into electric vehicles are now being presented with the bill. Alfen's equity price halved following a worse-than-expected update and Fastned likewise continues to tumble. This shows how risky it is to buy companies that earn little or nothing and don't generate a positive cashflow. Much of the optimism surrounding AI, technology and innovation consists of such companies and history tells us that excessive optimism often leads to disappointing results further down the road. That doesn't mean though that it's impossible to find undervalued businesses in a sector that is generally overvalued.

Himax

Roll up, roll up: AI with a dividend and a P/E ratio of 10….

One company that went through a temporary rough patch in terms of equity price is Taiwan's Himax. It profited enormously from the chip shortages back in 2020/2021 but declined in value when supply routes were restored and when end customers then spent the past two years using up their old stock. The upshot was a downturn in revenue and earnings and the company's equity price dropped back to its former level. At its peak in 2021, its stocks briefly cost almost USD20 but later plummeted to USD4. The company recently published a quarterly update that surprised markets positively, pushing the price back up to USD8. We think there's potential for it to rise even higher. As far as we're concerned, Himax is a totally overlooked tech company that's quietly been doing lots of great things. It's now a sizeable player in dashboards for vehicles, for which it supplies all kinds of sensors, cameras and projectors. Furthermore, it possesses technology that enables a sensor to film or respond to movement while using an extremely small amount of power. This product, WiseEye, can be found in things such as smart doorbells, cameras, laptops, air conditioning systems that detect where people are and security sensors. Its partners in this field include serious heavyweights like Google and Nvidia. Himax also owns patents and has partnerships with Apple and Google for VR/AR headsets, potentially the next big growth market. In short: Himax operates in a wide range of growth markets and is perfectly positioned for a variety of future developments relating to AI, virtual reality and further automation. Now that the destocking of the past two years seems to have come to an end, the company's revenue is growing again. For this year we anticipate earnings per share of USD0.75 to USD1.00. Despite the recent price hike, it's possible to buy these equities at a price/earnings (P/E) ratio of less than 10. They also pay a solid dividend of about 4% versus the current equity price. Himax has always been quite shareholder-friendly and normally pays out at least half of its profits. If this growth persists, in the coming years earnings per share could revert to the level of top year 2021 when the company earned USD2.50 per share. It enjoys significant operating leverage, as a result of which revenue growth translates into even faster earnings growth. In our view, Himax is one of the very few businesses in this sector that can still be bought at an attractive multiple, is profitable and pays attractive dividends.

Once investors realise this, the upside could be very large indeed as companies in this industry change hands at astronomical prices these days.

Marlowe

Following on from last quarter, here's another update on Marlowe. Whereas last time we wrote about the prospect of a super dividend, we now know more about the size and structure of the capital distribution. Marlowe has decided not only to pay a super dividend of GBP1.55 per share, but also to buy back a further GBP75 million in shares. This share buyback programme should be completed sometime in September, which means the company's equities could experience strong upward price pressure in the next couple of months. Its stocks climbed substantially in the run-up to the ex-dividend date in June and are currently trading at a corrected price of nearly GBP6. This is a solid price increase from the amount we paid only a short time ago in the knowledge that part of our investment will soon be repaid. Just before the announcement of the capital distribution, on which it was being advised by Stifel, the company decided to switch consultants and turned to Investec. A rather surprising move and not something you'd normally do just before announcing a strategic reorientation. Investec is the principal bank of Lord Ashcroft, the major shareholder in Marlowe. He apparently wants the company to end up with a balance sheet that is totally free of debt but also doesn't hold a large cash balance. That's exactly what he did at Impellam before selling the company to Headfirst. Whether we need to think along similar lines in this case is pure speculation, but as we said last quarter it wouldn't surprise us if another party puts in an offer on the remainder of the company. Rumour has it that it was precisely this type of activity that piqued the interest of a private equity party last year. We'll continue to monitor the company closely over the next few months and despite the strong price rally we believe it continues to enjoy an interesting valuation.

The latest on the situation in Kurdistan

There are two encouraging developments in Kurdistan that are worth briefly mentioning here. Firstly, a short time ago, and for the first time since the closure of the Ceyhan pipeline, a meeting took place between the three parties that need to reach agreement: the oil companies (Apikur), Baghdad and the Kurdistan Regional Government (KRG). While this meeting failed to produce a solution, according to Apikur progress has been made. The companies that collectively form Apikur all have individual contracts with the KRG. These need to be converted into new contracts with Baghdad, which will be the counterparty from now on. Apikur has indicated that it's perfectly willing to do this, as long as the economic value of the contracts remains unchanged. It also wants payment surety and outlines three options for this.

Either payment will be made in advance, or the funds will be deposited in a special externally managed account. The third option is that a specific share of the oil in the port of Ceyhan is assigned to the oil companies, which can then sell the oil to traders in return for direct payment. A solution also needs to be found for the more than one billion US dollars owed by the KRG. In short: we're not there yet, but we are moving forward.

Perhaps even more importantly, as we've noted before, the oil companies aren't doing at all badly under the present circumstances. Selling oil to local parties may not be the most lucrative option but it still yields considerable profits. Now that the situation has persisted for some time, a growing number of traders are interested in this oil and the price the companies can charge for it is rising. This is sharply increasing cashflow at these companies, while investments are at an extremely low level. Their cash positions are therefore growing, and this means the companies can resume capital distributions to shareholders. Gulf Keystone is the first to do so. It initiated a share buyback programme last month worth USD10 million and last week announced it would pay dividends amounting to USD15 million in early July as well. The realisation on the market that stocks in this exceptional sector are highly attractive, even in the absence of a solution for reopening the pipeline, means that equity prices are climbing nicely. We'll see big price hikes when a final agreement has been reached but in the meantime on this basis we anticipate further value creation, dividends and price recovery.

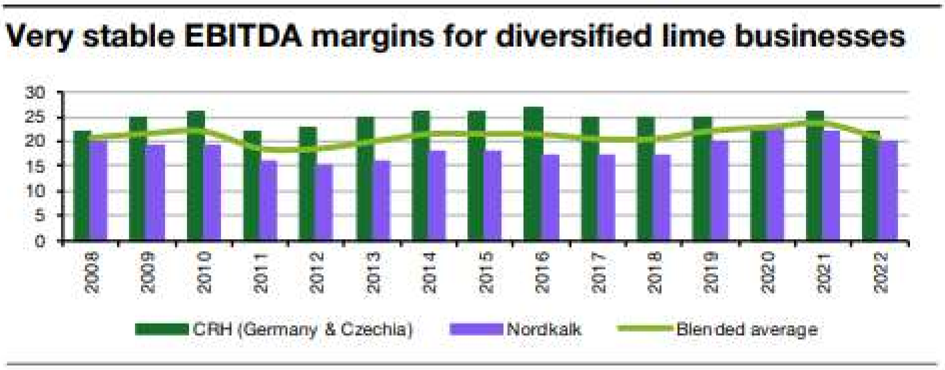
SigmaRoc Plc – Lime for life

In recent quarterly reports we've regularly focused on new names in the portfolio, such as CAB Payments, PPHC and Marlowe Plc. A British company with a Dutch connection also belongs on this list: SigmaRoc Plc. This UK producer of lime and industrial limestone finds itself in an exceedingly interesting position in a consolidating market. Lime has multiple applications in industry, construction and the food sector.

After monitoring the company for some time, in November 2023 the news broke that SigmaRoc was to take over the operations of CRH (Cement Roadstone Holding Plc), enabling it to double its revenue to more than one billion pounds. This formed the next step in the remarkable rise of the company headed by Dutchman Max Vermorken. In 2019, SigmaRoc noted revenue of 'only' GBP70 million.

This sector is clearly consolidating and SigmaRoc is gaining the upper hand. The recent acquisition was described by analysts at Liberum as 'a once in a lifetime opportunity' and financed in part by a share issue. OVMK immediately grasped the opportunity to participate in this issue.

What excites us most about SigmaRoc's assets is that they enjoy extremely stable margins and multiple recurring revenue streams. The graph below shows that average earnings before interest, taxes, depreciation and amortisation (EBITDA) have stood at about 20% since 2008. Local networks are very important here too as you don't want to transport limestone over long distances for economic and environmental reasons. Via a direct rail link the recently acquired German operations contribute daily to the supply of steel manufacturer Salzgitter. Yet the group is also a regular supplier of cat litter, the basis for mortar (a type of concrete) and cellular concrete blocks for applications in the construction industry. SigmaRoc displays its innovative side here too as it manufactures products under patents, including cellular blocks that are less CO_2 intensive. Limestone has dozens of different applications. It's part of our daily lives as it's in many things we do and that makes it interesting. The product is needed for a considerable number of processes.



Source: Liberum

We visited the limestone quarry in East Germany (Felz Werke) in May 2024. Here we witnessed the company's rigorously controlled and efficient operations for extracting limestone. This quarry was taken into use before the war and following modernisation in 1991 became Germany's second largest limestone quarry in terms of production. SigmaRoc is the new owner after a period in which the location changed hands several times (including private equity). This acquisition means that most of the cards in Europe have already been shuffled as far as production locations are concerned. It makes SigmaRoc number one or two in no fewer than eight markets.

The recent acquisition of CHR means that together with the other assets (including in Poland) the company can now achieve synergies of GBP30-60 million per year. SigmaRoc enjoys a sound track record in this respect and we have every confidence in the company's management being able to achieve these.

We made our initial investment when the stocks stood at 46 pence and since then they've climbed to about 67 pence. The price has stabilised at this level for the time being. There's plenty of upward potential though given that the full benefits of upscaling have yet to materialise. Naturally there are also risks, as despite the multiple applications slightly more than half of the company's revenue is exposed to construction in Europe. The most recent acquisition means a temporary increase in debt but certainly nowhere near levels that cause us concern. Moreover, the acquisitions have rapid payback periods, and the amount of debt will quickly drop in the years after 2025.


A section of the limestone quarry

In addition, SigmaRoc's end markets are expected to display annual growth of 2.4% to 2.7% up to and including 2031. On top of the existing applications, limestone will also play a role in the energy transition (carbon capture) and lithium batteries. There's plenty to inspire enthusiasm here.

Find more information on Sigmaroc.com or felz.de/en.

Renewi

Last September Macquarie Asset Management announced it was considering making an offer for waste processor Renewi. The initial offer was 775p (nearly 9 euros) per Renewi share. This translated into a substantial premium on the equity price at the time. Despite this indicative offer later being raised, Renewi's response was clear: the amount was too low. This was reason enough for Macquarie Asset Management not to make a formal offer. Renewi's equity price subsequently fell and at its current price of EUR7.90 its shares are still trading below last year's offer prices.

The rationale behind the management's rejection of the offer is that it believes it's in an excellent position to add substantial value itself in the long term. In our opinion, the recent improvement in profitability and divestment of the UK business are a solid basis for this.

Improved margins

One of the reasons for Renewi's low valuation is the disappointing margin growth. In addition to the cyclical headwind in the all-important commercial waste division, this was further exacerbated by low margins, especially in the Mineralz & Water division. This division is market leader in the Netherlands and Belgium in treating and cleaning contaminated soil, wastewater and oily sludge. The company also carries out a wide range of packed chemical waste processing activities. After a few tough years, this division has achieved significant improvements over the past year. Operating profits increased from EUR0.5 million to EUR9.6 million. This improvement is expected to continue in coming years.

Sale of UK business

In May, Renewi announced it had agreed to sell its UK Municipal division (at a significant discount) to industry peer Biffa. UK Municipal consists of five customised contracts for processing household waste, the longest of which runs up to 2040. These contracts were entered into over ten years ago, are structurally loss-making and cannot be terminated early or renegotiated by Renewi. They've squeezed the company's profitability and cashflows for many years. Despite the division requiring recapitalisation before being transferred to Biffa, this transaction will substantially reduce the financial risks.

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Conclusion

The growing focus on sustainability makes Renewi an attractive addition to investment portfolios. Macquarie's actions are in keeping with this trend, and the Australian asset manager viewed the company as a good addition to (one of) its investment funds. Given the fundamental improvements and what remains an attractive equity price, renewed interest in acquiring Renewi cannot be ruled out, but even if this fails to materialise, we expect the company's improved performance and risk profile to push up its equity price. An excellent reason for expanding our position in Renewi over the past quarter.