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12 December 2019

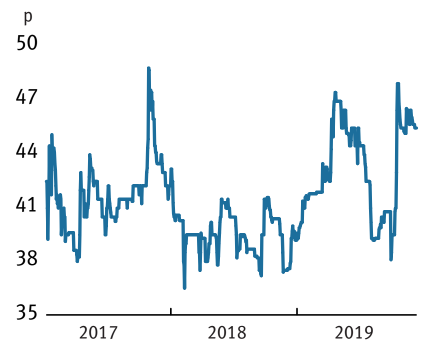
SigmaRoc: General Election winner

UK Infrastructure spend is set to surge no matter which political party wins the General Election. This company should be a major beneficiary

SigmaRoc (Aim:SRC)

Ticker	SRC
Current price	45.6p
12-month target price	60p
Market cap	£117m
52-week high	48.8p
52-week low	37.1p
Net debt	£41m (pro forma post-placing and land sale in Oct 2019)
Shares in issue	253.7m
Financial year-end	31 Dec
Next event	Annual results in Mar 2020
Company website	sigmaroc.com

SigmaRoc share price



Source: Bloomberg

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Alpha Production Editor: Sameera Hai Baig

Simon Thompson's view:

SigmaRoc SigmaRoc has been under the radar of investors since its IPO in early 2017, but that could change in the coming year, as the company's profits and earnings per share are set to post material growth driven by the contribution of some well-timed and shrewd acquisitions made in 2019. A highly experienced management team has already proved its capability at markedly improving the profitability of past acquisitions. Importantly, by targeting four separate platforms for growth, the company has built up a diversified revenue stream that should prove resilient no matter the economic backdrop. Add to that the manifesto promises from UK political parties to boost UK infrastructure spending significantly, and the shares are simply too lowly valued on a 2020 price/earnings (PE) ratio of 10 and trading in line with book value.

Bull points

- Successful record of acquiring, improving and integrating acquisitions.
- Strong management team.
- October's earnings-enhancing acquisition of a leading Belgium quarry group.
- Diversified revenue stream mitigates macro-economic risks.
- Strong hard asset-backed balance sheet.
- Low capital expenditure requirement and strong cash flow generation should reduce balance sheet gearing ratios quickly.
- Discretionary capital expenditure can be deferred, if end-user demand slows, to protect cash flows and profits.
- Beneficiary of higher UK government infrastructure spending post General Election.
- Expansion in Belgium, a new territory.
- Low tax charge resulting from Channel Islands operating companies.
- Low-cost debt facilities and significant headroom.

Bear points

- No dividend.
- Short track record.
- Integration risk on acquisitions.
- Increased debt levels following four acquisitions in 2019.
- Economic slowdown could impact trading.

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Since **SigmaRoc's (Aim:SRC)** IPO on London's junior market in January 2017, its highly-regarded management team has pursued a strategy of buying, improving and integrating platforms of companies in the heavy building materials sector. The focus is on cash-generative assets located in niche markets that produce aggregates, concrete, precast and pre-stressed concrete and other related assets. To date they have made nine acquisitions, all of which are asset-backed and control strong market shares in mainly regional markets, offering protection thanks to strong customer relationships while providing scope to add value by improving operational efficiencies.

SigmaRoc takes advantage of acquisition opportunities at modest earnings multiples, resulting from multinationals scaling back their operations to pay down borrowings, as well as smaller players with succession issues looking to crystallise the value of their assets. Businesses bought from major players can offer scope to revitalise sales that may have flagged due to a lack of focus, while value can be added to smaller acquisitions by strengthening sales teams and improving the cost effectiveness of finance and administration activities.

SigmaRoc (Aim: SRC)

Ord Price: 45.6p | **Market Value:** £116m
Touch: 45.2-46p | **12-Month High:** 48.8p **Low:** 37.1p
Dividend Yield: nil | **PE Ratio:** 10
Net Asset Value: 43.2p | **Net Debt:** 37%*

Year to 31 Dec	Revenue (£m)	Pre-tax profit (£m)	Diluted earnings per share (p)	Dividend per share (p)
2016	0.0	-2.4	-1.40	nil
2017	27.1	2.6	1.79	nil
2018	41.2	5.5	3.49	nil
2019**	68.0	7.1	3.03	nil
2020**	119.4	13.4	4.42	nil
2021**	138.5	15.9	4.76	nil
% change	16%	19%	8%	–

Normal market size: 5,000 SETSqx
*Includes intangible assets of £31.8m, or 12.5p a share. Based on pro forma closing year-end net asset value of £109m and net debt of £41m post-acquisition of Carrieres du Hainaut and share placing of 80m shares at 41p in October 2019.
**Liberum Capital estimates. Pre-tax profits and EPS stated before amortisation of intangibles assets, and one-off non-recurring items. EPS stated on a fully diluted basis.
Source: SigmaRoc annual report, London Stock Exchange

Ronez supplies the Channel Islands with aggregates, ready-mixed concrete, asphalt and precast concrete products

High value in the Channel Islands

A good example is the first acquisition SigmaRoc made, that of Channel Islands based Ronez, a wholly-owned subsidiary of Aggregate Industries (part of the Lafarge-Holcim Group) for £45m in cash at the start of 2017. Ronez operates two quarries, St John's Quarry in Jersey and Les Vardes Quarry in Guernsey, as well as multiple associated and downstream businesses on both islands. These offer a full range of construction materials for sale into the local market, including aggregates, ready mixed concrete,

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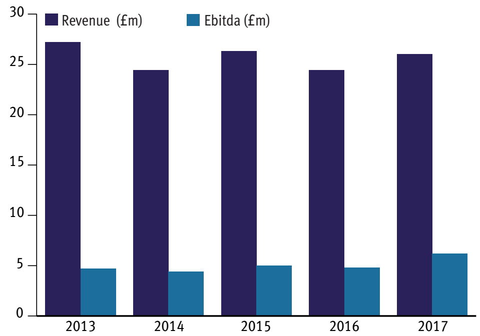
asphalt, precast concrete products and cement, as well as providing certain services, including road contracting.

Ronez operates plant and machinery that produces various sizes of crushed rock aggregates from the raw material extracted from the quarries. The aggregates are then sold directly to the local construction industry or to the general trade and retail markets. The vertically integrated business has a dominant share of a low-growth but very stable market in the Channel Islands, where construction accounts for around 6 per cent of gross domestic product (GDP).

Ronez revenue and cash profits



Source: Company data

Ronez stable rising cash profit margins pre-acquisition

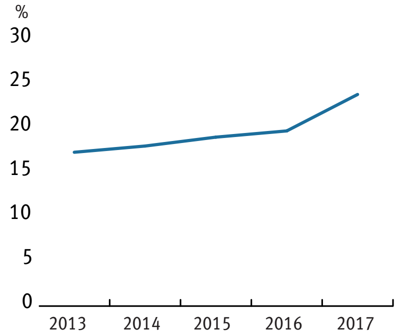
Financial year	Revenue	Ebitda	Ebitda margin (%)
2013	£27.2m	£4.7m	17.3%
2014	£24.4m	£4.4m	18.0%
2015	£26.3m	£5.0m	19.0%
2016	£24.4m	£4.8m	19.7%
2017	£26.0m	£6.2m	23.8%

Source: Company data

It's not difficult to see the attractions of the business, as Jersey and Guernsey are both stable and developed jurisdictions with both governments committed to ensuring local supply of aggregates and construction materials. Moreover, Ronez is the market leader in the Channel Islands where there are high barriers to entry, while at the same time there is potential to improve operational efficiencies. Also, Ronez' mineral reserves represent around 40 years output at current production rates, highlighting the value embedded in the mineral assets acquired.

Importantly, the acquisition has worked out well. Ronez's turnover increased from £24.4m in the 2016 financial year to £26m in 2017, to drive its earnings before interest, tax, depreciation and amortisation (Ebitda) up 29 per cent to £6.2m. In 2018, Ronez generated revenue of £27m and investment bank Liberum Capital estimates that Ebitda rose by at least 40 per cent in the first two years post acquisition, implying that the trailing Ebitda multiple is now only 6.5 times rather than nine times at the time of the purchase. The £23m goodwill paid by SigmaRoc at the time of the acquisition has been reduced to only £4m after Ronez's plant, property and equipment were subsequently revalued upwards to reflect a higher estimate of reserves at its St John's and Les Vardes quarries.

Ronez Ebitda margin rising pre-acquisition



Source: Company data

It's worth flagging that in the event of a downturn, capital expenditure at quarries with a 40-year life can be tightly reined in without impacting the quality of the assets. To put this into perspective, Ronez currently makes Ebitda of around £7m and its £2.5m depreciation charge is in line with capital expenditure. So, even if Ebitda declines by a fifth from £7m to £5.6m, capital expenditure could be reduced easily by the same amount to protect Ronez's profits and cash flow, highlighting the defensive qualities of the business which mitigate economic risk.

Sigma Precast Products Group

SigmaRoc's management team have also been working their magic on the UK mainland, having made three acquisitions (Allen, Poundfield and CCP) between October 2017 and January 2019, which now form its pre-cast products group (PPG) division.

All three were private companies at the time of acquisition and have strong positions in niche markets. Combined they have annual sales of £33.5m and generate Ebitda of £6.2m at a margin of 18.5 per cent, based on the latest reported numbers available. SigmaRoc paid an average of 6.5 times Ebitda based on a combined consideration of £40.1m, including a deferred element of £6.5m, so the acquisition prices seem reasonable.

SigmaPPG Group of acquired companies key financial data

Acquisition	Date	Last reported revenue	Last reported Ebitda	Ebitda margin
Allen	Oct 2017	£5.2m	£2.0m	38.5%
Poundfield	Dec 2017	£7.4m	£1.5m	20.3%
CCP	Jan 2019	£20.9m	£2.7m	12.9%
Total		£33.5m	£6.2m	18.5%

Acquisition	Initial consideration	Deferred consideration	Total consideration	Enterprise value/ Ebitda multiple
Allen	£9.0m	£3.5m	£12.5m	6.3
Poundfield	£9.5m	£0.8m	£10.3m	6.8
CCP (note one)	£15.2m	£2.2m	£17.3m	6.4
Total	£33.7m	£6.5m	£40.1m	6.5

Source: Company data; CCP deferred consideration estimate from Liberum Capital

In terms of their individual markets, Allen provides specialist wetcast concrete products in London and the Midlands, selling products for fencing and wider building applications through builders merchants and directly to infrastructure operators like Network Rail.

Founded in 1999, Ipswich-based Poundfield has a reputation for developing unique and effective concrete products. Its core business is to manufacture quality concrete solutions and to provide a complimentary support service from design through to aftercare in three key areas of specialism: retaining walls; bespoke projects precast concrete, with a focus on sea defence and car parks; and beam & block flooring.

Strategically, the acquisitions enabled SigmaRoc to establish its SigmaPPG platform and take a strong position in the UK market for precast and pre-stressed products, targeting the industrial and agricultural sectors, as well as

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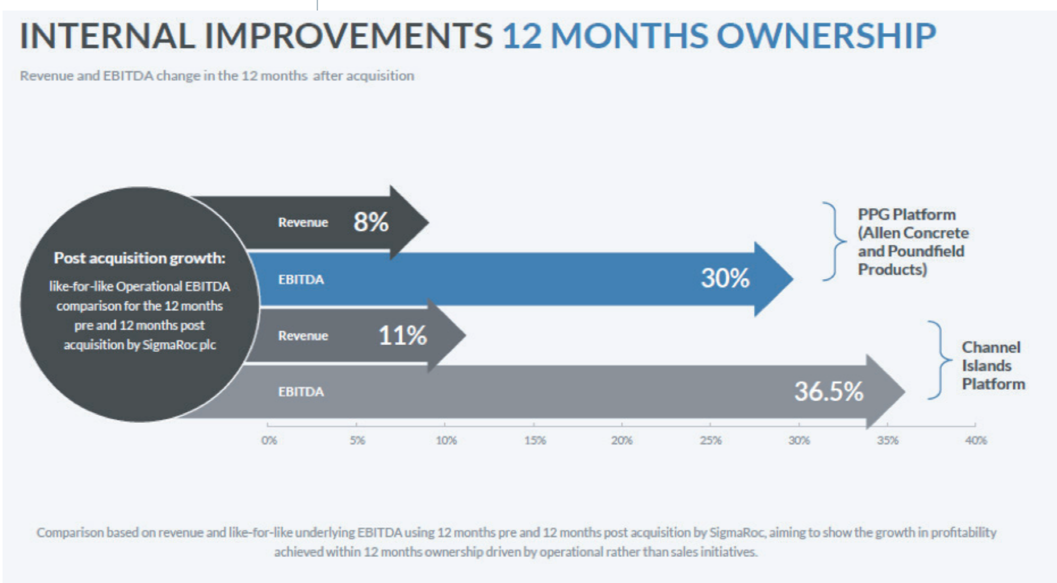
Poundfield Products manufacture high-quality precast concrete beam & block floors finished to a very high smooth standard

housing and specialist infrastructure projects. Both companies are asset backed with significant land holdings, and hold intellectual property in the form of patents and trademarks, making them an ideal fit within the SigmaRoc business model. Indeed, Poundfield holds 19 patents alone, thus creating a barrier to entry for rivals.

A key driver for any acquisition is the assessment by SigmaRoc's management of their ability to improve the business' performance in a relatively short time. It does not, however, destroy the main fabric of businesses through asset stripping and redundancy driven cost cutting. It's fair to say that the directors have been successful, delivering 30 per cent higher Ebitda from both Allen and Poundfield, on 8 per cent higher revenue in the first 12 months under the company's ownership.




Shuttabloc can reduce build time in half compared with full on-site construction

For instance, under SigmaRoc's ownership, Poundfield signed a March 2018 agreement with Tarmac for it to produce Poundfield's Shuttabloc system under license. The Shuttabloc™ reinforced precast concrete wall system is designed to withstand significant impact from loading plant or to retain high loads. It provides a faster, more economical alternative to casting in situ. The agreement with Tarmac has accelerated the commercialisation of the system. It's not the only one either. Earlier this year, Poundfield partnered with American giant Lindsay Corporation to bring to the UK the Road Zipper® – a smart lane separation system made of concrete and with the ability to change lanes in real time.

Also, SigmaRoc has been able to release hidden value from the acquisitions, having sold a non-core freehold land site in October 2019 that it acquired as part of the October 2017 acquisition of Allen. SigmaRoc realised £5.5m in cash, a chunky sum in relation to the £1.5m historic book value of the land and the £12.5m total consideration it paid for Allen. Effectively, this reduced the acquisition cost to £7.5m, or a bargain basement 3.75 times the £2.7m adjusted Ebitda Allen made on revenue of £5.2m, in the financial year to 31 August 2018.

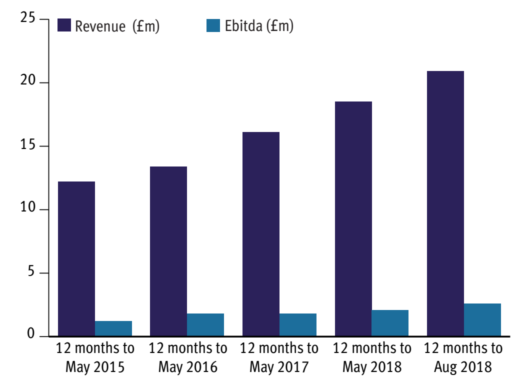
It's worth noting Poundfield reported its highest revenue month in July this year, which it subsequently matched in August, helped by demand for retaining walls and flooring. Trading in the second and third quarters have been so strong, buoyed in part by major sea defence work, that the business had no spare capacity. Reassuringly, the directors guided investors at the time of the interim results in September to expect these positive trends to continue.

CCP acquisition a sound strategic move

Given the success SigmaRoc has enjoyed with both the Allen and Poundfield acquisitions, the directors decided to boost the scale of the SigmaPPG operation at the start of this year by acquiring CCP, an integrated concrete products and quarrying group located in the Liverpool and Manchester area.

A placing of shares, at 41p, funded £12m of the initial £15.2m consideration. The vendors were issued with 4.8m shares worth £2m, and £1.2m was funded from cash from SigmaRoc's balance sheet. There is an earn-out element to the transaction based, in part, on the Ebitda growth of CCP over the 2019, 2020 and 2021 financial years. Realistically the total earn-out is likely to be around £2.2m. That's because for the £15m capped earn-out to be paid in full, CPP would have to increase Ebitda to £6m, or more than double the £2.6m the business made in its last financial year prior to the acquisition.

CCP revenue and cash profits



Source: Company data

CCP revenue and cash profit growth

Financial period	Revenue	Ebitda
12 months to May 2015	£12.2m	£1.2m
12 months to May 2016	£13.4m	£1.8m
12 months to May 2017	£16.1m	£1.8m
12 months to May 2018	£18.5m	£2.1m
12 months to Aug 2018	£20.9m	£2.6m

Source: Company data

The earnings accretive acquisition represents an excellent strategic fit within SigmaRoc's pre-cast platform, SigmaPPG. CCP has five operations that include the production of blocks, aggregates, flag stones as well as trading of cement and aggregates. The business runs at a 96 per cent production capacity, producing 18m blocks and more than 600,000 flag stones a year; has a regional market share of 20 per cent; and has delivered consistent

CPP produces 1.8m precast aggregate blocks and more than 600,000 paving flags each year

underlying Ebitda growth and cash flow generation. Prior to the acquisition by SigmaRoc, CPP's revenue increased at a compound annual growth rate (CAGR) of 15 per cent between 2015 and 2018, during which time Ebitda more than doubled. Growth was largely driven by market share gains. CCP also adds an increased asset footprint – one with high barriers to entry, and substantial mineral reserves and resources.

There is hidden value, too. CCP has two concrete block paving plants in Middlewich, Cheshire and Lay, Wrexham; a flag paving plant in Bury, Lancashire; a quarry at Aberdo, Flintshire; and a bulk aggregates and cement trading arm. Consultancy work carried out by SigmaRoc suggests that the Middlewich and Lay facilities would cost around £22m to replicate in their current condition (they have been well invested and were acquired inexpensively by the vendors of CCP), or 11 times the £2m carrying value in CPP's accounts prior to SigmaRoc's acquisition.

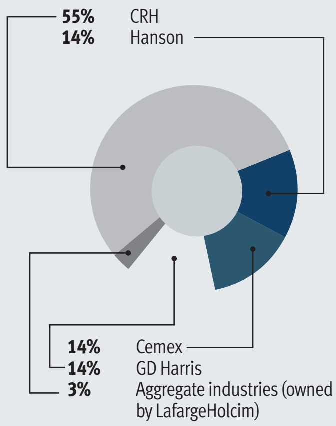
Sigma South West: a strong strategic platform for highly profitable growth

In April 2019, Sigma announce the acquisition of a 40 per cent equity stake in GD Harries, a quarrying group located in South Wales. The cash consideration was £4.89m and it entered an option agreement with the owners to have the exclusive right to purchase the remaining 60 per cent for cash consideration of £7.5m, on or before 31 August 2020. The initial consideration was funded through a combination of internal resources and credit facilities and SigmaRoc intends to fund the further consideration on the same basis.

Founded in 1977 by Mr Gerald D. Harries and built into a leading independent regional supplier by his son Ian Harries – who continues to have an active involvement in the company – GD Harries operates seven hardstone quarries, six concrete plants, three asphalt plants, a wharf and four road contracting units. An independent assessment of its mineral assets by SLR Consulting indicated 80m tonnes of reserves and resources, implying a total expected life of the reserves and resources of 100 years at the present rate of consumption.

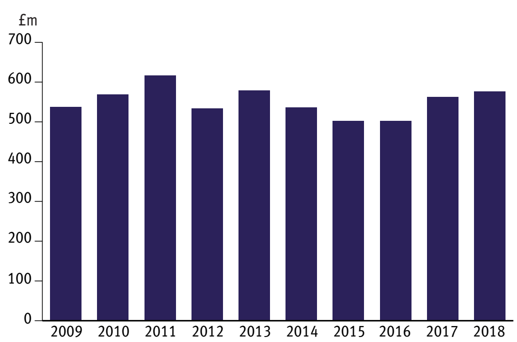
In the three years prior to acquisition, the business posted average revenues of £23.4m and adjusted Ebitda of £3.4m (for the calendar years ended 31 December 2015, 2016 and 2017) and held assets with a book value of approximately £26m and net assets of £13m. The business had net debt of £14m at the time of acquisition, implying SigmaRoc will pay an enterprise value of £26.5m, or a reasonable 7.6 times Ebitda, assuming it exercises its option to buy the outstanding 60 per cent equity in the company

South Wales asphalt production market share (2016-17)



Source: Competition Markets Authority

Road spending in Wales (2009-18)



Source: Department of Transport

by August 2020. The directors have confirmed that they plan to exercise the option, so GD Harries will become a wholly owned subsidiary of SigmaRoc.

Strategically, it makes sense to do so as SigmaRoc can implement operational improvements by using its quarry management and concrete expertise, source lower cost materials (especially cement), modernise IT and reporting systems, and expand the operation's reach and potential customer base eastwards towards Cardiff. Also, SigmaRoc's management believe that the consolidation in local asphalt production is set to continue into aggregates, thus offering potential for improved profitability within the industry. GD Harries controlled 14 per cent of asphalt production in South Wales, according to the Competitions and Market Authority (2016).

South Wales asphalt production market share (2016 to 2017)

Operator	Market share
CRH	55%
Hanson	14%
Cemex	14%
GD Harries	14%
Aggregate Industries (owned by Lafarge Holcim)	3%

Source: Competition & Markets Authority

Importantly, the acquisition has expanded SigmaRoc's activities in South Wales, which it started through the acquisition of Foelfach quarry in 2018. The Foelfach quarry produces high Polish Stone Value (PSV) aggregates which are in the top decline in the UK and are valuable in road surfacing given the skid resistance of the aggregate particles. SigmaRoc's management intends to increase output from Foelfach fourfold, to 80,000 tonnes, by selling to road applications. Department of Transport data reveals that road spending in Wales has risen by 15 per cent in the past two years, to £576m, and is at the highest level since 2013, so demand for PSV aggregates is stable.

It's worth noting that the economics of aggregates are very attractive as quarries serve an economic range of around 30 miles, thus giving producers a degree of pricing power, especially if they extract specialist minerals such as PSV aggregates. Moreover, setting up a quarry is expensive, so creating a barrier to entry for new entrants. Add to that the scope for local consolidation and it's not difficult to see why SigmaRoc is targeting South Wales as one of its four business platforms.

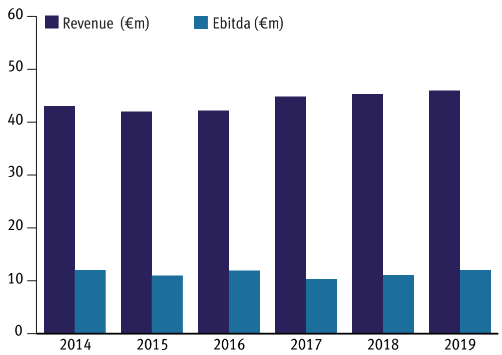
Bluestone: A game changing acquisition

In October 2019, SigmaRoc announced its largest acquisition to date, that of **Carrières du Hainaut (CDH)**, the

Belgium blue limestone and aggregates business. The consideration of €81.3m (£70m) factors in SigmaRoc assuming CDH's debt of €36.2m and equates to a multiple of 6.8 times CDH's underlying Ebitda of €12m for the 12-month period ended 30 June 2019. That seems a reasonable price to pay for a business that has produced stable revenue and Ebitda over the past five years, and has scope to boost profitability (see below).

The earnings enhancing acquisition was funded by a placing of 79.9m shares, at 41p, which raised £32.8m, of which £25.3m (€29.1m) was paid to the vendors as initial consideration. Deferred consideration of €2m is payable on the first anniversary post completion of the deal, and a further €14m on the second anniversary.

CDH's stable revenues and cash profits



Source: Company data

CDH's stable revenues and cash profits

Year to 30 Jun	Revenue	Ebitda	Ebitda margin
2014	€43.0m	€12.0m	27.9%
2015	€42.0m	€11.0m	26.2%
2016	€42.2m	€11.9m	28.2%
2017	€44.8m	€10.3m	23.0%
2018	€45.3m	€11.1m	24.5%
2019	€46.0m	€12.0m	26.1%

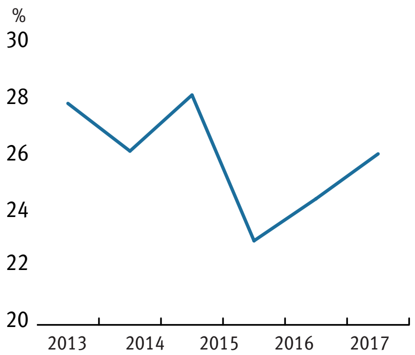
Source: Company data

Founded in 1888, CDH is Europe's largest Bluestone quarry, controlling a 50 per cent global market share. It is also a major aggregates quarry, producing 1.5m - 2m tonnes per year. The site has 150 years of reserves remaining and 352 hectares of freehold land and minerals (subject to current consultation regarding a 117 hectare extension). To put the size of the quarry into perspective, it would house 360 football pitches after its extension and be 2.5 times larger than Hyde Park in Central London.

Importantly, it is situated in a prime location with infrastructure to deliver products into Brussels as well as into neighbouring countries. In fact, around 27 per cent of CDH's revenue is generated internationally through more than 40 global partners. It has a diverse customer base, too, with less than 3 per cent of revenue being generated from its largest Bluestone customer in 2018.

Due to its high quality and distinctive characteristics, Belgian Bluestone is a Global Heritage Resource and a highly prized product that travels worldwide (unlike most aggregates). It can be used in residential, commercial and infrastructure projects, as well as for architectural and cosmetic applications. Also known as little granite, the premium product is a relatively rare material that is found in small geographical areas. Prized for its colour and hard, durable and non-porous qualities, it is widely used in Belgium and sold into Northern France, Germany and Holland.

CDH's stable Ebitda margin



Source: Company data

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The Museum of the City of Brussels is located in the historic centre and resides in a neo-Gothic style building known as Maison du Roi

Around 30 per cent of Belgian Bluestone is sold into town squares, airports and train stations, about 20 per cent is purchased by hospitals, museums and other commercial buildings, and the balance is used in residential construction. For instance, the 19th century Maison du Roi in Brussels is clad in Belgian Bluestone, highlighting the longevity and durability of the stone.

Rationale for acquisition

CDH has reported stable revenue and cash profits in the past five years and SigmaRoc's management believe there is an opportunity to boost returns through the following measures:

- **Geographic expansion.** CDH is located not that much further from London than the Yorkshire quarries which supply the sandstone to buildings in London. SigmaRoc's PPG division has good relationships with UK merchants, so it's a logical step to try to sell Belgian Bluestone to them, too. Also, there is an opportunity to expand the geographic reach into Scandinavia. SigmaRoc's directors believe that the combination of increased efficiencies and expanding sales has potential to increase Ebitda by up to €2m over the next 12 to 24 months.

- **Additional profit from reserves of quality limestone aggregate.** Around 15 per cent of volume from the quarry currently generates 100 per cent of CDH's profit, as profit is only currently generated from Bluestone sales. The 1.5m to 2m tonnes of limestone aggregate produced each year, from mining Bluestone, is deemed by the previous owners to be a waste product and is quarried under an unprofitable 30-year third-party agreement with Holcim, Belgium's third largest aggregates supplier. The agreement ends in 2022.

Currently, Holcim receives €3.5 per tonne for material that is drilled, blasted and hauled by CDH (at its own expense) to Holcim's crushing plant at the edge of the quarry. The arrangement is unprofitable and CDH has already served a three year notice to Holcim and launched a tender process for the aggregates processing contract.

The opportunity here is to either enter a royalty-based charge to make the contract more equitable and restore profitability immediately, or let the Holcim contract expire and take the aggregates business in house from 2023 onwards, selling the crushed aggregates for €9 to €10 per tonne. The first option could boost Ebitda by €2m if SigmaRoc drives a hard bargain. That's not unreasonable given the company's in house expertise in aggregates. The second option would entail spending around €15m in commissioning, purchasing and installing a new crushing plant, but result in a €6m uplift in Ebitda, according to SigmaRoc's management.

■ **Use CDH as a platform for further regional expansion.** The Belgian aggregates industry is quite consolidated, but has a long tail with almost half the market outside the control of the four largest players. In fact, the 38 members of the industry body, FEDiEX, run 60 quarries between them.

Belgium estimated construction aggregates market shares

Operator	Market share
Sagrex (owned by Heidelberg)	20%
Group de Cloedt	15%
Holcim	10%
CCB (owned by Cemetir)	9%
Others	46%

Source: Liberum estimates November 2019

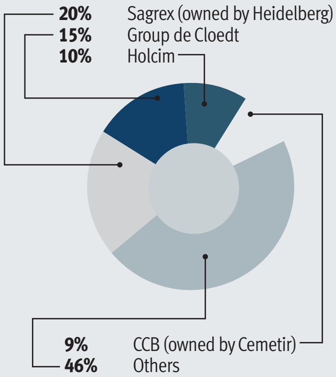
There is a geological shortage of hard rock in Northern France, Holland and Germany, which means the hardstone quarries in Belgium are well located to make up the shortfall. Also, from a domestic demand perspective, Belgium's dense motorway network, and mega projects in rail, road and canals are all supportive as is the country's robust housing market. Consultancy Euroconstruct forecast healthy construction growth of 3 per cent in 2020, and even higher in 2021.

The concrete and aggregates market

In the UK, the heavy building materials market is dominated by four multi-national players (Cemex, Heidelberg Cement, Lafarge Holcim and Tarmac (owned by CRH), producing virtually all the cement and around 70 per cent of the market for aggregates and ready-mix concrete. Around 200 producers of aggregates account for the remaining 30 per cent market share, based on data from the Competition Commission's last study in 2014.

In total, these players produce around 250m tonnes of aggregate each year and the market has been pretty stable outside the 1980s boom years and the cyclical slowdowns during the early 1990s recession, and post the 2008/19 Global Financial Crisis. Interestingly, the market for concrete products (blocks, paving stones and prestressed and precast concrete such as railway sleepers, fencing posts and kerbs) is far more fragmented as many producers make product for local markets. This is one of the markets targeted by SigmaRoc. It makes sense to do so because the major players have become less interested in this niche area. In turn, this is positive for the pricing environment with higher price growth being reported for concrete block deliveries in the past 18 months.

Belgium estimated construction aggregates market shares



Source: Liberum estimates (Nov 2019)

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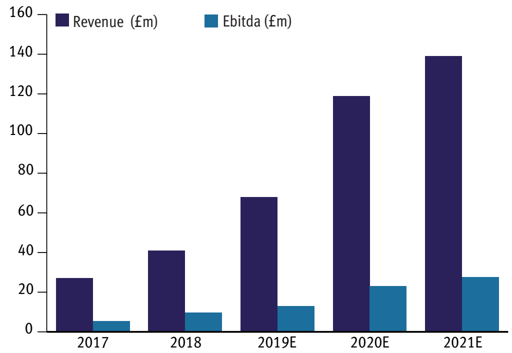
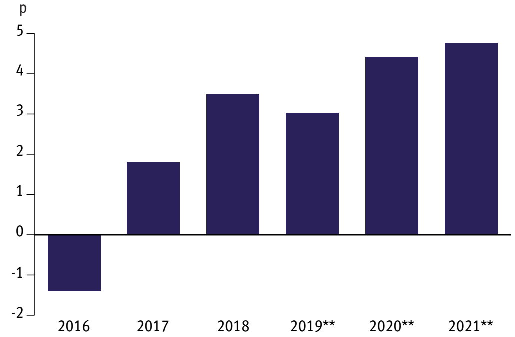
SigmaRoc's revenue and cash profits growth profile



Source: Company data and Liberum Capital estimates (November)

SigmaRoc's EPS set to rise sharply in 2020



Source: SigmaRoc annual report, London Stock Exchange and Liberum forecasts**

Financial forecasts

The timing of the CDH acquisition at the tail end of this year, and the fact that the full upside from the January acquisition of CCP will materialise in 2020, means that next year's financial results will benefit from a strong tailwind.

House broker Liberum expects SigmaRoc's Ebitda to rise sharply from £12.9m in 2019 to £23.1m in 2020, but with the depreciation charge only forecast to rise from £4.8m in 2019 to £8m in 2020. A higher proportion of Ebitda is being converted into pre-tax profit, even after allowing for higher debt servicing costs. This explains why pre-tax profit is expected to surge to £13.4m in 2020, up from £7.1m forecast in 2019 and £5.5m reported in 2018. And this feeds through to sharply higher fully diluted earnings per share (EPS), which is expected to increase by 46 per cent, to 4.42p, in 2020.

SigmaRoc's improving financial performance

Financial year	Revenue	Ebitda	Ebitda margin
2017	£27m	£5.5m	20.3%
2018	£41m	£9.8m	23.8%
2019E	£68m	£12.9m	19.0%
2020E	£119m	£23.1m	19.3%
2021E	£139m	£27.5m	19.9%

With a relatively fixed annual depreciation charge of £8m to £9m forecast (2019 to 2021) then a higher proportion of Ebitda will be converted to operating profit which will accelerate pre-tax profit and EPS growth

Financial year	Ebitda	Pre-tax profit	Fully diluted earnings per share
2017	£5.5m	£2.6m	1.8p
2018	£9.8m	£5.5m	3.5p
2019E	£12.9m	£7.1m	3.0p
2020E	£23.1m	£13.4m	4.4p
2021E	£27.5m	£15.9m	4.8p

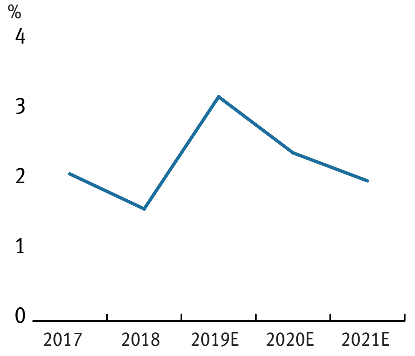
....but debt levels are not excessive

Financial year	Net debt	Ebitda	Net debt/Ebita ratio
2017	£11.8m	£5.5m	2.1
2018	£16.0m	£9.8m	1.6
2019E	£41.0m	£12.9m	3.2
2020E	£54.6m	£23.1m	2.4
2021E	£54.4m	£27.5m	2.0

Source: company data; and Liberum Capital estimates November 2019. Net debt forecasts for 2020 and 2021 take into account deferred consideration on CCP and CDH acquisitions

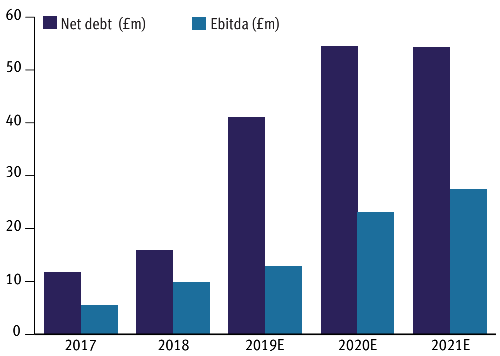
Importantly, the 2020 Ebitda forecast of £23.1m is fully backed up by the €12m (£10m) annual profit from the CDH acquisition, £7m from Ronex, and £6.2m from SigmaPPG based on the last reported operating results from Poundfield, Allen and CCP, thus de-risking earnings expectations. Also, assuming SigmaRoc exercises its option to buy the 60 per cent outstanding stake in GD Harries, it will have an economic interest in 100 per cent of GD Harries'

SigmaRoc's net debt/Ebitda set to fall sharply



Source: Company data and Liberum

SigmaRoc's debt levels not excessive



Source: Company data and Liberum Capital estimates

Ebitda of £3.5m, thus giving a further lift to forecasts.

Balance sheet gearing comfortable

The company's debt profile is worth considering as net debt is set to end 2019 at £41m after factoring in the £5.5m receipt of the Allen land sale in October, and the £7m surplus proceeds from the October £32.8m share placing – which part funded the initial £25.3m cash consideration (based on an exchange rate of £1:€1.15 at time of completion) on the CDH acquisition. The most important point is SigmaRoc's ability to service its borrowings. This is not an issue as estimated Ebitda of £23.1m for 2020 cover the company's £2.1m forecast annual debt servicing cost 11 times over. Furthermore, although net debt is expected to end 2021 at £54.4m after SigmaRoc has settled deferred consideration on acquisitions, Ebitda estimates of £27.1m that year covers the company's £2.7m forecast interest payments 10 times, too.

SigmaRoc has a low-cost £34m debt facility with Santander (negotiated in January 2019 and expiring in August 2022) on which interest is charged at a highly competitive rate of between 1.5 per cent and 2.75 per cent above Libor, based on the company's leverage ratio for the period. So, as Ebitda rises in 2020 and 2021, then the leverage ratio will fall which is good news for the interest bill. The company had net assets of £70.5m at 30 June 2019, of which £54m was in property, plant and equipment (PPE). Since then ,the acquisition of CDH has added €100m (£85m) of net assets, so PPE is close to £120m, highlighting substantial tangible asset backing on the company's balance sheet.

Bearing this in mind, CDH is negotiating with its lenders to refinance the €30.5m term-loan facility which SigmaRoc took on when it made the acquisition, so there is scope for positive news flow on this front, too.

Highly cash-generative business model

This year's acquisitions should have a positive impact on SigmaRoc's future cash flow generation. Liberum Capital expects SigmaRoc's cash flow from operations to almost treble from £7.9m in 2019 to £22.1m in 2020 to produce free cash flow of £11.1m, a sum equivalent to 10 per cent of the company's market capitalisation. Please note that free cash flow is calculated after deducting from operating cash flow maintenance capital expenditure (effectively the annual depreciation charge in the case of SigmaRoc), corporation tax and interest on borrowings.

SigmaRoc's improving free cash flow generation (2017-21)

Financial year	Cash from operations	Free cash flow
2017	£2.6m	-£0.2m
2018	£8.1m	£3.5m
2019E	£7.9m	£8.2m
2020E	£22.1m	£11.1m
2021E	£26.9m	£13.3m

Source: company data; and Liberum Capital estimates November 2019

The attractive free cash flow generation highlights the ability of SigmaRoc not only to service its debts, but free up surplus cash to fund future acquisitions and pay the deferred consideration on both the CCP and CDH acquisitions.

Major shareholders

Interestingly, several directors have made significant share purchases this year.

Chief executive Max Vermorken purchased 60,000 shares in June at 44p and a further 45,528 shares in October at 43.9p and now owns 437,511 shares. Finance director Garth Palmer purchased 45,761 shares at an average price of 43.62p in October and holds 221,330 shares, while technical director and co-founder Charles Trigg also purchased 22,547 shares at 44.35p in October and holds 143,645 shares. Chairman David Barrett spent almost £200,000 purchasing 440,000 shares at 44p in June and now holds 1.69m shares and non-executive director Tim Hall made a maiden purchase of 150,000 shares at the same time and price. In aggregate, the main board holds 2.64m shares, or 1 per cent of the issued share capital of £253.7m.

That may not seem high, but the directors and senior management also hold options over 22.2m shares, representing 8.7 per cent of the current issued ordinary share capital. Of these options, 3.35m were awarded to four main board directors in April 2019. They are exercisable at 40p and expire in January 2022, thus providing a strong incentive for the insiders to deliver the profits analysts' forecast and drive a re-rating of the shares. Also, a further 9.65m share options were awarded to 16 members of the senior management team, all of which are exercisable at 46p a share and expire in April 2026. The point being that external investors can play the potential upside on equal terms as the insiders, given that SigmaRoc's share price is trading in line with the 46p option exercise price.

Clearly, institutional investors see the upside as the October 2019 placing that raised £32.8m at 41p a share was backed by a number of heavyweight asset managers including Polar Capital, which bought 13m of the 79.8m placing shares to lift its stake to 20.3m shares, or 8 per cent of the issued share capital.

The top seven shareholders holding stakes above the 3 per cent London Stock Exchange disclosure limit control 47 per cent of the issued share capital. As a result there is a decent free float, so the shares are readily tradable in bargain sizes well above the London Stock Exchange Normal Market Size of 5,000 shares. Indeed, in the past week, individual trades above 30,000 shares have passed through the market within the official bid-offer spread of 45.2p to 46p, highlighting the liquidity.

SigmaRoc major shareholders

Shareholder	Number of shares (m)	Percentage held
M&G	31.07m	12.25%
Polar Capital	20.33m	8.01%
Bailiwick Investments	20.00m	7.88%
BGF Investment Management	14.63m	5.77%
Slater Investments	12.70m	5.00%
Legal & General	12.01m	4.73%
Mr Nigel Wray	10.68m	4.21%
Total		**47.86%**

Source: London Stock Exchange RNS post October 2019 placing, based on issued share capital of 253.7m shares

Peer group comparison

Admittedly, SigmaRoc is a tiddler compared to the five other large-cap companies that make up the heavy segment of the UK listed building materials sector. However, its earnings growth profile stands out clearly, buoyed not only by the growth being generated from past acquisitions, but with the added potential to outpace forecasts if management can over deliver on efficiency savings and other synergy benefits, too.

To put SigmaRoc's superior earnings growth profile into perspective, in the 2020 calendar year the five large players are expected to post single-digit earnings growth, whereas SigmaRoc is predicted to report 31 per cent EPS growth. Despite the significantly higher EPS growth forecast, SigmaRoc's shares are rated on a 2020 forward PE ratio of 10.3, representing an unwarranted 28 per cent discount to the average PE ratio of 14.4 for this sub-sector. Moreover, a 2020 forward enterprise value to Ebitda multiple of 7.1 times is a full two points below the sector average and below that of all the other companies in this sub-sector.

Even taking into account the absence of a dividend, this seems an overly harsh rating given that SigmaRoc will be using its forecast free cash flow of £13.3m in the 2020 financial year to settle deferred consideration on past acquisitions. At this stage of the company's life, recycling cash flow into acquisitions should produce a higher investment return for shareholders than returning the cash through a dividend.

SigmaRoc peer group comparison

	Breedon	CRH	Forterra	Ibstock	Marshalls	SigmaRoc	Average
Share price	69.5p	2,880p	295p	270p	773p	45.6p	
Market value	£1,170m	£22,806m	£590m	£1,105m	£1,546m	£116m	
2019E PE	14.5	13.4	11.8	14.2	27.4	15.0	16.1
2020E PE	12.9	12.5	11.2	13.6	26.1	10.3	14.4
2020 EPS forecast growth	**11.1%**	**6.7%**	**5.3%**	**4.0%**	**4.7%**	**31.3%**	**10.2%**
2019E Dividend yield	nil	2.6%	3.8%	6.1%	1.6%	nil	2.4%
2020E Dividend yield	2.2%	2.8%	4.2%	6.4%	1.7%	nil	2.7%
2019E EV/Ebitda	7.9	8.2	7.9	9.7	16.7	11.2	10.3
2020E EV/Ebitda	7.0	7.7	7.6	9.4	16.0	7.1	9.1

Source: Liberum Capital (SigmaRoc, CRH); Peel Hunt (Breedon, Forterra, Ibstock); Marshalls (Panmure Gordon); and Investors Chronicle

Target price

SigmaRoc may be under investors' radar at the moment, but they are likely to have their interest sparked in the year ahead when the company starts to report sharp increases in its profits and EPS as the upside from the major acquisitions made in 2019 are seen.

Moreover, if the forthcoming General Election results in an uptick in UK infrastructure spend as the main political parties have committed to in their manifestos, then SigmaRoc will be a major beneficiary given its strategic position in key regions across the country. The Conservative Party (favourites to win a majority) is committed to increasing UK infrastructure spend by £20bn annually, rising to £67bn. Priority projects in their manifesto include Northern Powerhouse Rail, Midlands Rail Hub, upgrading flood defences and a multi-billion investment in roads, areas in which SigmaRoc has a strategic presence.

Labour's spending plans are even more aggressive, prioritising £250bn investment over the next decade in energy, transport and other networks, and an additional £150bn spend over five years to replace, upgrade and expand schools, hospitals, care homes and council houses. In total, this would double government net capital spending to £102bn. Clearly, this is positive for companies with exposure to UK infrastructure spend whichever political party wins. Importantly, it is not being priced into SigmaRoc's current valuation, nor is potential for the company's highly experienced management team to over deliver on the recent CDH acquisition.

The other point worth noting is that SigmaRoc's share price is tantalisingly close to breaking out above the 48.75p closing high that has acted as a glass ceiling since the company's IPO on Aim in early January 2017. The odds of a major chart break-out have shortened dramatically in light of the operational progress being delivered and the likely positive news flow that is set to emerge in the months ahead. So, with both the fundamental and technical case for investing well aligned, and having taken in account the risk factors below - and the track record of SigmaRoc's management team - a 60p target price based on a 2021 target PE ratio of 12 seems a very realistic target on a 12-month basis. **Buy.**

Meet the management

■ The board of directors is chaired by 62-year old **executive chairman and co-founder David Barrett,** who previously co-founded London Concrete in 1997, London Concrete was ultimately sold to Aggregate Industries and is a leading concrete supplier in London.

■ Another co-founder is 36-year old **chief executive Max Vermorken,** who has been at the helm since August 2016. He was previously a strategic advisor to Lafarge-Holcim, a role in which he had responsibility for the global merger of Lafarge SA and Holcim. Prior to working for LafargeHolcim, Mr Vermorken worked in private equity at Luxembourg-headquartered The Genii Group.

■ The company's **finance director** is 39-year old **Garth Mervyn Palmer**, who has held the position since January 2017. He was previously a partner at Heytesbury Corporate LLP, a partnership engaged in the provision of corporate financial and company secretarial services. He holds a Bachelor of Commerce Degree and is a member of the Institute of Chartered Accountants in England and Wales.

There are four **non-executive directors** on the board: **Dominic Traynor, Patrick Dohlberg, Tim Hall and Jacques Emsens**.

■ Mr Traynor is a 43-year old corporate lawyer based in London who specialises in listings and reverse takeovers, mergers and acquisitions (M&A) and corporate finance work.

■ Mr Dohlberg brings a wealth of industry experience. From 2008 to 2013, he was an Executive Committee Member of Holcim, reporting directly to the chief executive, where he was responsible for Western and Central Europe. He joined Holcim in 1991, having previously held executive positions at US multi-national corporations Exxon Chemical International and Monsanto.

■ Mr Hall joined the board in April this year, having spent his whole career in the aggregates industry. He joined **Breedon Group (BREE)**, an independent construction materials company, when it was formed in 2010 and was chief executive of Breedon South until September 2017.

■ Mr Emsens appointment to the board is conditional on due diligence on SigmaRoc's €2.2m proposed acquisition of Stone Holdings, a Belgium sea defence quarrying company of which he is one of the owners, holding a 60 per cent share. He helped build SCR-Sibelco into a world leading materials solutions company.

It's worth noting that €1.3m of the consideration for SigmaRoc's acquisition of Stone Holdings will be satisfied by a combination of cash and the issue of shares, at 50p each, so Mr Emsens will have a financial interest in SigmaRoc's equity, too.

The company's executive committee consists of Mr Barrett, Mr Vermorken, Mr Palmer and five other key individuals including technical director Charles Trigg, the third co-founder of SigmaRoc.

■ **Mike Osborne** has been **managing director of Ronez** since 2006, where he has been responsible for the strategic direction and operational management of the Channel Islands-based company.

■ **Michael Roddy** has been **managing director of SigmaPPG** for the past two years, having worked in the industry for 16 years.

■ **David McClelland** has held the position of **managing director of Sigma South West** since December 2018 and is responsible for the strategic development of the region. He was previously Managing Director of Tarmac Trading's central region aggregates, asphalt and concrete business.

■ **Emmanuel Maes** joined SigmaRoc in May 2019 to help build a European presence. Based in Belgium, he was previously chief executive of Belgian Group De Cloedt, an aggregates producer.

Risk assessment
Of course, investing is never without risks and there are several to consider for SigmaRoc:

■ **Reserve and resource estimates.** The company's reported reserves and resources are estimates, and so there is potential uncertainty over the amount of reserves held at the year-end. These may require revision based on future actual production. In addition, there is risk of new leases (in particular its Chouet quarry's phase two extension in Guernsey and the west extension at St John's Quarry in Jersey) not being approved and, as such, leading to revised valuation and future income streams for the operations at Ronez.

The Chouet site is located near Les Vardes Quarry, on the north-east coast of Guernsey. The area of Chouet owned by Ronez has an estimated 2m tonnes of resources and the area owned by the Guernsey Government is estimated to contain a further 3m tonnes of resources. Ronez is in negotiations with the States of Guernsey to lease a portion of the Chouet site that it does not own. Should Ronez be granted this, and subject to additional exploration, obtaining the requisite planning permission and completing environmental studies to enable quarrying at the Chouet site, this could extend the operational life of Ronez's Guernsey quarrying operations by up to 40 years.

■ **Dependence on key personnel.** SigmaRoc is dependent upon its executive management team. While it has entered into contractual agreements with the aim of securing the services of these personnel, the retention of their services cannot be guaranteed. The development and success of the company depends on its ability to recruit and retain high quality and experienced staff. The loss of the service of key personnel or the inability to attract additional qualified personnel as the company grows could have an adverse effect on future business. To help maintain and incentivise senior management, 16 key personnel have been awarded stock options equating to 8.7 per cent of SigmaRoc's issued share capital as part of their remuneration which provides a major financial incentive to stay with the company.

■ **Uninsured risk.** SigmaRoc may become subject to liability for hazards that cannot be insured against or third-party claims that exceed the insurance cover. It may also be disrupted by a variety of risks and hazards that are beyond its control, including geological, geotechnical and seismic factors, environmental hazards, industrial accidents, occupation and health hazards and weather conditions or other "acts of God".

■ **Health and safety.** SigmaRoc's safety record is impressive. In February 2019, its Ronez operation had gone 1,000 days without a major incident, and SigmaPPG has reduced harm incidents by 10 per cent since acquisition with 98 per cent of days in the first half of this year incident free. To mitigate this risk, SigmaRoc operates a comprehensive health and safety programme to ensure the wellness and security of its employees. The control of work-related hazards requires a dedicated team effort involving the active participation of all employees to incorporate employee suggestions, learn lessons from past incidents and implement new guidelines relating to new projects, with the aim of identifying areas for further improvement of health and safety management.

■ **Funding risk.** The only sources of funding currently available are through the issue of additional equity capital or debt financing. The directors' ability to raise further funds is dependent on the success of its activities and investment strategy. The board may not be successful in procuring funds on terms which are attractive and, if such funding is unavailable, the directors may be required to reduce the scope of the company's investment activities. That said, SigmaRoc has been able to successfully raise capital from low-cost credit lines as well as institutional backed share placings, highlighting positive investor appetite for its paper.

■ **Financial risks.** SigmaRoc's operations expose it to a variety of financial risks that can include market risk (including foreign currency, price and interest rate risk), credit risk, and liquidity risk. The board has a risk management programme in place that seeks to limit the adverse effects on the financial performance of the company by monitoring levels of debt finance and the related finance costs. It does not use derivative financial instruments to manage interest rate costs and, as such, no hedge accounting is applied.

■ **Macro-economic risks.** The company mitigates economic risk by targeting acquisitions in segments of the market that historically continue to perform well during economic slowdowns.

■ **Integration risk on acquisitions.** To date, SigmaRoc's record of integrating acquisitions has been mightily impressive, albeit there can be no guarantee that the management team can continue reaping chunky efficiency gains and improve the profitability of target companies.

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