Bingo Industries – A Case Study

Bingo Industries (BIN), the commercial and industrial waste management business operating in SE Australia, disappointed the market on Monday 18 February 2019 by downgrading earnings expectations for 2019. Company guidance had previously been set at 15% to 20% growth on 2018 EBITDA, with this company revising this down to no growth. The share price response was savage with the stock down ~50% on the day to a historic low of $1.17/s, a significant de-rating of the company's valuation. Disappointingly, the Flinders Emerging Companies Fund held the stock and the move detracted performance on the day. So, what to do with a business that had confirmed guidance at their AGM in October 2018 and then eroded investor confidence with a downgrade in February 2019, one week out from their half year result?

At Flinders, we let the earnings and resulting valuation tell the story. After the shock of the announcement, emotion can quickly spill into anger. The 50% decline in the share price on the day demonstrated that. But emotion is not a fundamental or successful driver of investment decision making. So, back to fundamentals. We implemented the resultant change to expected earnings together with a rebasing of expectations in the 2020 and 2021 financial years. Then for good measure, we applied a de-rating to our valuation, setting a target multiple below the prevailing small cap industrial multiple. Therefore, we risk adjusted both earnings and valuation to take into account the poorer earnings outlook, uncertainty and maintained a tick in the box for management quality (which we still believe to be competent despite this misstep). In the end we arrived at a conservative valuation of ~$1.50/s or a ~30% premium to the close price on the day of the downgrade. Hence, we didn't sell the stock. In fact, we re-built our position having conviction in our analysis.

At this point, the company was due to report their interim 2019 result the following week, which would provide some further granularity around the skew in earnings and potentially more detail around the competitive environment. Importantly though, the main event due to occur the following week related to the ACCC decision on Bingo's proposed acquisition of Dial A Dump Industries (DADI). This acquisition was announced in August 2018 and the proposal, if it were to proceed would be funded by a combination of cash (~$377m) and shares in Bingo (~$200m). To fund the cash component of the transaction, Bingo raised equity at the time of the announcement through an underwritten rights issue at $2.54/share. So, management effectively balanced their liabilities as at the time of the announcement.

A week out from a decision by the ACCC, the company was in a strong net cash position. If the deal were to proceed, it would be highly accretive, with our valuation on the company pointing to upside of close to 100% from the $1.17/share. If the deal failed to proceed, the company had intimated that they would undertake some form of capital management. An option here would be to buy back stock (which would be highly accretive). If they bought back ~$200m of stock around $1.20 to $1.30 (remembering the equity was raised at $2.54 only six months ago), the level of accretion to earnings per share would be in the order of 30% to 40%. So, we formed the view that either outcome would be highly accretive, leading to the share price appreciating which lent further support to our decision to purchase additional shares.

Fast forward to close Wednesday 27 February 2019. The share price had rallied 24% off its lows ahead of the ACCC decision. Pleasingly, the ACCC approved the BIN acquisition of DADI first thing Thursday morning (28 February) and the company additionally announced a $75m buyback resulting in the stock rallying a further 15%, or 43% from the close price on the day of the downgrade. Therefore, from a position where the portfolio was impacted materially by the initial decline, we managed to recover most of that lost ground within two weeks purely on the back of solid fundamental analysis. In addition, we now have a business with numerous options for both costs and business synergy opportunities. Emotion can move stocks over the short-term but fundamental research is the only analytical tool to determine a company's value and establish a real investment thesis, and we remain steadfast in this view.

Flinders Investment Partners
28 February 2019