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A Golden Age of Event-Driven Investing? (pt 5)

SEPTEMBER 2, 2021 / PUPPYEH / EDIT

I am continuing my intermittent series of event-driven setups/trades I find interesting. Today's study is a bit of what I would call a 'low latency' trade, ie a high likelihood of modest (~20-30%) upside, with some optionality around a higher payoff; but at the same time a very low likelihood of material downside. I am instinctively attracted to these situations because, even if the absolute upside is not large, if there is a hard, near-term catalyst to extract 25%+ upside with limited downside, the risk/reward on that type of setup is tough to beat. Let's dig in.

Cardno Ltd (Australia: CDD) – last price 1.03 – \$390mm market cap, \$300-400k ADV

(apologies in advance, this stock is not as liquid as I would have liked and given the low latency nature of the trade I would especially advise all readers to exercise discipline. This makes a ton of sense around \$1-1.1, but progressively less sense, from a risk/reward perspective, much higher than that. Because of the natural limitation here I will keep this write-up briefer than usual).

According to the blurb on their website, **Cardno** is 'a professional infrastructure and environmental services company, [that] engages in the development and improvement of physical and social infrastructure for communities worldwide.' That bland

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description doesn't really give you a sense for what they do, concretely, so here is how they present their activities in their latest presentation materials:

As worldwide investors, regulators and community stakeholders are driving for more transparency and disclosure of ESG factors, Cardno is well positioned to support our clients to manage the risks and expand opportunities.

 Environmental services	<ul style="list-style-type: none"> Assessment, permitting and compliance for the energy, power and defence sectors (bases, ports, harbours, hydroelectric power dams, natural gas pipelines, solar fields and wind farms) Environmental restoration work to repair environmental damage and mitigate climate change impacts with an emphasis on green infrastructure solutions Incident response management services such as for spills and fires
 Health sciences	<ul style="list-style-type: none"> Characterising human health and environmental risks associated with exposures to chemical, pharmaceuticals and/or radionuclides in a variety of media and environments Science-based sustainable solutions for responsible product stewardship, employee safety and community health support Designing and conducting epidemiological studies in community and occupational settings, most recently with an emphasis on COVID-19
 Water, transport & urbanisation	<ul style="list-style-type: none"> Asset management for efficient life cycle management of infrastructure assets, streamlining maintenance, optimising supply chain performance and enhancing safety Sustainable design solutions for land development, brownfield redevelopment, ports and harbours, transportation, water and wastewater infrastructure projects Military master planning to create, improve and sustain military communities across the globe
 Social development	<ul style="list-style-type: none"> Partnering with public and private sector clients to promote sustainable economic development and improve the well-being of local communities in the areas of agricultural and rural development, climate change, education, economic growth, gendered and inclusion, governance, global health, infrastructure and environment Modern Slavery business reporting, identification and eradication

6. 2021 Full-Year Results

Suffice to say, perhaps, this is a very diversified set of businesses, or at least end-markets. I believe the segment of the market Cardno occupies – infrastructure services and environmental contracting – is very much a ‘black box’ of sorts, where outfits like Cardno are asked to do all manner of projects – run tollroads; oversee bridge construction; environmental assessment for ports, harbors, etc; manage facilities like airports – all under the amorphous banner of ‘infrastructure services.’ Cardno is by no means unique in this realm: if you look at the corporate websites of some of their larger competitors, like **Aecom**, **Stantec**, or **WSP**, you will see a similar amalgam of industries and buzzwords.

As a result, this will not be an investment pitch full of complex financials, or division-by-division modeling. It is instead all about the setup, and imperatives for the owners of the company. I think CDD is a compelling investment today for four reasons:

- it is likely to be sold in the very near-term;
- the sale is likely to be competitive, given the natural synergies available to a strategic buyer;
- in most any sale scenario I think there is a high likelihood of 25-30% upside without stretching;
- and even if there is no consummated sale downside looks quite modest (10-15%).

Let's unpack these points one by one.

CDD seems like it is about to be sold, and the process will likely be competitive

This is fairly straightforward. The company announced a ‘Strategic Review’ in early June (code for exploring a sale). Of note, they specifically mentioned they were contacted by a number of parties (ie more than one), and that the major shareholder, Crescent, approves the pursuit of a sale:

CLMT CNE.LN CVN.AX DXLG E2N

ELTA.LN eml.ax **EVO.AX** **FAR.AX**

GAN hdg.na **HRBR** INTL **LMN**

MBR MET.NZ **MFD.AX** **NIO** **PAC.AX**

PBIT.TO RAPAX **RE4.SI** **SAVE** SDF

SF3.DE SHVA.TA **SMR.AX** **SNEX** **SQZ.LN**

TER.AX tnk.ax **TRQ** **TWTR** **UNTC**

URF.AX **WRKS.LN** **WTE**

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March 2023 (14)

February 2023 (13)

January 2023 (11)

December 2022 (6)

November 2022 (9)

October 2022 (7)

9th June, 2021

Cardno Announces Strategic Review

more than one bidder

Following receipt of a number of unsolicited approaches from interested parties, the Board of Cardno Limited (ASX:CDD) (Cardno) has decided to commence a strategic review process with the objective of maximising Cardno shareholder value. This process will involve an assessment of Cardno's strategic options and the alternative strategies available to unlock and enhance value for Cardno shareholders. There are no assurances that the Board will decide to pursue, nor that any transaction or transactions will result from, this review.

Crescent Capital Partners, Cardno's largest shareholder, has advised the Cardno Board that it is supportive of Cardno conducting the strategic review. **56% shareholder, sale only exit strategy**

Cardno will continue to keep shareholders informed in accordance with Cardno's continuous disclosure obligations. No action is currently required by Cardno shareholders.

Cardno has appointed Baird and Gresham Advisory Partners as its financial advisors and Gilbert + Tobin as its legal adviser, in relation to the strategic review.

Crescent's approval here is obviously key as they own 56% of the company. More importantly, though, Crescent's managing partner is Chairman of CDD's board – this was a bungled takeover transaction from 2015 that somehow stayed listed and went through the ringer (see [this](#) article for more details), with Crescent basically taking a bath on the investment. They still have two board seats, including Chairman, and given the natural dynamics around private equity fund timelines, it stands to reason they are quite happy to sell now (six years in), as a full sale of the company is the only realistic exit strategy for them given the illiquidity of the stock and their huge ownership position.

Keep in mind, too, the timeline of events. CDD announced the review in early June; at the time the stock price was in the mid-70s range. I doubt CDD management would have been willing to pursue alternatives, let alone announce the approval of its largest shareholder, for a small-premium transaction. That is to say, *I believe the initial exploratory bids for the company were probably already at healthy premiums*, call it in the 90c+ range, if not much higher.

So we know a strategic review is ongoing and – probably – that initial bids were maybe 10% below where we currently trade (or maybe a good deal higher). More than this, though, the **most recent annual results** significantly derisk the proposition, to me, and make a near-term transaction by far the most likely outcome. I say this because in its FY report – which was much better than expected – the company included this quite curious comment at the bottom of the PR:

"As we advised last year, in FY22 some Cardno businesses will undoubtedly be impacted by the COVID-19 pandemic, but equally some businesses stand to gain both market share and share of wallet.

"The Board expects that the business will continue to grow from its FY21 level, but the Board has chosen to not provide explicit earnings guidance to the market for FY22 due to the ongoing Strategic Review process."

There are many companies listed on the ASX who choose not to provide explicit earnings guidance; many indeed cited the uncertainties of COVID as part of that reason. But to give generically bullish commentary around the next fiscal year, and yet refuse to provide numbers specifically because of the ongoing discussions – that seems highly unusual to me. It would be one thing if there was an announced and/or agreed transaction on the table (which often happens with earnings or conference calls post deal announcement) – but that is certainly not the case here. *This may well be the first time I have seen a listed company specifically decline to provide guidance because of an*

September 2022 (7)

August 2022 (10)

July 2022 (8)

June 2022 (8)

May 2022 (10)

April 2022 (7)

March 2022 (7)

February 2022 (7)

January 2022 (7)

December 2021 (5)

November 2021 (8)

October 2021 (7)

September 2021 (6)

August 2021 (7)

July 2021 (7)

June 2021 (7)

May 2021 (9)

April 2021 (8)

March 2021 (7)

February 2021 (8)

January 2021 (5)

December 2020 (7)

November 2020 (7)

October 2020 (6)

September 2020 (7)

August 2020 (10)

July 2020 (7)

ongoing Review. I can only conclude, in concert with the earlier disclosures around core shareholder support and multiple interested parties, that the process is very much advanced.

June 2020 (6)

May 2020 (7)

April 2020 (5)

March 2020 (4)

February 2020 (4)

January 2020 (4)

December 2019 (2)

November 2019 (1)

October 2019 (1)

August 2019 (2)

July 2019 (3)

April 2019 (1)

March 2019 (3)

July 2016 (1)

March 2016 (1)

February 2016 (2)

December 2015 (1)

October 2015 (1)

September 2015 (2)

August 2015 (3)

July 2015 (1)

June 2015 (1)

May 2015 (2)

April 2015 (4)

March 2015 (6)

Who could be interested, and what would they pay?

This is where it gets interesting. The vast majority of larger players in this space – Aecom, Arcadis, WSP, Stantec – have all been built through acquisition, because the synergies available to acquirers make a 'roll-up' model inherently attractive. Large entities already operating in a geography can simply staple on bits of other companies' backlog into their platforms, employing many of the same workers (contractors/consultants) but without a lot of the middle management/overhead. This is why, for example, when some of these companies tout acquisitions, they claim extremely large cost synergies as part of the acquisition rationale.

Take a **recent deal** (December 2020) done by WSP, for example (one of the leading serial acquirers in this space). In the deal deck announcing the purchase of Golder, they suggested *a huge 3.3% of acquired revenues would turn into cost synergies*, alone, taking the purchase multiple from 10.4x to 8.4x:

FINANCIAL HIGHLIGHTS

- Acquisition of Golder for an enterprise value of US\$1.4B (approx. CAD\$1.5B) representing gross Golder's value pre-IFRS 16 adjusted EBITDA or 8.4x post synergies¹²¹.
- Immediately accretive¹²² to WSP's adjusted earnings per share¹²³, with accretion¹²⁴ increasing in the mid-term once synergies are fully realized¹²⁵. **Cost synergies alone at 3.3% of revenues.**
- Annual cost synergies of approximately \$80 million expected to be achieved over a 24-month period with 50% to be realized within the first twelve months after the closing date. Costs required to realize each annual cost synergies estimated not to exceed \$10 million in the aggregate¹²⁶.

We will come to what this means for CDD shortly, but the simple takeaway is that acquirer's EBITDA in these kinds of roll-up deals can be quite a bit larger than standalone EBITDA. Thus, for example, CDD recently reported \$51mm (AUD) of EBITDA in the just-completed FY21...

		REMOVING FX			
\$M	FY21	FY20 @ FY21 FX Rate	% change year on year	FY20	% change year on year
Gross Revenue	890.4 M	939.6 M	▼ (5.2%)	978.0 M	▼ (8.0%)
Fee Revenue	612.7 M	626.9 M	▼ (2.3%)	637.1 M	▼ (0.5%)
Underlying EBITDA ¹	78.5 M	80.0 M	▲ 15.5%	73.5 M	▲ 6.0%
Underlying EBITDA ¹ (Pre AASB 10 Impact ²)	61.2 M	70.9 M	▲ 31.0%	43.0 M	▲ 19.0%
Underlying NPAT ³	27.7 M			9.4 M	▲ 194.7%
Net profit after tax	32.7 M			56.0 M	▼ (42.2%)
Operating Cash Flow	62.6 M			73.6 M	▼ (14.8%)
NPAT EPS - basic (cents)	6.69			2.10	▲ 216.6%
Backlog	1,177.3 M	1,188.1 M	▼ (0.9%)	1,214.3 M	▼ (3.0%)

¹Underlying EBITDA = EBIT plus underlying adjustments, depreciation, amortisation and impairment losses

²Underlying EBITDA = EBIT plus underlying adjustments, depreciation, amortisation and impairment losses pre AASB 10 Impact

³Underlying NPAT = NPAT plus underlying adjustments and impairment losses

...a number that they are simply guiding to 'grow' in FY22, largely a function of the US infrastructure-led boom:

Outlook for FY22



Cardno stands to gain from (1) industry tailwinds across most sectors the company operates in, together with (2) the benefits of ongoing operational discipline globally.

- **Cardno is:**
 - A leading DOD professional services-consultancy achieving clients on complex and technically demanding environmental, social and sustainable infrastructure projects. The company has unique service offerings in the areas of ESG, advocacy, health sciences, procurement, regulation, asset management, resilience and international development.
 - An engineering and sustainable infrastructure-consultancy with a reputation for quality work and innovative technical outcomes. The company is well positioned to capitalise on the growing demand for infrastructure (particularly transport and water) in new markets in Asia, Pacific and the US.
- Most Cardno markets are experiencing a degree of tailwinds, most notably in demand for environmental services and physical/societal infrastructure.
- There remains ongoing opportunity for further simplification and lower cost to serve (e.g. moving to a single-global ERP).
- The company advised the ASX in June 2021 that it was conducting a Strategic Review. That process is underway and the Board will update the market as the process develops. In the meantime, it is very much business as usual for Cardno's 4,800+ team around the world.

Cardno clients are B2B (business to business) or B2G (business to government). An FY21 year end Cardno's working capital position approached break-even and net debt was positive (cash exceeded debt). Despite the challenges associated with COVID-19, Cardno commences FY22 with encouraging levels of backlog and pipeline of future work.

As we advised last year, in FY22 some Cardno businesses will undoubtedly be impacted by the COVID-19 pandemic, but equally some businesses stand to gain both market share and share of wallet.

The Board expects that the business will continue to grow from its FY21 level, however the Board has chosen to not provide explicit FY22 earnings guidance to the market due to the ongoing Strategic Review process.

33 from investor relations

For argument's sake, let's assume this means 10% growth in EBITDA – hence to \$56mm. To an acquirer gaining CDD's \$1bn backlog and ~\$900mm in gross revenues, though, you would think at the bare minimum 1%, maybe 1.5% of sales could be extracted in cost synergies (keeping in mind the 3.3% of revenues taken in the Golder example). That alone would imply acquirer's EBITDA of say **\$65-70mm this year**, and I don't think that is at all aggressive as CDD margins (high single digit) are well below some of the large players (mid-teens).

Who might the 'interested parties' be?

The above all suggests there is a strong industrial logic for a business like this to be folded into a larger player. The question is, which larger player? I think there are two obvious potential buyers: Stantec, and Aecom. There may well be others, and financial buyers as well too, but for now I think these two names will be involved in the bidding. Let me explain why.

Let's look at Stantec first. Whilst a Canadian holding company, Stantec has significant global interests – one of which MWH, is where CDD's CEO, Susan Reisbord (an American, still running CDD from the US), used to work (see [here](#)). Moreover, if you look at Stantec's investor materials, you will note that when it comes to M&A, they are particularly focusing on Australia/NZ and the US:

Acquisition priorities going forward



Expand our Portfolio

Winning projects that neither firm could win alone.

Expand our Market

Penetrating a sector or geography we could not have absent the acquisition.

The Cardno business is essentially a large and profitable mainstay North American platform; and the large-but-in-need-of-cost-cutting Australia/NZ business. I think ~85% of revenues (and backlog) relates to these two markets, so it is hard to think of a better geographic fit for an acquisition on this basis, than CDD. The personal history

with the CEO appears to line up as well. Stantec is also apparently looking for 'small and mid-size' opportunities – meaning CDD could well be the right size they are looking for:

Disciplined acquisition growth

Small and medium-sized acquisitions that meet our minimum requirements:

Accretive to earnings

- Risk adjusted internal rate of return must be > weighted average cost of capital.

Synergistic opportunities

- Earnings potential as a whole must be greater than the parts.

Global platform

- Earnings expansion by placing acquisitions on global back office and marketing platform

Fits our risk profile

Business and cultural fit

Then there is Aecom. A globally diversified player with a very large Australian (and of course US) business, Aecom is less specific than Stantec in their materials, but nevertheless highlighted again these two geographies as areas they want to grow inorganically in:

Prioritizing Investments in Our Highest-Returning Markets

FOCUSING OUR CAPITAL AND TIME ON OUR LARGEST MARKETS WITH THE HIGHEST RETURNS

- Our core operating footprint allows us to deliver for clients around the world
- We are now focused on operating in markets that generate a strong return on management's time and return on our investments, and continue our process to exit more than 30 lower-returning countries
- These core markets feature our highest ROAC and are our priority for internal investment
- These markets also present the best opportunities for growth as a result of substantial, sustained funding in infrastructure



Core Geographic Footprint
ROI+ of Our Profitability

United States & Canada
United Kingdom
Middle East
Russia
Central Europe
France
Germany
Italy
Spain
Portugal
Greece
Turkey
Balkans
Australia & New Zealand
Hong Kong

AECOM

Again, CDD would make sense geographically, and could be plugged in fairly seamlessly (and synergistically) into the Aecom platform. Note that these are just two potential acquirers, and there could well be others (like WSP). But it really only takes two to get a bidding war going – and remember the company has already told us there were multiple interested parties...

What is the right price?

If you accept the conceit that CDD is highly likely to be sold near-term and that there are probably a number of buyers who could make the acquisition quite accretive, the only real question then is what is the right price? Well, whether it is Aecom, WSP, Stantec, or Arcadis, basically all these names trade at rich valuations (13-15x NTM EV/EBITDA), meaning even paying a premium to where CDD trades and getting no synergies is accretive to their equity valuations. Still, I think 10x EV/EBITDA, pre-synergies, is quite achievable and may well be exceeded – but 10x NTM EV/EBITDA of say \$56mm still implies a **\$560mm market cap (there's no debt) and a \$1.35 stock price (FDSO is 420 shares, I think), ie good for 31% upside.**

As per above, Golder was the last transaction in the space that I could find, and that went off above 10x EV/EBITDA. Earlier (late 2019), Aecom sold their management services business for 11.6x EV/EBITDA, to private equity:

News Release

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AECOM accelerates value creation strategy with sale of its Management Services business for \$2.405 billion

- The sale of the Management Services business at 11.6x multiple of EBITDA represents a material premium to AECOM's valuation and provides substantial capital for debt reduction and stock repurchases.
- The ongoing transformation of AECOM's portfolio maintains its position as the world's premier infrastructure firm and furthers its focus on higher-returning, lower-risk professional services.

LOS ANGELES--(BUSINESS WIRE)--Oct. 14, 2019-- AECOM (NYSE:ACM), the world's premier infrastructure firm, today announced that it has entered into a definitive agreement for the sale of its Management Services (MS) business to affiliates of American Securities LLC and Lindsay Goldberg for a purchase price of \$2.405 billion, which reflects an 11.6x multiple on expected fiscal 2019 adjusted EBITDA¹ and a premium to AECOM's overall valuation. Included in the purchase price is contingent purchase price of approximately \$150 million. The sale of the MS business marks the continuation of a revenueular increase that began with the Company's fiscal 2017 separation.

No doubt this is a better business than CDD and American cost of capital is different; it is also difficult to granularly analyze the differences between some of these smaller-scale infrastructure service providers. But nevertheless in the context of prior transactions; synergies; and where their own equities trade, I think 10x EV/EBITDA is eminently reasonable. And again, I expect we have more than one bidder involved...

What is the downside if no deal happens?

I think the likelihood of no deal being done is incredibly low, given the imperatives of Crescent in this situation – in other words I think it much more likely they sell into a weak bid around \$1 and just get out, than leave us hanging and waiting. Still, if worst came to worst I still don't think the stock would trade much below 90c. Keep in mind this is a totally unlevered entity now and has committed to paying out 70% of net income, and just guided to growing earnings again this coming year, just after earning 7c EPS normalized. To me that means something like 8c in EPS and, I would guess ~5.5c in dividends, thus at 90c you'd be looking at 11x (unlevered EPS) and a >6% yield – hardly aggressive multiples in the context of the US-led infrastructure boom of which CDD is a primary beneficiary. Moreover CDD retired a huge amount of the stock (10%) through a buyback last year, I would expect that program to be reinitiated if the Strategic Review somehow didn't result in a transaction.

So all in all I like the risk-reward hear and expect to hear something definitive in the coming months, if not sooner, and have added CDD.AX to the event book.

Disclosure: long CDD.AX

 Uncategorized

 CDD.AX

← DXLG thoughts post the 2Q print

A Golden Age of Event-Driven Investing? (part
6) →

15 thoughts on “A Golden Age of Event-Driven Investing? (pt 5)”



Shreeni I

SEPTEMBER 2, 2021 AT 4:05 PM

Thanks for the idea!

[REPLY](#) [EDIT](#)



jehu molina

SEPTEMBER 2, 2021 AT 4:25 PM

[REPLY](#) [EDIT](#)



DP

SEPTEMBER 2, 2021 AT 5:05 PM

fabulous idea.

[REPLY](#) [EDIT](#)