BEYOND OIL

My #1 UK green stock for 2021

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My #1 UK green stock for 2021

By James Allen

Editor and Publisher, *Exponential Energy Fortunes*

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In 2018, China's carbon dioxide (CO2) emissions amounted to 10.06 metric gigatonnes (GT), or 28% of the global total.

China is the world's largest emitter of CO2.

In second place, the US' CO2 emissions were 5.41 GT, or 15%.

Imagine if one company came up with a brand-new technological solution that could bring about a massive reduction in emissions for either of these countries.

That is what decarbonisation is all about – a reduction in (or elimination of) the CO2 emissions, which have driven global warming.

The company whose stock we are recommending has, in fact, developed brand-new technology that could really cut CO2 emissions in the world's third largest emitter.

The technology is so new that it doesn't even form a part of the company's business, at least not yet.

However, we are certain that will change, because the technology represents a true breakthrough in a critical sector.

In other words, this stock delivers growth potential.

The company in question already has a solid record of rapid expansion.

It's also in an industry which hasn't – as yet – featured in our portfolio of recommended stocks.

It's the kind of investment that we're looking for.

The world's third largest emitter of CO2 emissions

If the cement industry were a country, it would be the world's third largest producer of CO2 emissions. It accounts for an estimated 7% of the global total.

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In 2019, members of the Institutional Investors Group on Climate Change and the Climate Action 100+, two groups of money managers with a combined $33 trillion under management, pushed for European construction material companies to commit to net-zero emissions by 2050.

Bill Gates, in his latest role as a climate-concerned philanthropist, has also recently focused his attention on cement, the key ingredient for concrete blocks, pipes, paving stones and other products.

For this stock recommendation, concrete blocks are perhaps the most important because they are the main product of the company that we discuss below.

Concrete blocks are widely used in place of bricks in the building of walls and floors in homes, offices and other buildings, such as schools.

Made in uniform shapes from cement, sand, water and aggregates, the concrete blocks are cheaper to produce and easier to use than bricks.

Concrete blocks have other advantages – such as strength in face of extreme weather events and good insulation (because there are pockets of air inside them).

What you need to know about cement

Cement – the key ingredient for concrete and concrete blocks – is an industry that has a reputation for being “hard to decarbonise”.

“Hard to decarbonise” means that production processes have typically – and unavoidably – generated large emissions of CO_2.

This is unquestionably true of cement.

In the first place, limestone gets heated to pull out calcium – that process releases CO_2.

In the second place, the burning of natural gas to make the heat also releases CO_2.

What is also important is that the global cement industry is huge.

According to Research and Markets, global sales of cement and concrete products amounted to about $329 billion in 2020.

The Covid-19 pandemic caused sales to fall last year – but it is expected that they should recover quickly to almost $442 billion in 2023.

The total sales of “green cement”, produced in ways that reduce CO_2 emissions, are expected by other observers to expand by around 8.7% annually over the next few years to $43.59 billion in 2027.

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This stock is a UK building products company that is leading the charge against cement-related CO_2 emissions.

That company is **SigmaRoc PLC**, which is listed on London's Alternative Investment Market (AIM).

An acquisitive business with huge potential

SigmaRoc is a business based on acquisitions, so it's actually a collection of subsidiaries working mostly independently, but with some group synergies and advantages.

It has five main divisions or "platforms": Ronez, South Wales, Dimension Stone, Benelux and PPG.

PPG is made up of three companies, and one of them is called Cheshire Concrete Products (CCP).

It's CCP that has developed an exciting new green product.

That product is a concrete block, which has low CO_2 emissions.

It's called Greenbloc and will be launched under its own brand.

SigmaRoc's new Greenbloc range materially reduces the carbon footprint of these blocks when compared to a traditional product.

Greenbloc is completely cement free. This makes it unique in the UK market.

Specifically, it provides an average reduction in CO_2 emissions of 77% per concrete block.

What does this mean in practice?

The CO_2 emissions per concrete block are reduced by an average of 1.1kg.

The emissions for the blocks used to build an average semi-detached house in the UK are cut by an average of 2.7 tonnes.

This last figure is roughly equivalent to the CO_2 emitted by the typical UK household's electricity consumption over four years.

Greenbloc will be produced by SigmaRoc's PPG platform at its various production facilities.

Following extensive research and development and initial trials throughout 2020, the company says the product has been well received by the market, with strong interest from several leading national building materials merchants.

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Further sizes and specifications of concrete building blocks will be released over the next weeks and months. This will extend the Greenbloc range and give us a clearer picture of the market for these products.

How much impact will this have on the wider SigmaRoc business?

Well, currently it's hard to say.

But the concept behind an acquisitive company like SigmaRoc is that subsidiaries can offer collective strength and "synergies" to one another.

If one company has a great sales and customer network, while another is very niche but has a great product, then bringing them together under a single roof can help both to do much better than they were doing before.

This is what we expect to happen with CCP's exciting new Greenbloc.

It's the company's ambition to have a low carbon alternative for every concrete product it offers – and that's across the three companies comprising PPG group, one of the five SigmaRoc platforms.

Greenbloc should be just the first of many.

SigmaRoc's PPG Group: a proven performer

PPG Group has already progressed well as a business.

Via its CCP subsidiary, PPG, it provided the concrete for the Etihad Stadium in Manchester, the home of Manchester City Football Club and one of the largest football grounds in the UK.

Imagine if a building as iconic as that were built with Greenbloc.

As noted, the average saving from a single home is 2.7 tonnes of CO_2 emissions per year.

For something the size of the Etihad Stadium, the savings could be a thousand times higher.

PPG Group has also been chosen for construction projects by both the prison and nuclear industries, where performance and safety are paramount.

This shows how highly regarded PPG Group is as a large-scale concrete supplier in this country.

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The green agenda isn't just with PPG Group

PPG Group isn't the only SigmaRoc platform targeting the green agenda.

Ronez, another of the five platforms, is apparently on a similar path.

Hidden in the interim results for the six months ended 30 June 2020, was this line:

> *With regards to 2020 initiatives on the social and environmental front, Ronez is trialling a cement-free concrete to reduce Scope 1 carbon dioxide emissions. Ronez is also seeking to obtain 3rd Party accreditation for ISO 45001 Occupational Health and Safety Management Systems across the Ronez Platform.*

However, it seems reasonable to expect that, if Greenbloc is successful within the PPG Group, it will be made and/or distributed by the other four platforms within SigmaRoc.

PPG Group was also noted as having replaced the insulation of nine main ovens at its Middlewich site.

The previously poor designs, with associated old and inefficient insulation, were replaced with more modern bonded insulation products that increased insulation depth.

This has removed the need to use energy for heating during winter nights, reducing the carbon footprint and overheads.

It's a good example of how greening of a company's operations can also lead to cost savings.

This all reassures us that decarbonisation is a core focus across the different platforms.

Bigger companies will be watching Greenbloc closely

One large cap company in the cement sector that is at the forefront of decarbonisation is HeidelbergCement.

Its board chairman had this to say in 2019:

> *"Concrete has the potential to become the most sustainable building material. Our goal is to realise the vision of CO2-neutral concrete by 2050 at the latest. In the coming years, we want to make significant progress in this direction…"*

A product like Greenbloc will likely go straight on to Heidelberg's radar.

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Heidelberg may look for ways to partner with or license SigmaRoc's new concrete-free low-carbon concrete block.

Greenbloc has the potential to drive this acquisitive and British company to the forefront of the constructions industry's efforts to decarbonise.

It is worth pointing out though, that there is more to SigmaRoc than just Greenbloc.

Adding value through managing acquisitions well

The new decarbonisation technology of SigmaRoc's PPG Group is, of course, what makes the company interesting to us.

However, it's worth noting that the existing businesses are operating brilliantly.

SigmaRoc was founded in 2016 with the aim of making and developing acquisitions, in order to becoming a leading UK/European building materials company.

So far so good.

Its revenues have grown from £27 million in 2017 to £70 million in 2019, before a stellar year in 2020 when they grew 77% to £124 million.

When a company has been growing via acquisitions, it is a little difficult to assess the underlying, "organic" growth.

To do so, we can assess how the acquired companies have performed under SigmaRoc's management, compared to before.

According to a broker report from 2019:

> *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.*

Indeed, this seems to be what they have achieved in almost every case.

Take Ronez, for example.

Ronez's turnover increased from £24.4 million to £26 million in 2017, driving earnings before interest, taxes, depreciation, and amortisation (EBITDA) up 29% to £6.2 million.

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Then, in 2018, Ronez generated revenue of £27 million, and investment bank Liberum Capital estimated that EBITDA had risen by at least 40% in the first two years post acquisition.

The £23 million of "goodwill" (premium above fair value) paid by SigmaRoc at the time of the acquisition was also reduced to only £4 million, after Ronez's plant, property and equipment were subsequently revalued upwards to reflect a higher estimate of reserves at its two quarries.

This shows that SigmaRoc is both adept at spotting undervalued assets, as well as excellent at managing acquisitions once they have been incorporated.

It has also delivered 30% higher EBITDA from both Allen and Poundfield, on 8% higher revenue in the first 12 months under SigmaRoc's ownership.

SigmaRoc's other businesses span the entire construction materials value chain, from quarries to concrete.

But Greenbloc is what really sets SigmaRoc apart as a leader in the race to decarbonise the cement sector.

There is a specific reason why this is so.

Carbon credits

The EU has a system where it allocates "carbon credits" to companies, and then enables a free market in those credits.

We are incredibly bullish on this market for various reasons, including the fact that the EU is tightening the supply of these things over time.

SigmaRoc is perhaps an opportunity to benefit indirectly from this system.

At present, the EU gives industry such as cement companies a share of free carbon permits under its emissions trading system (ETS), allowing them to produce a certain amount for free.

According to the CEO at IIGCC and a member of the Climate Action 100+ steering committee, besides firms facing higher costs if they fail to cut emissions quickly enough (on the portion of emissions they still have to "cover" by buying permits in the market), they can also lose potential revenue coming from the sale of excess allowances as regulators tighten allocation of allowances in the programme.

Although Brexit means the UK left the EU ETS at the start of January 2021, the UK's version of the scheme launched in May – and is set up to copy the European equivalent in almost all ways.

In effect, by being a greener, lower carbon producer of cement and concrete blocks,

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SigmaRoc can reduce the number of expensive carbon credits it has to buy on the open market, reducing its costs.

And if it can do so enough, it might even be able to sell its excess credits.

That is a direct financial benefit to the company, but it's also a competitive benefit too, which should compound over time.

Being greener would make its costs lower than competitors, giving it a competitive advantage for winning clients and projects, helping it to grow and claim market share.

So being greener is not just about virtue, or climate.

There is a very direct way in which a construction materials company can benefit, financially and competitively, from being a lower-carbon company than the rest of the industry.

SigmaRoc's financials

At first glance, things are looking really good for SigmaRoc.

Its revenues have grown from £27 million in 2017 to £124 million in 2020.

That's up from £70 million in 2019 – a 77% increase.

EBITDA also more than doubled in 2020, from £9.6 million to £20.7 million.

However, these are difficult metrics to use when a company is regularly making new acquisitions, driving growth inorganically.

Nevertheless, as we discussed earlier, it looks as if SigmaRoc *is* materially improving the performance of its underlying businesses through better management and synergies.

In any event, its growth is still remarkable.

This is particularly the case when you compare SigmaRoc's prospects to those of the five large cap companies which make up the UK's building products stock market sector.

For the 2020 calendar year the five large players were expected to post single-digit earnings (net profit) growth, whereas SigmaRoc was predicted to report a 31% earnings per share increase.

Liberum Capital had expected SigmaRoc's cash flow* (from operations) to almost treble from £7.9 million in 2019 to £22.1 million in 2020, resulting in free cash flow of £11.1 million.

**Note: cash flow from operations is usually similar to EBITDA. Free cash flow is what is left after payment of interest and tax, as well as after repayment of maturing debts.*

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However, Sigmaroc went even better, with cash flow from operations topping £28 million in 2020, and free cash flow of £21.8 million.

This is important because of the nature of SigmaRoc's strategy.

Being an acquisition-led growth company, it needs new money to fund new acquisitions – for as long as it plans to keep adding now companies.

Naturally, this means more debt, as often such deals are financed by borrowing.

But an acceleration of cash flow generation reduces the company's dependence on debt finance, which is hugely beneficial.

Its long-term debt has increased quite sharply though, from £18.5 million in 2017 to £61 million in 2020, which leads me on to a discussion of some other risks to the company.

Risks

As is the case with almost all stock investments, risks exist.

The first issue is that this new product is very recently launched, and only by one company in one of five subsidiaries that make up SigmaRoc.

It's uncertain at this stage how successful the product will be. The PPG platform has ambitions to roll out low carbon equivalents of all its products – but it's not going as far as replacing its legacy products entirely.

Our belief is that, in time, the market will realise the immense value of Greenbloc, which provides a pointer for the direction of the entire cement industry.

SigmaRoc is ahead of the curve – but that doesn't mean that all cement producers will move rapidly to net zero carbon emissions anytime soon.

The second thing concerns broader market volatility that we are seeing today.

It doesn't feel like an environment to be piling into new recommendations with high leverage, or being too heavily exposed in general.

With inflation fears rising and bond yields following suit, the rationale of low interest rates supporting equity markets – and growth stocks in particular – might lead to some volatility. Our firm belief is that the energy transition is a multi-decade trend which is only beginning, but that doesn't mean valuations are going to rise in straight lines for 30 years.

Finally, the competitive landscape in construction is obviously immense, and the pressure to decarbonise concrete production is huge and increasing.

Other companies, large and small, will be coming to market with solutions to the

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challenge of reducing CO2 emissions.

SigmaRoc is unlikely to be out on its own for long in the race towards decarbonisation.

Nevertheless, its Greenbloc product could be a gamechanger for the cement industry – in the UK and elsewhere – where reduction in CO2 emissions is a key priority.

A great company with an exciting growth opportunity

As you know, decarbonisation – the reduction and/or removal of carbon emissions from the global economy – is a key theme for the global economy going forwards.

Exactly when the world economy becomes carbon-neutral – meaning that there are no net releases of CO2 – in 2040, 2050 or 2060 is a moot point.

What really matters is that it is the direction in which the world economy is moving.

The movement underpins enormous investment, involving trillions of dollars in green – or carbon-neutral – energy.

It's thanks to that investment that we can see growth opportunities in every one of the stocks that we like.

SigmaRoc, as one of the very few producers of "green" building, has an opportunity to play a large part in the race to make the world carbon neutral.

I recommend you buy it today.

Action to take: BUY SigmaRoc PLC (SRC:LON).

Please make sure you review the latest advice before purchasing. [Click here for the latest portfolio](). It's important to keep an eye on the latest updates and the portfolio. If the current price is above the buy-up-to price, wait until it has come back down to buy.

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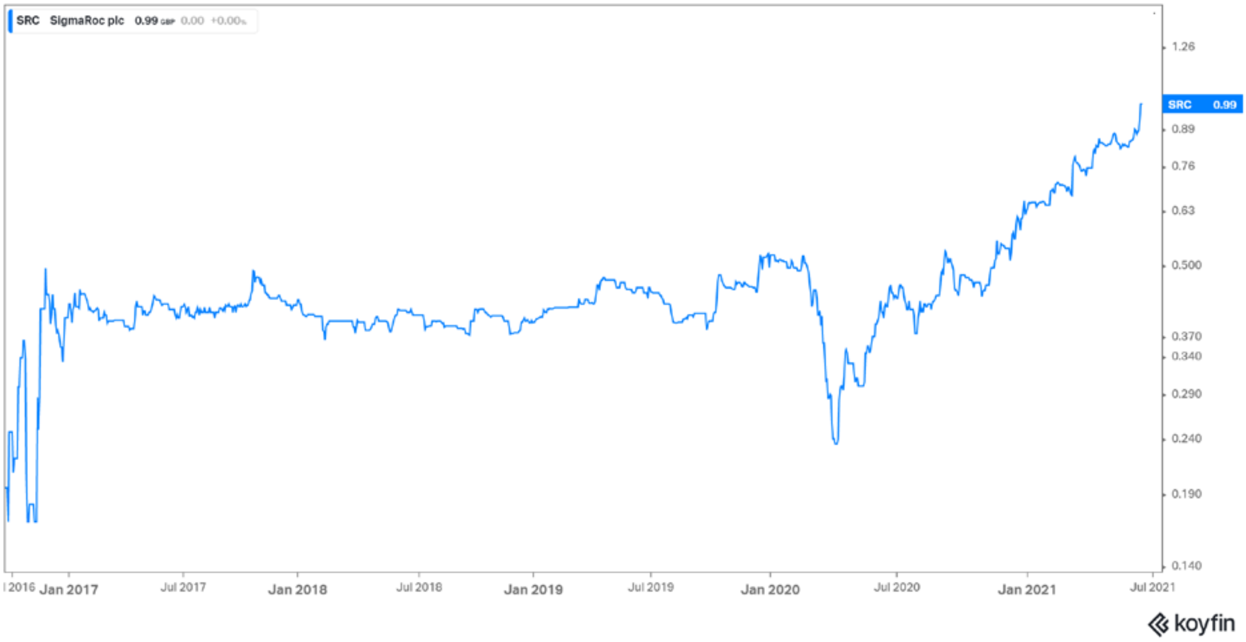

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