MOI GLOBAL

Gary Mishuris

Chief Investment Officer, Silver Ring Value Partners

BEST IDEAS 2019

SILVER RING
VALUE PARTNERS

ARCADIS (ARCAD NA) INVESTMENT OVERVIEW
BEST IDEAS 2019, HOSTED BY MOI GLOBAL

Gary Mishuris, CFA | Managing Partner, Chief Investment Officer

BIOGRAPHY

GARY MISHURIS, CFA

Managing Partner,
Chief Investment Officer

Professional Experience:

- Fidelity Management & Research (2001-2004): Equity Research Associate
- Evergreen Investments/Wells Capital Management (2004-2010): Vice President, Senior Equity Analyst/Portfolio Manager
- Manulife Asset Management (2011-2016): Managing Director, Portfolio Manager
- Silver Ring Value Partners (2016-present): Managing Partner, Chief Investment Officer

Prior to founding Silver Ring Value Partners in 2016, Gary successfully managed the US Focused Value strategy using a concentrated intrinsic value process at Manulife Asset Management from 2012-2016 as Lead Portfolio Manager.

Education:

Massachusetts Institute of Technology
Bachelors of Science in Economics, Computer Science (2001)

OBJECTIVE AND STRATEGY

The Fund seeks to compound capital over the long-term through a concentrated portfolio of well-researched securities.

Why Silver Ring Value Partners:

Competence:

Time-tested intrinsic value investment philosophy and process that have generated good results in the past.

Alignment:

Structured so that the investment manager can only build meaningful net worth if the clients do well over a number of years.

Passion:

Motivated by the intellectual challenge of investing and the desire to make a positive impact on others.

COMPETITIVE ADVANTAGE

Long-term Time Horizon – ability to take advantage of market inefficiencies

Limited Asset Base to preserve the ability to invest in the most inefficiently priced securities

Micro-Economic Focus – concentrate on opportunities where the key drivers of investment success are company- and industry-specific factors

Temperament to consistently implement a rigorous value investing process developed over fifteen years of professional experience

INVESTMENT PHILOSOPHY

- **Intrinsic Value:** A stock is a partial ownership interest in a business with its worth determined by the underlying business's long-term economics.
- **Margin of Safety:** An investment's margin of safety is determined by the combination of the *quality* of the underlying company and the discount from a conservative appraisal of intrinsic value offered by the *price*.
- **Long-term Time Horizon:** The focus is on achieving the best possible *compounding of capital* over a period of many years rather than managing short-term volatility of returns.
- **Rational and Disciplined Execution:** The market occasionally misprices securities for behavioral reasons. These arise due to market participants reacting to developments emotionally rather than rationally and to some market participants' misaligned incentives. By remaining rational and disciplined in the implementation of my process, I can both take advantage of the market's mistakes and guard against making mistakes of my own.
- **Concentrated Portfolio:** Investment opportunities that combine a company of high quality with a price that is at a material discount to intrinsic value are infrequent. After constructing a portfolio where being wrong on any single judgment should not result in a material loss of principal for the portfolio as a whole, additional diversification is more likely to increase rather than reduce risk by forcing the inclusion of increasingly inferior investments.

INVESTMENT PROCESS

Thesis Summary

Arcadis N.V. (Amsterdam: ARCAD NA) The company offers consulting and engineering design services worldwide without taking on the risk for the execution of the projects. The company is under new management with the board having removed the prior CEO and brought in the ex-COO of Fluor who is an engineer by training. The business had previously averaged a ~ 10% operating profit margin, but due to a combination of company-specific execution issues and a decline in oil-related infrastructure demand the company is currently closer to a 7% margin. My analysis leads me to conclude that management's actions should get the margin back part of the way to its historical levels aided by low single-digit organic sales growth. The stock has a high short interest, with short sellers claiming that the company is understating debt (currently at ~ 2.5x Net Debt/EBITDA based on company reports) and over-stating earnings. I have spoken to some of the short-sellers (whose work I have a healthy respect for) and carefully analyzed their assertions and my analysis leads me to believe that the company's finances are sound. Trading at less than 10x current run-rate depressed earnings and less than 7x what I estimate to be normalized mid-cycle EPS/FCF, **the stock is currently at less than half of my Base Case intrinsic value with a downside to the Worst Case of ~ 30%.** Risks include the company being unable to improve margins through management's actions, my analysis regarding the company's balance sheet proving to be incorrect and the risk of a global recession further lowering profitability in the medium term.

DCF Value	**EUR 7.5**	**EUR 21.3**	**EUR 39.5**		
Price	EUR 10.77	EUR 10.77	EUR 10.77		
Price % Value	**145%**	**51%**	**27%**		
Expected Return	**-31%**	**98%**	**267%**		
IRR	**8%**	**16%**	**25%**		
Implied P/E on Normalized EPS	10.0x	13.3x	16.8x		
Current P/E on Normalized EPS	13.2x	7.0x	4.7x		8.1x
Implied EV/EBITA	9.4x	11.6x	14.0x		
Current EV/EBITA	11.2x	7.3x	5.3x		7.6x

INVESTMENT PROCESS

Security Research and Valuation

Five-Step Research Process

Step 1	Step 2	Step 3	Step 4	Step 5
Company Quality Assessment	Analysis of Key Economic Variables	Financial Modeling	Valuation	Behavioral Checklist

The goal is to answer the following two questions:

- How predictable is the long-term economic outcome of the business?
- What is a reasonable range of intrinsic values?

INVESTMENT PROCESS

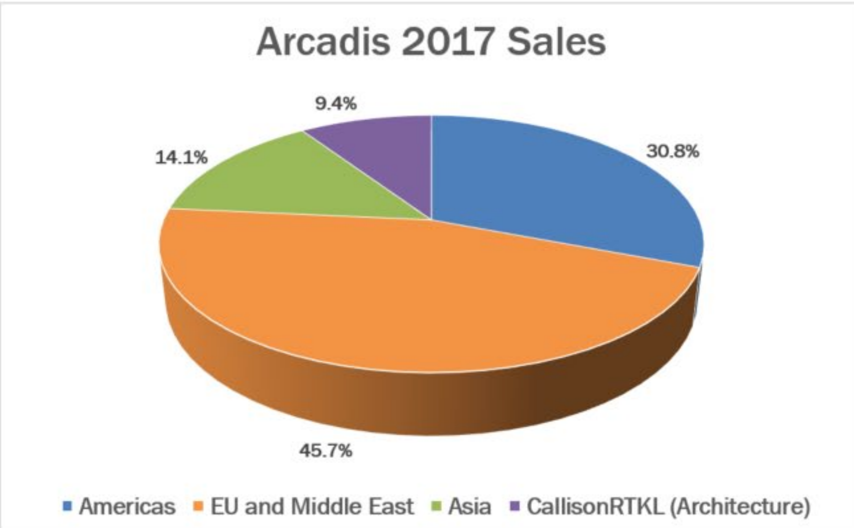
Security Research and Valuation

Step 1 Company Quality Assessment

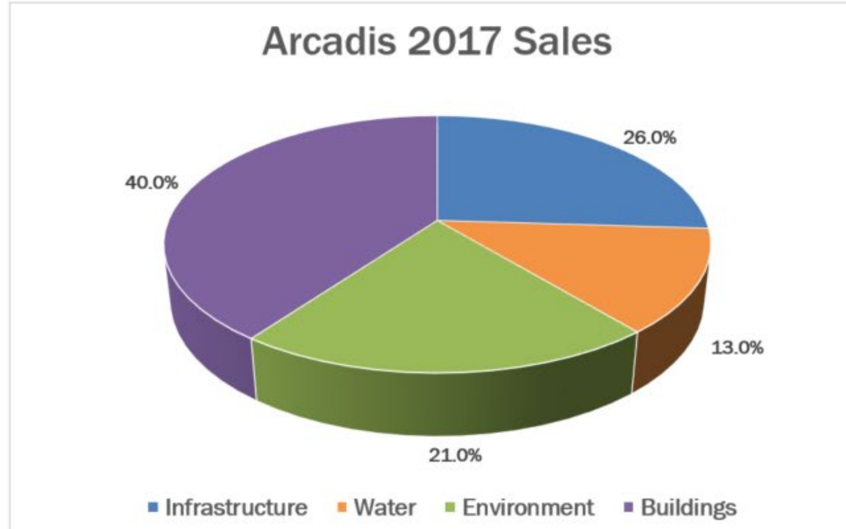
- **Business Quality** – industry's structural attractiveness and company's sustainable competitive advantage
- **Management Quality** – track record of operations and capital allocation as well as alignment of incentives
- **Balance Sheet Quality** – ability to withstand temporary adversity without reducing security value

INVESTMENT PROCESS

Business Overview



Source: Company reports



Source: Company reports

Arcadis is a global engineering and design consultancy. The company typically does not handle the execution of the projects, just the design, and is therefore a capital-light business.

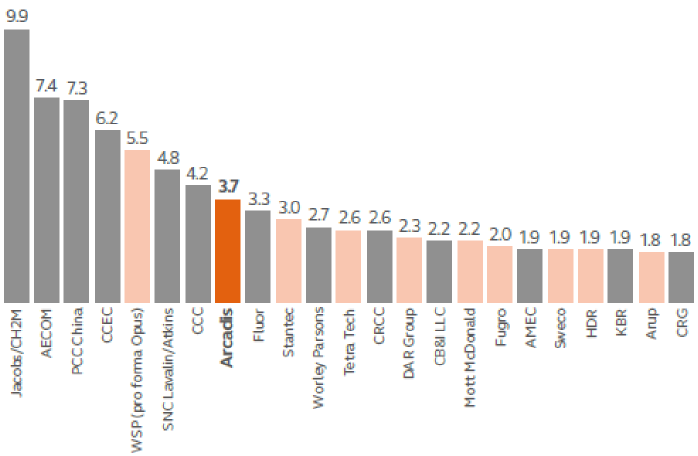
Strong niche competitive positions: #3 International Design Firm, #2 in Water, #1 in Buildings (Source: ENR rankings)

INVESTMENT PROCESS

Business Overview

GLOBAL PLAYERS

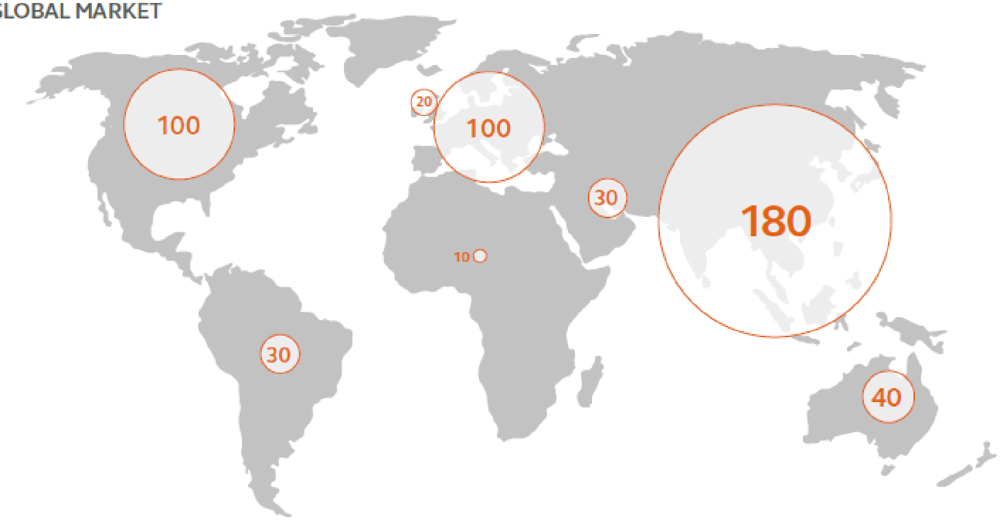
In US$ billion of engineering revenues



Integrated E&C firms   Pure play engineering firms

ENR 2017 ranking based on 2016 revenues, adjusted for recently announced acquisitions

GLOBAL MARKET



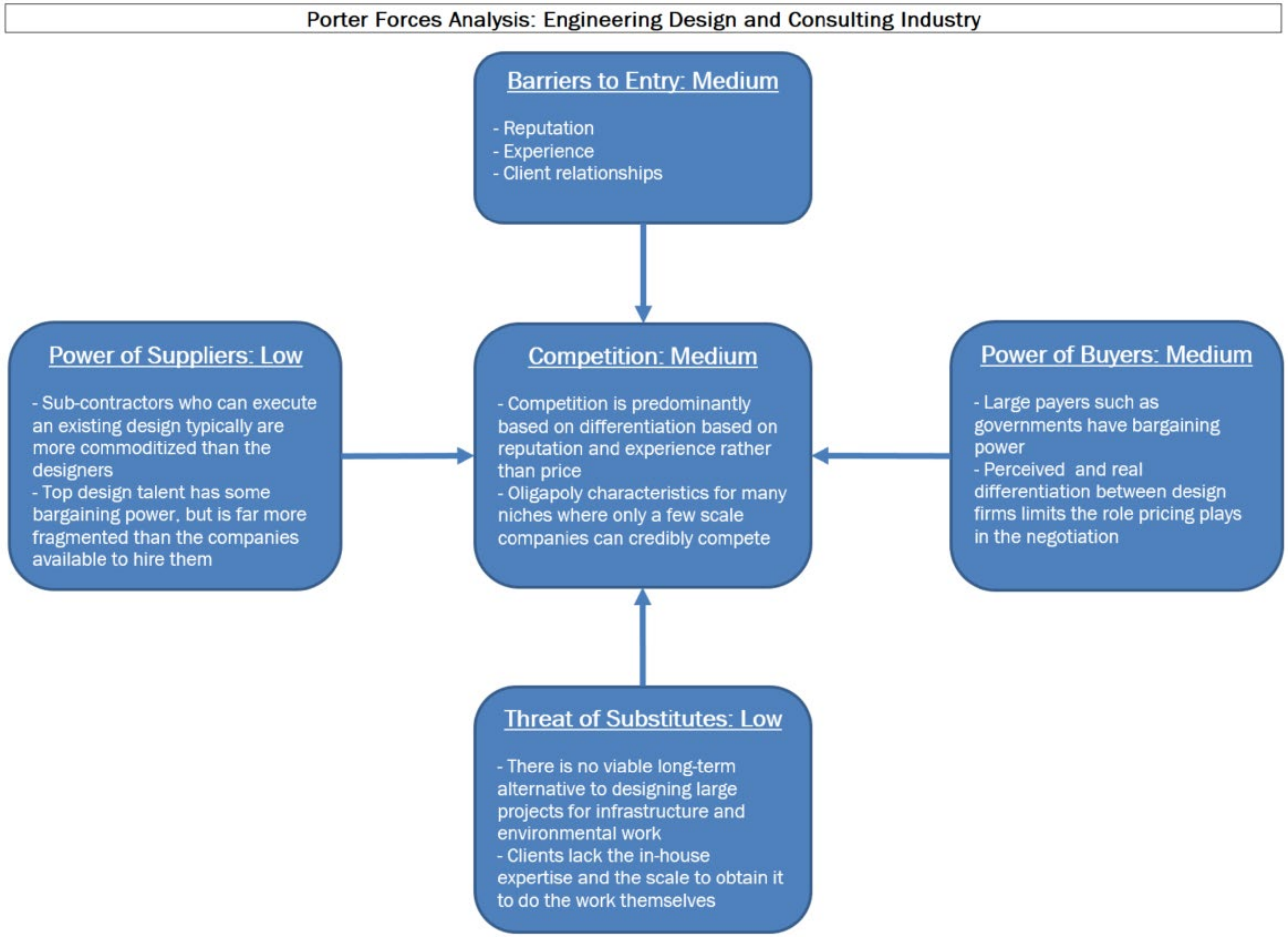
Addressable market in US$ billion

32 **Arcadis** Annual Integrated Report 2017

Arcadis is one of the largest global pure engineering and design firms

INVESTMENT PROCESS

Business Quality: Structural Industry Attractiveness



<u>Conclusion</u>: Engineering Design and Consulting industry is of **Above Average structural attractiveness**

INVESTMENT PROCESS

Business Quality: Competitive Advantage

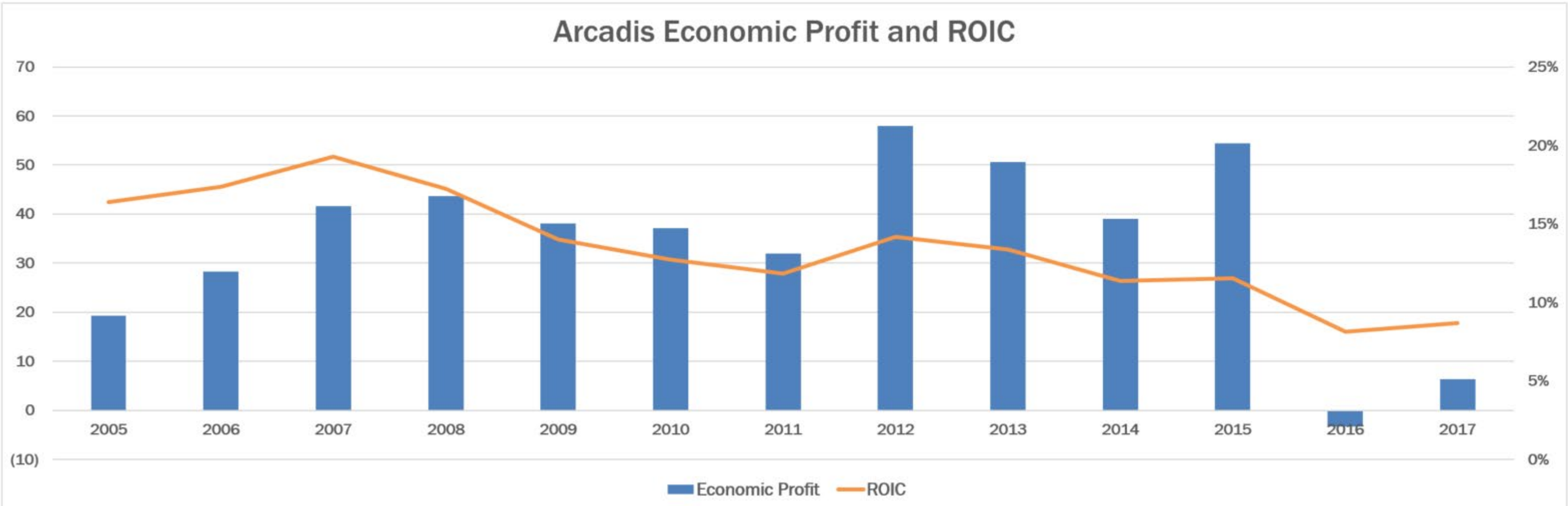
Sources of Sustainable Competitive Advantage

1. Strong reputation in key niches such as Environmental and Water
2. Quality organization of engineers and designers capable of doing the work well
3. Long-term track record of doing similar projects leads to many reference clients that can influence future wins

<u>**Conclusion:**</u> **Arcadis has a moderate competitive** advantage on average across its portfolio with some areas where the company is very strong and others where they are one of many qualified competitors

INVESTMENT PROCESS

Business Quality: Validation



Source: Company Reports, Silver Ring Value Partners estimates

- It is important to compare our qualitative analysis against historical financial metrics
- High quality businesses should have Return on Invested Capital well in excess of their cost of capital
- The above returns are despite a large number of acquisitions, with a particularly large deal in 2014
- Until the recent drop-off in margins the company had clearly added economic value through the cycle
- Financial results validate the qualitative analysis given that long-term ROIC comfortably exceeds cost of capital

Conclusion: Arcadis is an above-average business due to a combination of above-average industry attractiveness and a moderate competitive advantage

INVESTMENT PROCESS

Management Quality

What Determines Management Quality

1. Track-record of a) operating the business b) capital allocation
2. Alignment of incentives with shareholders

Arcadis Management History

- Harrie Noy (CEO until May 2012): Led the company for many years, combination of acquisitions and organic growth
- Neil McArthur (CEO from 2012 until 10/2016)
  - Former consultant
  - Managed the company by spreadsheet, setting unrealistic targets top-down and did a large deal in 2014
  - Fired by the board after he failed to achieve goals at the end of 2016
- Peter Oosterveer (CEO from April 2017 through present)
  - Engineer by background
  - Former COO of Fluor, President of Fluor's Energy and Chemicals business prior to that
  - Focus on execution, profitability, and mostly organic growth
  - "While our focus is on organic growth, we continue to look for opportunities to further expand our service offering and invest in digitization." – CEO 2017 Annual Letter

INVESTMENT PROCESS

Management Quality

- In 2017 I did a due diligence call with an ex-Arcadis executive. Despite being let go from the firm by the prior CEO (and therefore having a potential bias to be negative on the company), the person told me that the culture was still intact and that the key people were energized by the arrival of the new CEO who was "one of them" (an engineer).

Source: Glassdoor.com as of 1/6/2019

- Glassdoor survey data shows a good absolute rating and more importantly a sharply improving trend in employees' perception of the company and the CEO

INVESTMENT PROCESS

Management Quality

Glassdoor Ratings				
	Rating	Recommend to a friend	Approve of CEO	No. of Ratings
Aecom	3.2	56%	65%	1,474
Hill International	3.1	40%	34%	26
CH2M	3.5	63%	63%	428
Jacobs	3.4	66%	83%	467
Fluor	3.8	78%	71%	592
Poyry	3.4	56%	70%	7
RPS Group	3.0	52%	71%	15
SNC Lavalin	3.4	62%	77%	125
Stantec	3.3	53%	74%	67
Sweco	3.6	72%	100%	4
Tetra Tech	3.4	63%	81%	165
Worley Parsons	3.3	57%	59%	377
WS Atkins	3.6	70%	83%	51
WSP	3.4	62%	76%	160
Arcadis	**3.8**	**77%**	**87%**	**68**
Industry Average ex- Arcadis	**3.4**	**61%**	**72%**	**283**
Global High Quality Companies				
Walt Disney	3.8	73%	82%	1,495
Google	4.4	89%	93%	2,467
Apple	4.0	78%	91%	8,143

Source: Glassdoor.com as of 1/6/2019

- Glassdoor employee survey data compares very favorably with competitors/peers
- Survey results not far from some of the better-managed large, global companies

INVESTMENT PROCESS

Management Quality

PERFORMANCE CRITERIA

In order to support the Company's strategy, the financially driven criteria determine 75% of the short-term variable remuneration, reflecting the Company's financial priorities, while the non-financial criteria determine 25% of the remuneration.

In %

CRITERION	Weight
FINANCIAL CRITERIA	**75**
Collective financial criteria:	50
- Earnings per share	25
- Return on invested capital	25
Individual financial criteria:	25
- CEO: organic growth (all operating segments)	
- CFO: free cash flow	
- EB members: organic growth (operating segments)	
NON-FINANCIAL CRITERIA	**25**
- Strategy implementation	
- People development	
- Role modeling behavior	
- Health & Safety	
TOTAL	**100**

- Compensation outlined in the 2017 Annual Report includes a meaningful ROIC and FCF components
- Long-term incentives structured around relative Total Return vs. peer group on a 3-year basis

INVESTMENT PROCESS

Management Quality

Summary:

- This is a turnaround: management and culture matter – a lot!
- So far no meaningful undesired turnover following new CEO starting (primary research + LinkedIn Insights data)
- Employee morale seems to be both improving and company and CEO well perceived by employee base on average both in absolute terms and relative to similar metrics for peers
- Incentives seem to be reasonably well aligned with a good balance between operating metrics like EPS and organic revenue growth, ROIC and relative TSR
- New CEO focused on a back-to-basics approach to improve profitability and grow mostly organically with the exception of a few technology acquisitions to help digitize the business
- CEO is still unproven as he has never been a public-company CEO nor has he yet accomplished his objectives at Arcadis
- Stichting Lovinklaan Foundation (employee-led) owns 18% of the shares and provides additional oversight over management to ensure alignment (e.g. firing of the underperforming CEO by the board)

Conclusion: Management is Average to Above Average

INVESTMENT PROCESS

Balance Sheet Quality

What Determines Balance Sheet Quality

1. Ability to withstand temporary adversity without needing to raise capital
2. Appropriate leverage relative to profitability that doesn't necessitate the use of Free Cash Flow to reduce debt

Short Thesis Against Arcadis:

- There is a substantial short interest in Arcadis stock
- I have a healthy respect for the level of work that short-sellers do and do not take this lightly
- I believe in actively seeking out opposite points of view to de-bias myself and have spoken with one of the main short sellers to fully understand his thesis
- The summary of the thesis is that the short sellers believe the company 1) is under-stating its debt 2) over-stating its profits 3) will have trouble refinancing upcoming notes and 4) is going to implode just as service companies such as Carillion, Capita and Mitie have recently

INVESTMENT PROCESS

Balance Sheet Quality

Short Thesis Point #1: Arcadis is under-stating its debt

- Gross Interest Expense EUR 33.8M (Cash Flow Statement)
- Interest Expense Rate on Gross Debt was 3.2% for 2017 (Footnote 27)
- Dividing gross debt by the interest expense you would get EUR 1.06B instead of EUR 690M that the company reports on the balance sheet
- The short sellers believe the company is manipulating end-of-period numbers to appear lower than year-average debt really is

Likely Explanation

- The company uses notional pool accounting, which means that various entities within the group borrow from each other and pay interest to each other
- Cash Flow Statement has EUR 9.9M interest received, a significant portion of which is likely due to this inter-company borrowing/lending
- If we assume that half is due to this and reduce gross interest expense accordingly, the implied debt would be EUR 900M
- Furthermore, it's possible that gross interest includes a portion of pension-related expense, which would account for the remaining difference

INVESTMENT PROCESS

Balance Sheet Quality

Short Thesis Point #2: Arcadis is over-stating its EBITDA

- The company capitalized EUR 26.3M in 2017 related to intangibles under development for an ERP system that is being built but is not yet in use
- The short sellers believe this inappropriately increases EBITDA and should really be expensed

My View

- I checked with one of our LPs who is a CFO of a major public company regarding accounting treatment. He explained that it is standard practice to capitalize such software-related costs for large ERP systems
- This makes sense from first principles as well: you are creating a future asset with a multi-year useful life from which you are not yet deriving any current economic benefit
- I believe that it is appropriate to capitalize these expenses and then amortize them once the system is in use

INVESTMENT PROCESS

Balance Sheet Quality

Short Thesis Point #3: The company will have trouble refinancing near-term maturities

18 LOANS AND BORROWINGS

Loans and borrowings as at period-end are as follows:

In € thousands	INTEREST RATES BETWEEN	30 JUNE 2018	31 DEC 2017
Bank loans	1.3% - 5.0%	198,852	194,427
Loan notes issued to financial institutions	1.7% - 5.1%	374,930	445,841
Financial lease contracts	3.0% - 4.0%	120	85
Other long-term debt[1]	3.0% - 6.9%	8,734	7,262
Short term borrowings	0.8% - 1.0%	130,000	41,080
TOTAL LOANS AND BORROWINGS		**712,636**	**688,695**
Current[2]		328,286	214,266
Non-current		384,350	474,429
TOTAL		**712,636**	**688,695**

1 Including retentions and expected after-payments not due within one year, amounting to €7.9 million (31 dec 2017: €6.5 million)
2 Excluding after-payments for acquisitions

Aggregate maturities of non-current loans and borrowings are as follows:

In € thousands	30 JUNE 2018	31 DEC 2017
2019	10,013	104,180
2020	129,358	127,874
2021	93,940	91,608
2022	111,065	110,790
2023	39,974	39,975
BALANCE AT PERIOD-END	**384,350**	**474,429**

- According to the half-year debt schedule (above) and disclosures in the 2017 Annual Report, the bank revolver is due in 2019 and $90M of private placement notes are maturing in 2018
- The short sellers believe this will create a refinancing crisis for the company

INVESTMENT PROCESS

Balance Sheet Quality

My View Regarding Short Sellers' Point #3 (Refinancing Risk)

- Anything is *possible* but we have to look at what is *likely*
- The company is well within its debt covenants (more on this later)
- It is producing consistent annual Free Cash Flow well in excess of its dividend
- It is focused on reducing debt even further
- The business is growing organically and management is focused on improving profitability
- At least 320M of the debt is termed out to 2021-2023 according to the 2017 Annual Report

Conclusion: Under these circumstances I view it as extremely unlikely that the company will have trouble refinancing its debt obligations in 2019. If I am correct in my assessment this will remove a major overhang on the stock and substantially weaken the validity of the short-sellers' thesis.

INVESTMENT PROCESS

Balance Sheet Quality

The company has a legacy money-losing JV in Brazil that it is trying to sell in 2019:

Non-core clean energy assets Brazil (ALEN):

- Gas-to-gas plant operational, certified and has started limited delivery of gas to the market
- Final negotiations with several parties, including the Rio metropolitan utility gas company (CEG) on long term off-take contracts for the remaining renewable natural gas
- The loss from the associate in the quarter was €6 million
- Re-assessment of the business case led to an impairment and provision of in total €53 million

24 October 2018 | Q3 2018 trading update | © Arcadis 2018 3

ARCADIS Design & Consultancy for natural and built assets

- Arcadis has issued EUR 86M of debt guarantees to the JV which are not included in the debt
- Adopting a “hope for the best, but prepare for the worst” approaching, I am assuming that the amount of the guarantee should be counted as debt for Arcadis
- While the new, more business-friendly administration has entered office in Brazil, it is hard to be sure whether management will realize its goal of exiting ALEN

INVESTMENT PROCESS

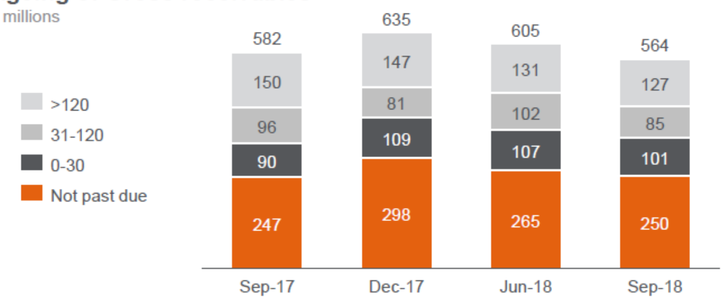
Balance Sheet Quality

Arcadis has some legacy stale receivables from Middle Eastern countries:

IMPROVEMENT IN AGEING OF RECEIVABLES, WORKING CAPITAL AND DSO

Ageing of Gross receivables

€ millions



	Sep-17	Dec-17	Jun-18	Sep-18
Gross Receivables	**582**	**635**	**605**	**564**
Provision Receivables	-51	-57	-56	-55
Provision %	8.8%	8.9%	9.3%	9.8%
Trade Receivables [1)]	**531**	**578**	**549**	**509**
Net Work In Progress	280	202	270	281
Net Trade Receivables	**811**	**780**	**819**	**790**
Accounts payables	-203	-237	-204	-205
Net Working Capital	**608**	**543**	**615**	**585**
Net Working Capital %	**19.8%**	**16.9%**	**18.8%**	**18.1%**
DSO	**96**	**88**	**91**	**89**

- Gross receivables at €564 million, improvement:
  - vs. Q2: €40 million, reduction across all ageing buckets
  - YoY: €18 million, driven by reduction long overdues Middle East
- Net Working Capital improved to 18.1% and DSO down 7 days YoY to 89 days; largely driven by collection efforts of overdue receivables

- As of the Q3 2018 update (above) the company had EUR 127M receivables more than 120 days past due against which it had ~ EUR 55M of reserves
- If we assume that none of those would get paid, that would be an extra 72M hit

INVESTMENT PROCESS

Balance Sheet Quality

The company has two debt covenant ratios that it needs to comply with:

DEBT COVENANTS

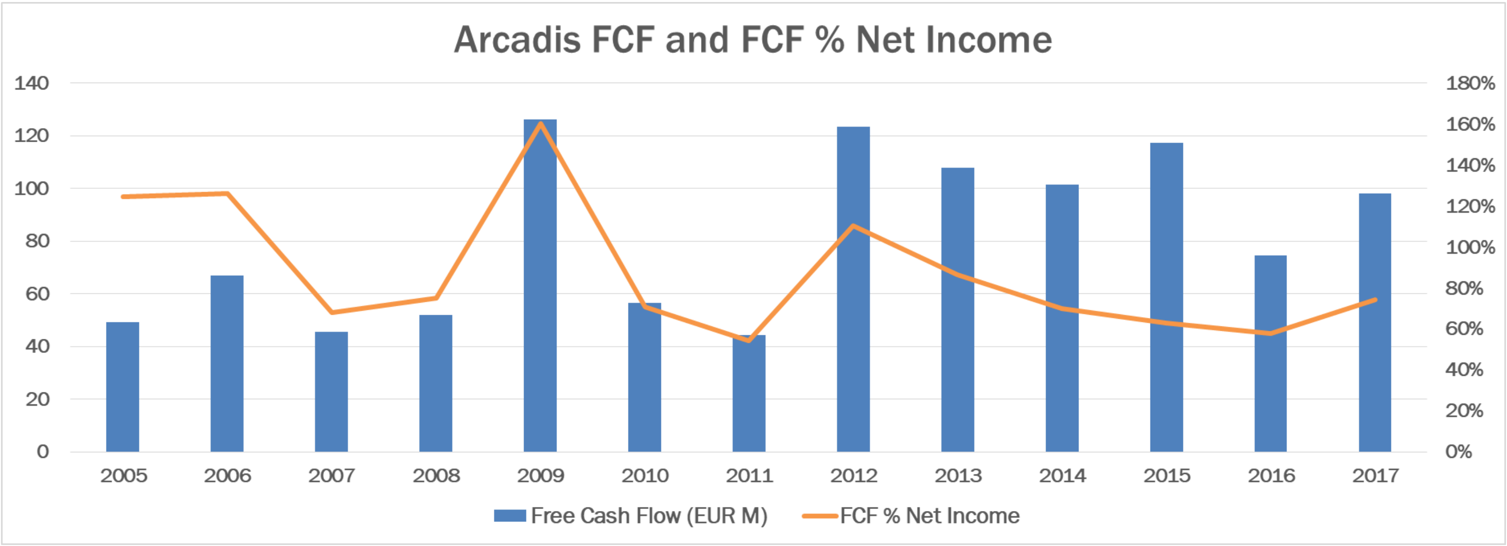
The debt covenant for the above mentioned long-term debt facilities states that the average net debt to EBITDA ratio is not to exceed the maximum ratio of 3.0, which is confirmed to the group of banks twice a year. At 31 December 2017, the average net debt to EBITDA ratio calculated in accordance with agreements with the banks is 2.3 (2016: 2.5), see note 29.

With effect from 31 December 2013, a lease-adjusted interest coverage ratio is also applicable in which EBITDA to Relevant Net Finance Expense (Net Finance Expense plus Operating Lease Expense) must exceed 1.75. At 31 December 2017, this ratio calculated in accordance with agreements with lenders is 2.4 (2016: 2.3).

- As of the half-year report the company's reported Net Debt/EBITDA ratio was 2.2x vs 2.5x at H1 2017
- If we count the JV guarantee as debt the ratio would be ~ 2.6x
- If we also assume that the company needs to replace the EUR 72M of additional bad receivables with debt, that would bring the ratio to 2.9x
- None of this assumes any improvement in EBITDA or any additional debt reduction from FCF

INVESTMENT PROCESS

Balance Sheet Quality



- Arcadis has generated consistently strong Free Cash Flow
- Over the period of 2005 through 2017 Free Cash Flow amounted to 82% of Net Income over that time period, supporting the quality of its earnings
- In 2017, before any progress from the new CEO's turnaround efforts the company produced FCF of 98M compared to the current market cap of 940M and reported net debt of less than 500M

INVESTMENT PROCESS

Balance Sheet Quality

Summary:

- I believe the substantial majority of the probability is that the company is not under-stating its debt as the short-sellers claim
- If my analysis is correct then we have a company with ample FCF with Net Debt/EBITDA of less than 3x for a business that is moderately cyclical (but for which a major component of demand, energy infrastructure, is already close to trough levels)
- The company does need to renew its bank revolver in 2019, but this is not an unusual event – many companies periodically have to do this and given that the company is in compliance with its covenants I do not believe it should have major difficulty getting a new revolver
- If things go according to plan, then 2019 should remove several balance sheet-related overhangs (refinancing of the bank revolver, resolution of the ALEN JV guarantees)
- I never want to be arrogant and know that it's possible that I am wrong, but strongly believe that my conclusions are substantiated by my analysis of the facts

Conclusion: The company has an **Average Balance Sheet**

INVESTMENT PROCESS

Security Research and Valuation

Step 2

Analysis of Key Economic Variables

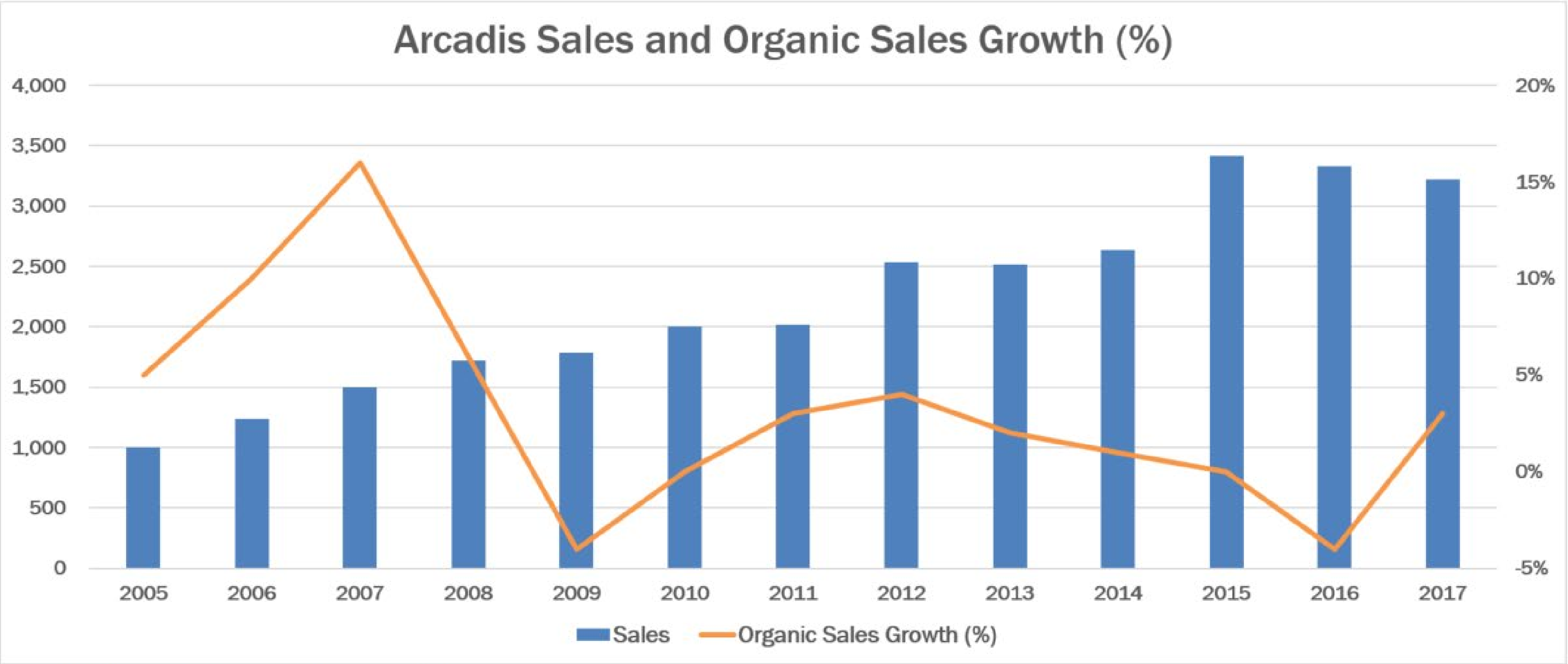
- Identify key economic variables most likely to materially impact the long-term business outcome
- Establish a range of reasonable values for each variable under different scenarios

If we could only know 5 or fewer things about the business 10 years from now, what would they be?

1. Organic Sales Growth
2. Degree to which the company can restore profitability to prior levels
3. Need to use Free Cash Flow to shore-up the balance sheet

INVESTMENT PROCESS

Key Economic Variables – Organic Sales Growth

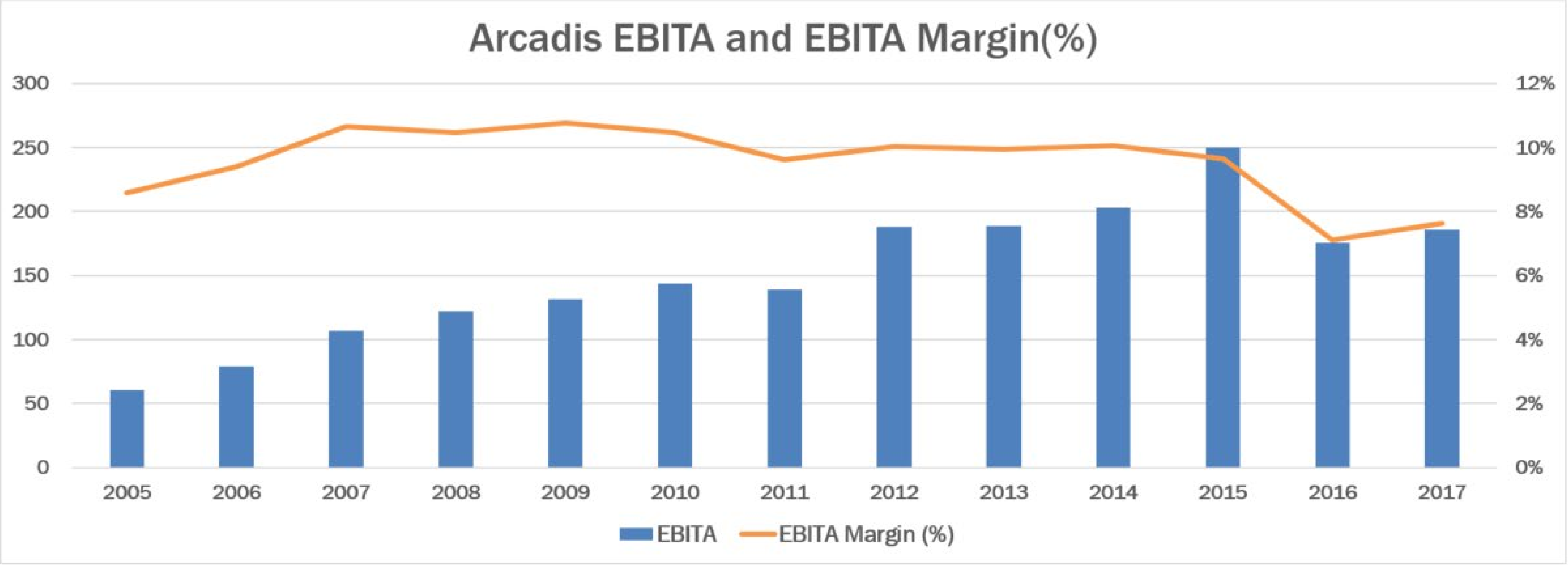


Source: Company Reports, Silver Ring Value Partners estimates

- Average of 2005-2017 organic sales growth = ~ 3%
- YTD organic sales growth = 4%
- A substantial part of the business (Brazil, energy-related infrastructure) is likely near trough demand
- Assuming future growth in the range of **0% to 5% with a Base Case of 3%**

INVESTMENT PROCESS

Key Economic Variables – EBITA Margin (%)



Source: Company Reports, Silver Ring Value Partners Analysis

- Average EBITA margin between 2005-2017 = 9.6%
- 2018 YTD EBITA margin = 7.3%
- Management focused on profitability, selecting only profitable projects and pricing based on value
- Assuming long-term EBITA margins in a range of **7.3% to 10% with a 8.5% Base Case**

INVESTMENT PROCESS

Key Economic Variables – Balance Sheet/ALEN JV

- Accounts Receivables past 120 days were ~ 72M net of reserves
- ALEN JV in Brazil lost 12M in 2017 and had 86M in Arcadis guarantees for its debt
- Company is targeting Net Debt/EBITDA below 2x

Assumptions:

- In the Base Case, assume 50% of the 72M of stale A/R goes bad and needs to be replaced with cash (100% in the Worst Case, 25% in the Best Case)
- In the Base Case, assume ALEN JV breaks even but cannot be sold so that the 86M of guaranteed debt needs to be brought onto Arcadis balance sheet (Worst Case assumes it continues to lose 12M/year, Best Case assumes it makes a modest profit and can support its own debt)

INVESTMENT PROCESS

Security Research and Valuation

Step 3 **Financial Modeling**

Use the analysis from Steps 1 and 2 to model the company's income statement, balance sheet and cash flow statement, and create 3 scenarios:

- *Worst case*, where each key economic variable has its *worst* likely outcome
- *Base case*, where each key economic variable has its *most* likely outcome
- *Best case*, where each key economic variable has its *best* likely outcome

INVESTMENT PROCESS

Financial Modeling

ARCADIS NV (ARCAD NA) Model & Value Estimate	Worst	Base	Best	LFY	LT Avg	LFQ
Sales	**2,193**	**2,566**	**2,920**	**2,437**	**1,924**	**2,428**
EBITDA	**203**	**269**	**350**	**226**	**212**	
EBITDA (%)	9.3%	10.5%	12.0%	9.3%	11.0%	
Depreciation	44	51	58	40	34	
% Sales	2.0%	2.0%	2.0%	1.6%	1.8%	
EBITA	**159**	**218**	**292**	**186**	**178**	**185**
EBITA (%)	**7.3%**	**8.5%**	**10.0%**	**7.6%**	**9.3%**	**7.6%**
Interest Expense	24	27	33	26		
Tax Rate	25.0%	23.3%	21.5%	20.0%	26.7%	
Equity Income	-12	0	6	-12		
Net Income	**92**	**147**	**208**	**119**		
Shares	88.2	88.2	88.2	87.8		
EPS	**EUR 1.05**	**EUR 1.66**	**EUR 2.36**	**EUR 1.35**		
Organic Sales Growth	**0.0%**	**3.0%**	**5.0%**	**1.0%**	**5.3%**	
Forecast Period Growth	**0.0%**	**4.0%**	**6.0%**			
FCF % Net Income	**100%**	**95%**	**103%**	**70%**	**79%**	
Forecast Period	**5**	**10**	**10**			
Years Until Normal Year	**0**	**2**	**2**			
EPS % of Normal Prior to Normal Year	**75%**	**65%**	**80%**			
% of FCF Reinvested	**0%**	**0%**	**25%**			
Return on Reinvested FCF	**10%**	**13%**	**13%**			
Debt	568	568	568	539		
Debt/EBITDA	**2.8x**	**2.1x**	**1.6x**	**2.4x**	**2.6x**	

INVESTMENT PROCESS

Security Research and Valuation

Step 4 **Valuation**

- Estimate the range of intrinsic values for the business using Discounted Cash Flow (DCF) analysis
- Perform sanity checks on each part of the range by checking other valuation metrics, such as normalized P/E, EV/EBITA, and Price to Book (P/B) ratios

INVESTMENT PROCESS

Valuation

ARCADIS NV (ARCAD NA) Model & Value Estimate					
	Worst	**Base**	**Best**	**LFY**	**LT Avg**
ROITC	**25.1%**	**35.3%**	**48.3%**	**33.4%**	
ROIC	**7.7%**	**10.8%**	**14.8%**	**9.8%**	
Other Assets/Sh	(EUR 3.00)	(EUR 0.83)	(EUR 0.21)		
Net Cash	$0	$0	$0		
Unfunded Pensions	$0	$0	$0		
Future Contingent Payments	(EUR 265)	(EUR 73)	(EUR 19)		
DCF Value	**EUR 7.5**	**EUR 21.3**	**EUR 39.5**		
Price	EUR 10.77	EUR 10.77	EUR 10.77		
Price % Value	**145%**	**51%**	**27%**		
Expected Return	**-31%**	**98%**	**267%**		
IRR	**8%**	**16%**	**25%**		
Implied P/E on Normalized EPS	10.0x	13.3x	16.8x		
Current P/E on Normalized EPS	13.2x	7.0x	4.7x	8.1x	
Implied EV/EBITA	9.4x	11.6x	14.0x		
Current EV/EBITA	11.2x	7.3x	5.3x	7.6x	

INVESTMENT PROCESS

Valuation – Sanity Checks

- Current price puts the stock at 7x my Base Case normalized EPS estimate
- My Base Case value estimate implies a P/E of 13.3x normalized EPS at a sustainable capital structure and an EV/EBITDA of 9.4x
- Aecom bought URS in 2014 at 8x EV/EBITDA. URS had a much higher US mix and therefore a higher tax rate than Arcadis does at the time
- Jacobs Engineering purchased CH2M Hill for $2.6B at ~ 10x EV/EBITDA pre-synergies
- WS Atkins bought SNC-Lavalin for $4.2B (including pension deficit) or 13.6x EV/EBITDA pre-synergies in 2017

INVESTMENT PROCESS

Valuation – Sensitivity Analysis

What if the short sellers are right about Arcadis understating its debt?

- Short sellers believe gross debt is EUR 1.06B (33.8 gross interest / 3.2% interest rate)
- Let's assume we also have to take on the 86M ALEN JV guarantees on the balance sheet
- And let's further assume that we need to replace 75M of bad receivables with debt to fund working capital
- Currently the company has ~ 250M in cash, so this would put Net Debt at 970M
- This level of debt would put the company at 3.6x Net/Debt to EBITDA based on my Base Case and at 4.1x based on trailing 12 months actual results
- Let's assume that we need to get from 4.1x Net Debt/EBITDA to 2.5x to be comfortably below the 3x bank covenant
- The company would need to raise 380M of capital
- Assume they issue equity to raise this capital at a 50% discount to current market price
- **This would add 70.4M new shares and would reduce the Base Case value to EUR 12 per share**

INVESTMENT PROCESS

Valuation – Sensitivity Analysis

Additional Sensitivity Analysis			
Key Assumption Change	Change in Base Case Value	New Base Case Value	New Price % Value
Base Case sales growth is 0% instead of 3%	6.60	14.70	73%
Base Case EBITA Margins = Worst Case of 7.3%	3.80	17.50	61%
Base Case assumptions for ALEN and A/R changed to Worst Case	3.40	17.90	60%

INVESTMENT PROCESS

Security Research and Valuation

Step 5

Behavioral Checklist

- Ask a series of questions to guard against behavioral biases before finalizing the analysis
- Checklist includes questions such as:
  - Have the most recent developments – positive or negative – colored the analysis of the company's prospects disproportionately to their long-term significance?
  - If the markets closed and I couldn't sell this security for five years, would I be comfortable owning it?
  - Do I have emotions – positive or negative – towards this investment?

INVESTMENT PROCESS

Portfolio Construction

Quality Assessment:

- Margin of Safety comes from considering the combination of the quality of the company and the discount to intrinsic value.
- The goal is to avoid below-average businesses, as it is too hard to estimate their value accurately.
- The minimum required expected IRR is 12% for the highest quality businesses and increases to 15% for average businesses.

PURCHASE GUIDELINES

	Business Quality		
	Average	Above Average	Excellent
Price as % of base case value	<55%	<65%	<75%

- Arcadis clearly qualifies for purchase as my Business Quality assessment is 'Above Average' and the stock is priced at less than 65% of Base Case value

INVESTMENT PROCESS

Portfolio Construction

Position Sizing:

Three principles are used to size positions within the portfolio:

- Portfolio at Risk (PaR) – PaR is the position size multiplied by the downside to the worst case value estimate. As an example, a 10% position with worst case downside of 30% would have a PaR of 3%. PaR will typically not exceed 5% at purchase.
- Risk of permanent capital loss declines as company quality increases. Increasingly higher quality parameters are a prerequisite for larger positions in the portfolio.
- No position size should be so large that a complete loss, however improbable, would result in capital loss that the rest of the portfolio would be unable to overcome.

POSITION SIZING GUIDELINES

	Position Size		
	Small (5%)	Medium (10%)	Large (15%)
Price as % of Base case value	<75%	<75%	<75%
Business quality	Average+	Average+	Above Average+
Balance Sheet quality	Any	Average+	Above Average+
Management quality	Any	Average+	Above Average+
Downside to Worst case	Any	<35%	<35%

INVESTMENT PROCESS

Portfolio Construction - Allergan Position Sizing

- **Initially made Arcadis a small (5%) position** at ~ EUR 14 in March 2017 when it fell below 65% of Base Case Value
- **Increased the position size to a medium (10%) position** in 2018 at prices between EUR 11 and EUR 14 with the stock between 50% and 60% of Base Case value

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