Company Analysis of

MITIE

Date

September 2011

The Investment Checklist

Reasonable Size

The Market cap must be above £50M. This isn't a magic number but it rules out very small companies which have a greater trading spread and are often more volatile companies.

£850M

Low Debt

Net Debt (interest bearing debt minus cash equivalents) must be less 5 times the current earnings. This means that the debt should be manageable. Another check is that interest is covered at least 5 times.

1.9 years to pay off all debt.

Debt must have been low throughout the past 10 years rather than just in the last year or 2, otherwise earnings results are not comparable.

The company has either had net cash or interest cover of around 30 times.

Interest cover must be above 5.

41.

Consistent, Sustainable Growth

The company must be currently profitable, paying a dividend and generating free cash.

Yes.

The 10 year growth rate in earnings per share, turnover and dividend payments must be at least 30%. This means they have at least kept pace with inflation.

They've all grown by around 300%.

The net asset value per share should have increased by at least 30% in the last 10 years. Although not directly important, this will help rule out companies that are wasting their assets away to generate earnings or dividends. This of course is not sustainable.

300%.

Earnings, revenue and dividends have grown in at least 7 out of the last 10 years. If there are any drops in dividend or earnings it must be made up, or very close to made up, in the following year. Consistency is important as you want companies that can perform well over time and through various market conditions with various managers in place. This is exactly what you want heading into an unknown future.

Eps 10/10
Dividend 10/10
Revenue 10/10

There must be no losses in the last 10 years

None.

High returns on equity and retained earnings

The 10 year average return on equity should be above 10%.

20%

Return on retained earnings should be above 10%.

23%

Sustainable growing dividend with a good starting yield

For the dividend to be sustainable, total free cash generated over the last 10 years should be more than the total dividend paid out.

It’s three times as much.

What is the initial dividend yield and earnings yield?

Dividend = 4%

Earnings yield = 9.5%
3yr earnings yield = 8.5%

Projected Returns

The projected returns over 5 years must be at least 100%. This would be the average of the two projection methods, one using historical returns on equity and the other using historic earnings growth rates.

188%

Qualitative Factors

A simple understandable business

Describe what the company does in very simple terms.

MITIE is primarily an outsourcing and energy services company. They cover four main areas of Facilities Management (25% revenue), Technical FM (50% revenue), Property Management (20% revenue) and Asset Management (5% revenue).

What this actually means is they provide many of the services required to run buildings, such as cleaners, security, catering, engineers, energy reduction consultancy, fit-out, repairs, insurance claim management and much more.

With their centralised systems they can run these services more efficiently than their clients and more efficiently than if their clients used multiple different suppliers.

Low cost durable competitive advantage

Do they sell a unique product or service?

No. But they have a unique management system. Management Incentive Through Investment Equity. It's a system where they help fund teams with innovative ideas, giving the new management a healthy equity share. The incentive is that if they grow the new company over 5 or 10 years they can sell out in full to MITIE and perhaps get rich in the process.

Do they have a brand name that will make customers choose them over a competitor?

Yes. Mitie is a leading FM company with a very well known name.

Are they the lowest cost producer in a commodity business?

No.

Are they number 1 or 2 in their business?

They are certainly a major player but not necessarily #1 in their key markets.

Who are their main competitors?

Capita, Serco and other large outsourcing companies.

Describe the company's low cost durable competitive advantage.

Mitie doesn't have a low cost durable competitive advantage.

Rational management

The return on retained earnings needs to be above 10%, otherwise management is wasting your money.

23%

Have they allocated capital into their area of expertise or have they spent it on all sorts of non-core management fantasies?

Mostly.

Do they need to spend lots of capital on upgrading equipment or on R&D or does their product or service never need changing, like coke or doing people's taxes?

Not much need for capex or R&D for security and cleaning services.

What are their long term goals and strategies for the future? Do these involve big changes? Businesses that don't change much are usually better.

They are focussed on sustainable, profitable growth. Their short term focus is on entering new markets such as energy-related services and overseas markets.

Are they actively buying back their shares?

No.

Robustness - How would the company survive a depression?

Describe how they performed in the last severe recessions (2007-2011 for example)?

It may have had a positive effect. As an outsourcing company, Mitie can pick up work from other organisations that are looking to cut costs.

Do they sell something that the public constantly needs to buy (shavers, clothing, food, etc), i.e. are they defensive?

Yes, they are a services company providing services that clients need every day. No matter what happens, companies are still going to need their toilets cleaned and security desks manned.

Are earnings almost certain to be materially higher 5, 10 and 20 years from now?

Will their product or market exist in 10 years time?

Yes. The FM outsourcing market is apparently reaching maturity but there are still many opportunities, abroad and in the UK.

Are they almost certain to be around in 10 years time, and bigger?

Seems quite likely.

Is the company's share price suffering from a market panic, a business recession, an individual calamity that is curable, or an individual calamity that will cause long term damage to the company's earning power?

There don't seem to be any obvious causes other than the fears about the UK economy in general.