Medserv

FY16 results

FY16 results

Industrial support services

2016 turned out to be a far more challenging year for Medserv than we had anticipated. Project delays compounded the cost-saving actions of major customers in a depressed market. The delays are also likely to adversely affect 2017 prospects, especially H117, resulting in a sharp reduction in our near-term estimates. Longer-term cash values hold up well, assuming the stabilisation in market conditions persists, and our revised DCF value is now €1.83 compared to €2.03 previously.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/15	42.7	6.1	9.7	4.3	15.7	2.8
12/16	32.8	(1.3)	(2.1)	0.0	N/A	0.0
12/17e	35.2	0.5	0.6	0.0	N/A	0.0
12/18e	42.3	5.9	9.6	3.8	15.8	2.5

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and retention contracts, and exceptional items.

FY16 trading hurt by late project delays

The sharp contraction of exploration & production capex budgets of the oil majors meant that 2016 was a difficult year for all oilfield support services companies. In addition to reduced activity levels, customers bore down on cost leading to severe price pressures. Aided by the acquisition of METS, we had expected Medserv to maintain a robust level of profitability. However, a shortfall in sales for offshore logistical support due to project delays towards the year end sharply reduced the performance of the Malta base operations. As a result, revenues and profits missed expectations by a substantial margin. Sales of €32.8m were €5.3m short of our estimates, and €11.7m below the company's original forecast for 2016. EBITDA more than halved, falling from €10.3m to €5.0m, producing a €1.3m normalised loss before tax, compared to our expectation of a €2.3m profit. No dividend is being paid for 2016 to preserve capital integrity, with year-end gross cash balances standing at €6.2m and net debt of €47.0m.

FY17 will face similar challenges in H1

The weaker trading conditions in Malta are likely to persist through H117 until the offshore Libyan projects gather pace. Drilling programmes should commence in both Portugal and Cyprus in H217 providing a boost to shore-based logistics performance. METS should grow, with two extra months of consolidation and a recovery in performance in Iraq where trading conditions are returning to normal. We have taken a more conservative view of prospects for 2017, reducing our underlying pre-tax forecast to €0.5m from €6.6m, consistent with the new management projection for 2017 released today.

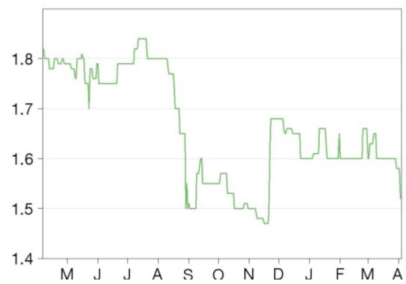
Valuation: Lower near-term forecasts

The company should see progressive recovery in its offshore logistical base activity through 2018 which, combined with continued growth at METS, should see a more meaningful improvement in earnings and cash flow. Our current DCF valuation stands at €1.83, down 10% as a result of the near-term reduction in returns.

6 April 2017

Price	**€1.52**
Market cap	**€82m**
	€/$1.10
Net debt (€m) at end December 2016	47.0
Shares in issue	53.7m
Free float	35%
Code	MDS
Primary exchange	Malta SE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(6.8)	(5.3)	(14.4)
Rel (local)	(5.5)	(6.6)	(16.7)
52-week high/low		€1.84	€1.47

Business description

Medserv is a Malta-based provider of integrated offshore logistics and services in support of drilling operations in the Mediterranean. The acquisition of the METS companies in February 2016 diversified the company into onshore steel tube stockholding and servicing for countries in the Middle East.

Next events

AGM	31 May 2017

Analysts

Andy Chambers	+44 (0)20 3681 2525
Roger Johnston	+44 (0)20 3077 5722

industrials@edisongroup.com

Edison profile page

Medserv is a research client of Edison Investment Research Limited

FY16 results

Difficult end to the year at Malta base

The outcome for 2016 was significantly below our expectations, as indicated in Exhibit 1 below, demonstrating the lumpiness of the core offshore logistical services contracting activity. We had already reduced our estimates due to the delay to the drilling programme in Portugal, but there was further weakness in shore-based logistics, principally due to project delays for offshore Libyan operations at the Malta base. The difficult trading conditions for METS in Iraq also persisted through the second half. The shortfall in revenues dropped through to profits due to the largely fixed cost element of the base operations. METS also performed worse than we had anticipated, all of which was caused by a lack of activity in Iraq and resultant cost reduction actions.

Exhibit 1: Medserv earnings revisions

Year to December (€m)	2016e	2016a	% change	2017e	2017e	% change
	Prior	Reported		Prior	New	
Revenues						
Malta operation	19.0	16.1	(15.5)	23.0	11.5	(50.0)
Libya	0.5	0.5	0.0	1.0	0.5	(50.0)
Cyprus	1.6	1.5	(1.6)	3.5	4.0	14.3
Portugal	0.5	1.1	129.4	0.5	1.2	130.0
METS	16.0	13.1	(18.0)	20.7	17.5	(15.4)
Photovoltaic farm	0.5	0.5	(11.0)	0.5	0.5	(8.3)
Group revenues	38.1	32.8	(13.8)	49.2	35.2	(28.6)
EBITDA	8.5	5.0	(40.9)	14.3	7.0	(50.9)
Depreciation	(3.6)	(3.5)	(3.8)	(4.9)	(3.6)	(25.3)
EBITA	4.9	1.6	(68.2)	9.4	3.4	(64.2)
PPA Amortisation	(1.4)	(1.4)		(1.7)	(1.7)	
EBIT reported	3.5	0.1	(95.9)	7.7	1.7	(78.4)
Underlying PBT	2.3	(1.3)	N/M	6.6	0.5	(92.6)
EPS - underlying continuing (p)	4.4	(2.1)	N/M	11.0	0.6	(94.3)
DPS (p)	1.1	0.0	(100.0)	4.4	0.0	(100.0)
Net debt	42	47	12.3	40.6	45.1	11.2

Source: Medserv reports, Edison Investment Research estimates

The company did report positive earnings of €0.059 (FY15 €0.089), but this was largely the result of a deferred tax net credit of €5.4m, which was a non-cash event. Our underlying pre-tax loss resulted in negative EPS for the year, after adjusting out that credit. Net debt at the year-end was €47m, some €5m worse than we expected largely due to the profit shortfall, and year-end gross cash balances stood at €6.2m. In order to maintain financial rigour, management is not proposing a dividend for 2016, and we would be surprised if there was a payment for the current year in the absence of an unexpectedly strong trading performance.

The major positive is that Medserv has renewed all of its existing major contracts for the Malta base, as well as winning the largest Oil Country Tubular Goods (OCTG) pipe servicing and supply chain management contract from Sumitomo that METS has ever won. As drilling activity recovers both onshore and offshore Medserv should experience a progressive improvement in performance.

Forecasts reduced

Overall, the company missed its original revenue forecast for FY16 by a margin and has adopted a cautious stance for 2017. The company is projecting a further weakening in Malta as the revenue run rate apparent as the company exited 2016 will persist until project pace for Libya picks up, which is currently expected in H217. The drilling programme for one well in Portugal has been licensed and should start in late Q3, with a renewed drilling programme offshore Cyprus expected to commence in Q417, serviced from Limassol.

METS should also make an improving contribution. In addition to an extra two months of consolidation, the Oman business is continuing to grow and Iraq is expected to recover sharply now that the trading conditions have stabilised, with customers having resolved the issues with the Iraqi oil authorities that had stymied activity.

We continue to use the company forecast as the best guide to current year performance, although clearly expectations are heavily weighted towards the second half. As the year progresses and the oil market and geopolitics continue to fluctuate the situation could vary once again, for better or worse. We still do not project any new regional streams of activity even though progress is being made in a number of areas, most notably Egypt. Our new forecast highlights are also shown in Exhibit 1.

We also introduce our 2018 estimates. The main element of our expectation is that Malta recovers significantly, Portugal drops away and that there is further progress in Cyprus as drilling continues. We anticipate continued growth for METS as Oman expands and Iraq continues to improve.

Valuation: Cash support holding up

Following the reduction in expectations, partially offset by a reduction in starting net debt (we had been using a higher pro forma figure of €52m for FY15 period-end net debt) as we have rebased to the current year, our capped DCF valuation for the company now stands at €1.83/share on a calculated WACC of 7.8%. The reduction of 10% from our former value of €2.03/share reflects a 15% fall in aggregate nominal cash flows over the six-year forecast period of €8.5m. The terminal cash flow has increased as we have extended and incorporated another year of growth in EBIT. The sensitivity to WACC and terminal growth rates is reflected in the table below, with the closest value to our assumptions highlighted.

Exhibit 2: Capped DCF sensitivity analysis to WACC and terminal growth rate (€/share)

	WACC						
Terminal growth	6%	7%	8%	9%	10%	11%	15%
0%	2.74	2.18	1.76	1.43	1.17	0.96	0.40
1%	3.34	2.59	2.05	1.65	1.34	1.09	0.45
2%	4.24	3.16	2.44	1.93	1.55	1.25	0.52
3%	5.74	4.02	2.99	2.31	1.82	1.45	0.60

Source: Edison Investment Research estimates

Financials: Reduced numbers with added complexity

In adjusting our profit numbers for the company we exclude the purchase price allocation (PPA) intangible amortisation that arose on the acquisition of METS. In addition, we exclude amortisation of retention contracts for key personnel relating to that deal from the calculation. The payments are already made and are thus non-cash impacts moving forwards, unless the party leaves and a repayment is due. We treat all of these as exceptional items. In addition, the company estimates other operating income of around €0.5m in its 2017 forecast. Last year this was largely made up of property, plant and equipment disposal proceeds and we choose to treat these as exceptional as they are unpredictable and outside normal trading activity.

With a favourable tax regime for METS in the Middle East and the write up of the deferred tax asset in 2016, we expect METS to be able to maintain its tax charge at around 10% for the foreseeable future. In our adjusted EPS calculation, as previously mentioned, we exclude the €5.4m net deferred tax credit. The cash benefit of this will be reflected in the subnormal tax charge moving forward.

While 2016 proved to a very trying year for the group in a turbulent market and geopolitical environment, we expect a solid recovery in profitability and cash returns should conditions continue to stabilise.

Exhibit 3: Financial summary

€m	2014	2015	2016	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	32.4	42.7	32.8	35.2	42.3
Cost of Sales	(23.2)	(29.9)	(22.9)	(24.4)	(25.8)
Gross Profit	9.2	12.9	9.9	10.8	16.5
EBITDA	5.9	10.3	5.0	7.0	12.4
Operating Profit (before amort. and except.)	4.2	7.6	1.6	3.4	8.7
Intangible Amortisation	0.0	0.0	0.0	0.0	0.0
Exceptionals	(0.0)	(0.1)	(1.0)	(2.5)	(1.7)
Other	(0.1)	(0.2)	0.0	0.0	0.0
Operating Profit	4.1	7.3	0.5	0.9	7.0
Net Interest	(1.1)	(1.5)	(2.8)	(2.9)	(2.8)
Profit Before Tax (norm)	3.1	6.1	(1.3)	0.5	5.9
Profit Before Tax (FRS 3)	3.0	5.8	(2.3)	(2.0)	4.2
Tax	(0.9)	(1.3)	5.4	0.2	(0.4)
Profit After Tax (norm)	2.3	4.8	(1.3)	0.4	5.3
Profit After Tax (FRS 3)	2.2	4.5	3.1	(1.8)	3.7
Average Number of Shares Outstanding (m)	46.1	46.1	52.8	53.7	53.7
EPS - normalised (c)	5.0	9.7	(2.1)	0.6	9.6
EPS - normalised and fully diluted (c)	5.0	9.7	(2.1)	0.6	9.6
EPS - (IFRS) (c)	4.2	8.9	6.2	(3.6)	6.8
Dividend per share (c)	4.3	4.3	0.0	0.0	3.8
Gross Margin (%)	28.4	30.1	30.2	30.8	39.0
EBITDA Margin (%)	18.1	24.0	15.3	20.0	29.3
Operating Margin (before GW and except.) (%)	13.0	17.8	4.8	9.6	20.5
BALANCE SHEET					
Fixed Assets	23.3	24.0	51.4	48.7	46.3
Intangible Assets	0.0	0.0	17.2	15.6	14.3
Tangible Assets	23.3	24.0	34.3	33.0	32.0
Investments	0.0	0.0	0.0	0.0	0.0
Current Assets	57.5	57.1	70.0	69.6	71.9
Stocks	0.0	0.0	1.3	1.4	1.7
Debtors	13.4	12.2	12.8	13.7	16.5
Cash	1.1	1.0	6.2	7.0	5.3
Other	43.0	43.9	49.7	47.4	48.4
Current Liabilities	(15.3)	(13.3)	(8.3)	(7.6)	(9.0)
Creditors	(10.4)	(9.5)	(7.2)	(7.6)	(9.0)
Short term borrowings	(4.9)	(3.8)	(1.1)	0.0	0.0
Long Term Liabilities	(56.1)	(56.7)	(87.9)	(86.1)	(82.9)
Long term borrowings	(21.1)	(22.4)	(53.2)	(52.1)	(49.8)
Other long term liabilities	(35.0)	(34.3)	(34.7)	(33.9)	(33.1)
Net Assets	9.5	11.1	25.3	24.6	26.3
CASH FLOW					
Operating Cash Flow	(1.7)	10.4	6.0	7.2	6.8
Net Interest	(1.1)	(1.5)	(2.8)	(2.9)	(2.8)
Tax	(0.9)	(1.3)	(0.0)	(0.0)	(0.6)
Capex	(13.4)	(3.8)	(1.7)	(2.4)	(2.7)
Acquisitions/disposals	0.0	(2.6)	(34.5)	0.0	0.0
Financing	(0.2)	0.5	11.2	0.0	0.0
Dividends	(0.7)	(2.0)	0.0	0.0	0.0
Net Cash Flow	(18.0)	(0.3)	(21.8)	1.8	0.7
Opening net debt/(cash)	6.9	24.9	25.2	47.0	45.1
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	0.0	(0.0)	0.0	0.0	(0.0)
Closing net debt/(cash)	24.9	25.2	47.0	45.1	44.4

Source: Company reports; Edison Investment Research estimates

EDISON

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia