

# Medserv

A platform for growth

FY19 forecast release

Industrial support services

**FY18 results met revenue and company-defined adjusted EBITDA guidance, although accounting changes and impairments led to higher depreciation charges than we expected. As a result, the adjusted pre-tax loss was a little below our estimate. The Suriname offshore base management contract is a prime driver of significant improvement in FY19, with group revenues set to almost double. However, even in other territories underlying progress is occurring, notably in Egypt, Cyprus and Malta, with potential for significant new opportunities to land this year for both the ILSS and OCTG operations. These may have helped to progress the major shareholders' intentions to sell to a strategic partner.**

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/17	28.8	(3.6)	(5.6)	0.0	N/A	N/A
12/18	36.2	(3.4)	(6.8)	0.0	N/A	N/A
12/19e	63.1	2.4	5.2	0.0	21.3	N/A
12/20e	57.2	4.2	8.9	2.0	12.5	1.8

Note: \*PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

## FY18 results: A year of transition

We would regard 2018 as a year of transition for Medserv. New operations in Egypt commenced, Cyprus oil discoveries transformed prospects for the base, Oman OCTG (oil country tubular goods) operations were transferred to the new facility at Duqm and the Suriname base management contract for ILSS (integrated logistic support services – offshore support bases) not only extended operations beyond the EMEA region, but also introduced management services as a new and sizeable revenue stream. FY18 results met management revenue and EBITDA expectations, providing the foundation for growth, despite some deferrals of OCTG prospects.

## Strong EBITDA development expected

Management's FY19 forecasts expect sales to double due to the large Suriname contract, also delivering strong EBITDA growth. Even if this contract ends after its 15-month term, workload elsewhere is expected to deliver EBITDA growth in FY20 and beyond. Our forecasts do not include identified projects that management is indicating for both OCTG (in the Middle East and Uganda) and ILSS (primarily Middle East), which offer potential upside to our FY20 forecast. As usual there are also some in-year engineering contracts that could bolster FY19 performance if awarded. Overall Medserv is now truly expanding internationally and appears to be increasingly verifying its credentials.

## Valuation: Moving into a profitable growth phase

Our revised estimates indicate positive EPS delivery from 2019, with growing contributions expected as Medserv progressively expands its operations internationally. An FY20e P/E ratio of 12.5x appears undemanding. Our capped DCF indicates a value of €1.33 per share at present, but we see upside to this if significant new long-term contracts are awarded this year.

23 May 2019

**Price** €1.11

**Market cap** €60m

\$1.12/€

Net debt (€m) at 31 December 2018 53.7

Shares in issue 53.7m

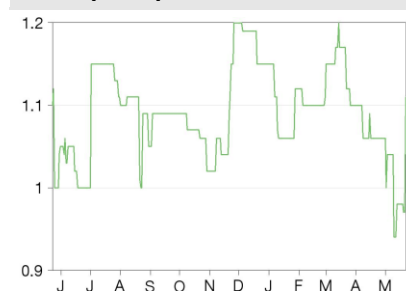
Free float 34.5%

Code MDS

Primary exchange Malta SE

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 4.7 0.9 0.9

Rel (local) 1.5 (7.2) (10.5)

52-week high/low €1.20 €0.94

### Business description

Medserv is a Malta-based provider of integrated offshore logistics and services in support of drilling operations in the Mediterranean and the rest of the world. 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 and beyond.

### Next events

AGM 27 May 2019

Interim results 22 August 2019

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## Update on strategic shareholding disposal process

On 20 May 2019 Medserv's board of directors provided an update on the intention of the two major shareholders, Anthony Diacono and Malampaya Investments, to source a strategic partner for their holdings, which total 65.5% of the share capital.

The update stated that the board was 'informed that, following an initial access of information in relation to the Company in accordance with the authorisation granted by the shareholders on the 28 May 2018, the Major Shareholders have received non-binding offers from interested offerors. The Major Shareholders are in the process of evaluating the said offers and it is anticipated that the Company will shortly proceed to grant selected offerors access to further information as part of the process.'

While this does not guarantee an offer for the majority shareholdings, with any ramifications that may entail for the remaining shareholders, it does mark a significant step forward in the process.

## FY18 results

Medserv published FY18 results, which beat management EBITDA expectations modestly on revenues that were pretty much as expected. The key highlights were:

- Revenues of €36.2m (FY17: €28.8m) were up 26% and marginally better than both management guidance and our own expectations.
- Company adjusted EBITDA expanded 69% to €7.3m (FY17: €4.3m), again modestly ahead of guidance.
- Edison adjusted EBITDA of €6.3m (FY17: €3.7m), which excludes other operating income, was up 71%, but 3% below our estimate, offset in the company defined EBITDA by the other operating income, which was higher than we anticipated.
- Reported EBIT loss of €3.5m (FY17: €4.1m) was lower than the prior year despite a net asset impairment charge relating to OCTG assets in Iraq and Sohar, Oman.
- Net debt at the year-end had expanded modestly to €53.7m (FY17: €49.2m).
- No dividend has been declared as a result of the continuing net loss and still unfavourable cash flow.

**Exhibit 1: Medserv FY18 results summary**

Year to December (€m)	2017	2018	% change
Revenues	28.8	36.2	26%
EBITDA adjusted, company definition	4.3	7.3	69%
EBITDA adjusted, Edison definition	3.7	6.3	71%
Operating profit (Edison adjusted)	(1.2)	(0.3)	-75%
Operating profit (reported)	(4.1)	(3.5)	-15%
Adjusted PBT	(3.6)	(3.4)	-5%
Adjusted EPS (c)	(5.55)	(6.76)	22%
Net debt	49.2	53.7	9%

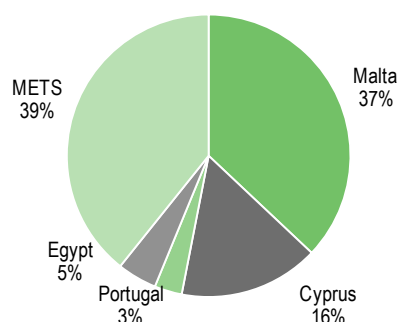
Source: Medserv reports, Edison Investment Research

The ILSS segment contributed 61% of revenues with the OCTG operations of METS contributing the remainder, which compares to the even segment split in FY17. In terms of adjusted EBITDA, it was METS that made the difference, increasing its contribution by 87% to €5.8m (FY17: €3.1m). ILSS contributed €1.0m, a modest improvement on the €0.7m generated in the prior year.

In ILSS, despite and to a degree as a result of the continuing political uncertainty, a large part of the Malta base revenues result from servicing Libya's offshore fields located 120km off the coast.

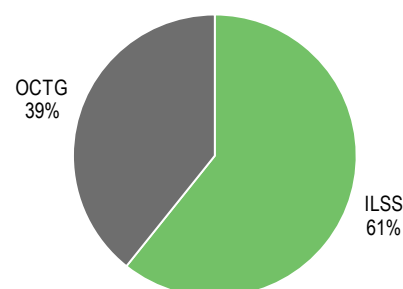
Revenues from customers incorporated in Libya increased to €8.9m from €7.2m in the prior year. The Portugal contribution remained relatively stable, but the project has now ended and the focus shifted to Cyprus following the major field discoveries in 2018 and early 2019. Cyprus base revenues more than doubled to €5.8m (FY17: €2.4m). Egypt grew its contribution as the operations for ENI were mobilised in the existing bases, and in Q418 made a positive EBITDA, with FY18 revenues of €1.6m from a standing start. The photovoltaic farm at the Malta base continues to make a consistent contribution of around €0.5m to revenues with a strong EBITDA contribution.

**Exhibit 2: Medserv revenue split by location FY18 (€36.2m)**



Source: Medserv reports

**Exhibit 3: Medserv revenue split by segment FY18 (€36.2m)**



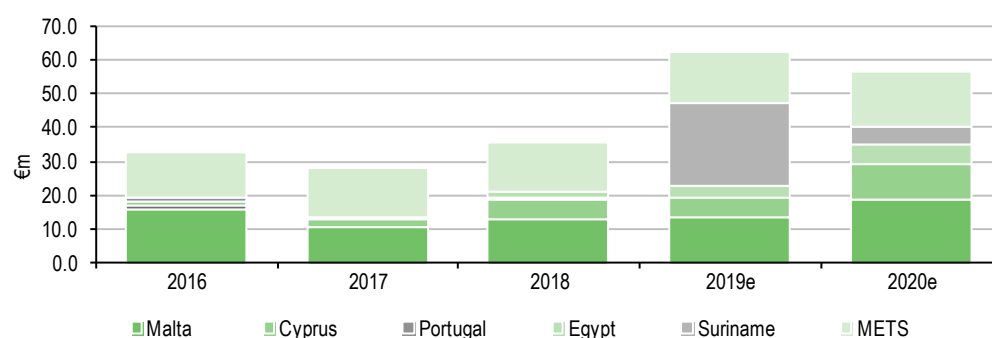
Source: Medserv reports

For the OCTG operations of METS, revenues were broadly flat at €14.2m (FY17: €14.3m), which was below our expectations, largely due to deferrals of projects as well as the impact of transferring operations within Oman to the new facility at Duqm. Iraq again remained tough, but there are signs of improvement in Q119 figures.

## Outlook

Even more encouraging are the outlook comments from management, which indicate a doubling of group revenues is expected for FY19, and is reflected in the newly released Financial Analysis Summary for FY19.

**Exhibit 4: Medserv revenue development by location of operations**



Source: Medserv reports, Edison Investment Research estimates

Clearly the major driver comes in ILSS (offshore base management and support) where the €30m 15-month contract for Suriname started to mobilise in January 2019. Drilling activity will likely increase as the year progresses and we expect around €25m of revenue to be booked for FY19. The uplift supports a healthy rise in group profitability, although we expect it to generate below FY18 group margin levels due to its nature as a management services contract. The contract is

thus a new revenue stream as the company manages the base and services for the customer rather than using its own personnel, facilities and equipment. We expect Medserv to replicate this type of contract elsewhere in the world.

Apart from the success in Suriname, progress elsewhere also appears encouraging. For ILSS a successful initial drilling programme in Cyprus is increasing customer interest in the area, with ExxonMobil becoming a second customer for the Limasso base. Others are likely to enter the region following the discoveries, including to countries with adjacent block opportunities. The new Egypt base is also building activity levels and is in the process of consolidating activities from the customer's former sites onto the new facility at Damietta. Egypt started to generate a positive EBITDA in Q4 so we would expect a significant progressive contribution to revenues and earnings as the Zohr field and other developments pick up pace. Again there is potential for additional work as other IOCs are showing interest to subcontract their shore base logistics. The Malta base is being kept busy by offshore Libya programmes, which in FY20 should include increased activity in support of the new offshore production structures being installed in the Bahr Essalam field.

For the OCTG business, METS FY18 was relatively flat with the largest contributor Oman continuing to make progress, but Iraq again remaining tough. Further growth is expected in Oman in the current year following the transfer to the new Duqm site.

FY19 should therefore be a year of expansion thanks largely to the success in Suriname, but other major growth opportunities exist for both ILSS and OCTG, which we have not included in our forecasts. Prospects include major OCTG projects in Uganda and a new territory in the Middle East, and Oman may provide the first cross-selling opportunity between the divisions with a possible offshore base for a customer being contemplated at Duqm.

We have revised our numbers in light of the newly released guidance for FY19 and the Q119 report. Our significantly increased new FY19 estimates remain slightly below the company's FY19 forecast for €64.2m of revenues and adjusted EBITDA of €14.1m. Our revisions are summarised below:

<b>Exhibit 5: Medserv earnings estimates revisions</b>							
<b>Year to December (€m)</b>	<b>2018e</b>	<b>2018 Actual</b>	<b>% change</b>	<b>2019e Prior</b>	<b>2019e New</b>	<b>% change</b>	<b>2020e New</b>
Malta operation	11.0	12.9	17.4%	13.2	13.9	5.6%	18.8
Libya	0.5	0.0	-100.0%	0.5	0.0	-100.0%	0.0
Cyprus	3.5	5.8	65.4%	3.6	5.6	54.2%	10.6
Portugal	0.8	1.1	51.2%	0.0	0.0		0.0
Egypt	2.0	1.6	-18.1%	2.2	3.3	48.9%	5.9
Suriname					25.0		5.0
METS	17.7	14.2	-19.7%	19.2	14.8	-23.1%	16.4
Photovoltaic farm	0.5	0.5	-5.0%	0.5	0.5	-5.0%	0.5
<b>Revenues</b>	<b>36.0</b>	<b>36.2</b>	<b>0.5%</b>	<b>39.3</b>	<b>63.1</b>	<b>60.5%</b>	<b>57.2</b>
<b>EBITDA adjusted (company definition)</b>	<b>7.2</b>	<b>7.3</b>	<b>1.0%</b>	<b>11.3</b>	<b>14.0</b>	<b>24.5%</b>	<b>15.7</b>
<b>EBITDA adjusted (Edison definition)*</b>	<b>6.5</b>	<b>6.3</b>	<b>-3.1%</b>	<b>10.5</b>	<b>13.1</b>	<b>25.0%</b>	<b>14.8</b>
Depreciation	(5.6)	(7.9)	40.5%	(5.8)	(8.6)	48.2%	(8.7)
Other operating income		1.3			0.9		0.9
<b>Operating profit (adjusted)</b>	<b>0.9</b>	<b>(0.3)</b>	<b>N/A</b>	<b>4.7</b>	<b>5.4</b>	<b>15.3%</b>	<b>7.0</b>
Exceptionals (incl. PPA amortisation)	(1.6)	(3.1)	93.8%	(1.5)	(1.8)	21.7%	(1.8)
<b>Operating profit (reported)</b>	<b>(0.7)</b>	<b>(3.5)</b>	<b>544.4%</b>	<b>3.2</b>	<b>3.6</b>	<b>12.3%</b>	<b>5.2</b>
<b>Profit before tax (adjusted)</b>	<b>(3.0)</b>	<b>(3.4)</b>	<b>13.1%</b>	<b>0.5</b>	<b>2.4</b>	<b>364.4%</b>	<b>4.2</b>
<b>EPS - underlying continuing (c)</b>	<b>(1.4)</b>	<b>(6.8)</b>	<b>383.0%</b>	<b>4.7</b>	<b>5.2</b>	<b>11.5%</b>	<b>8.9</b>
DPS (c)	2.0	0.0	N/A	2.0	0.0	N/A	2.0
Net debt	54.6	53.7	-1.6%	53.2	50.0	-6.1%	43.2
Source: Medserv accounts, Edison Investment Research estimates. Note: *Excludes other operating income.							

We expect a modest reduction in net debt in FY19 and positive adjusted EPS, but do not expect a dividend to be declared. We expect sufficient progress in FY20 for a resumption of payments.

Our new FY20 forecasts show that despite revenues declining on the assumption that Suriname ends and the major additional anticipated contracts do not get awarded, there will still be significant progress in FY20 company defined adjusted EBITDA of €15.7m and underlying EPS of €0.089.

## Q119 trading reflects strengthening prospects

Q119 trading supports the view that the full year should see substantial progress.

<b>Exhibit 2: Q119 trading summary</b>			
Three months to March (€m)	Q118	Q119	% change
■ ILSS	4.9	9.0	84%
■ OCTG	3.3	3.4	3%
■ PV farm	0.1	0.1	0%
<b>Group revenues</b>	<b>8.3</b>	<b>12.5</b>	<b>51%</b>
<b>EBITDA adjusted (company definition)</b>	<b>1.4</b>	<b>3.6</b>	<b>157%</b>
<i>Margin</i>	16.9%	28.8%	
Source: Medserv reports			

As expected, the mobilisation in Suriname has led to a strong improvement of ILSS revenues during the first quarter, with OCTG making more modest progress. The overall increase of 51% has supported EBITDA (company definition) growth of 157% to €3.6m, which readily supports the company guidance for FY19. ILSS is likely to have been the main contributor, but with support coming from OCTG as a recovery in Iraqi performance is noted.

For OCTG, both an additional long-term contract in Uganda and a supply chain management contract in the Middle East are progressing towards award, with METS well positioned to win them. The additional supply chain management contract has the potential to be larger than the current one for Oman, while the Uganda contract would be smaller but a stable contributor.

ILSS also continues to pursue additional base opportunities in the Middle East (eg for offshore Oman) as well as adjacencies to its now established presence in Suriname, following the recent success in neighbouring Guyana by ExxonMobil. If Suriname does find oil it seems likely in our view that the contract end next year will have to be positively revised.

## Valuation

Our capped DCF valuation currently returns a value of €1.33 per share. We use a calculated WACC of 8.1% and a terminal growth rate of zero, with working capital neutralised and depreciation normalised with capex. The sensitivity of our DCF to WACC and terminal growth rate assumptions is shown in the table below

Exhibit 7: Medserv capped DCF value per share (€) sensitivity to WACC and terminal growth								
	WACC	6.0%	7.0%	8.0%	8.1%	9.0%	10.0%	15.0%
Terminal growth rate								
0%		2.41	1.86	1.46	1.33	1.14	0.89	0.14
1%		3.01	2.27	1.75	1.59	1.36	1.05	0.20
2%		3.90	2.84	2.14	1.94	1.64	1.26	0.27
3%		5.39	3.70	2.68	2.41	2.01	1.53	0.34
Source: Edison Investment research estimates								

We note that we feel there are significant potential upside opportunities for earnings and cash flows from FY20 that we have yet to include in our assumptions. In its Q1 report, Medserv states that all subsidiaries have potential to increase earnings as a result of discoveries or new contract awards.

**Exhibit 8: Financial summary**

	€m	2017	2018	2019e	2020e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
Revenue		28.8	36.2	63.1	57.2
Cost of Sales		(18.2)	(23.6)	(45.1)	(37.2)
Gross Profit		10.6	12.6	18.0	20.0
EBITDA (Edison defined)		3.7	6.3	13.1	14.8
Operating Profit (before amort. and except.)		(1.2)	(0.3)	5.4	7.0
Intangible Amortisation		0.0	0.0	0.0	0.0
Exceptionals		(4.4)	(5.4)	(3.6)	(3.7)
Other		0.8	1.3	0.9	0.9
Operating Profit		(4.1)	(3.5)	3.6	5.2
Net Interest		(3.9)	(5.4)	(4.8)	(4.7)
Profit Before Tax (norm)		(3.6)	(3.4)	2.4	4.2
Profit Before Tax (FRS 3)		(8.0)	(8.8)	(1.2)	0.5
Tax		0.4	(0.7)	(0.1)	0.0
Profit After Tax (norm)		(3.2)	(4.1)	2.3	4.2
Profit After Tax (FRS 3)		(7.6)	(9.5)	(1.3)	0.5
Average Number of Shares Outstanding (m)		53.7	53.7	53.7	53.7
EPS - normalised (c)		(5.6)	(6.8)	5.2	8.9
EPS - normalised and fully diluted (c)		(5.6)	(6.8)	5.2	8.9
EPS - (IFRS) (c)		(13.8)	(16.8)	(1.5)	2.0
Dividend per share (c)		0.0	0.0	0.0	2.0
Gross Margin (%)		36.8	34.8	28.5	35.0
EBITDA Margin (%)		12.8	17.3	20.8	25.8
Operating Margin (before GW and except.) (%)		-4.1	-0.9	8.5	12.2
<b>BALANCE SHEET</b>					
Fixed Assets		46.4	46.4	44.6	42.4
Intangible Assets		14.5	13.2	11.7	10.2
Tangible Assets		31.9	33.2	32.9	32.2
Investments		0.0	0.0	0.0	0.0
Current Assets		106.9	110.4	112.6	108.6
Stocks		1.2	1.3	1.7	1.6
Debtors		12.2	12.8	16.8	15.2
Cash		3.6	5.6	6.6	9.3
Other		89.8	90.7	87.5	82.6
Current Liabilities		(9.4)	(16.2)	(15.4)	(13.9)
Creditors		(7.3)	(10.9)	(15.4)	(13.9)
Short term borrowings		(2.0)	(5.3)	0.0	0.0
Long Term Liabilities		(115.8)	(121.9)	(124.4)	(120.3)
Long term borrowings		(50.8)	(54.0)	(56.6)	(52.5)
Other long term liabilities		(65.0)	(67.8)	(67.8)	(67.8)
Net Assets		28.1	18.7	17.4	16.8
<b>CASH FLOW</b>					
Operating Cash Flow		1.8	6.6	10.9	13.2
Net Interest		(2.4)	(3.1)	(3.0)	(2.8)
Tax		0.4	(0.7)	(0.1)	0.0
Capex		(2.6)	(6.9)	(4.1)	(3.7)
Acquisitions/disposals		0.0	0.0	0.0	0.0
Financing		0.6	(0.5)	0.0	0.0
Dividends		0.0	0.0	0.0	0.0
Net Cash Flow		(2.3)	(4.5)	3.7	6.7
Opening net debt/(cash)		47.0	49.2	53.7	50.0
HP finance leases initiated		0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0
Closing net debt/(cash)		49.2	53.7	50.0	43.2

Source: Company reports, Edison Investment Research estimates. Note: FY17 and FY18e P&L miscalculation in previous notes corrected here.

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