

7 Aug 2019

Share Price:	\$0.29
Valuation:	\$0.60
12mth price target:	\$0.60

**Brief Business Description:**

Australian Energy Services Group focused on Gas Compression and Processing.

**Hartleys Brief Investment Conclusion**

VMX is exposed to the rapidly growing East Coast Australian Gas Market through its Gas Compression and EPC Services.

**Chairman & CEO:**

Mr Stephen Zurhaar (Non-Exec Chairman)  
Mr Steve Dropulich (MD)

**Top Shareholders:**

Stephen Zurhaar	12.9%
Stephen Lazarakis	13.6%
Vincent Goss	12.3%
Annash Pty Ltd	8.2%
Troy Harry	5.6%
Steve Dropulich	5.1%

**Company Address:**

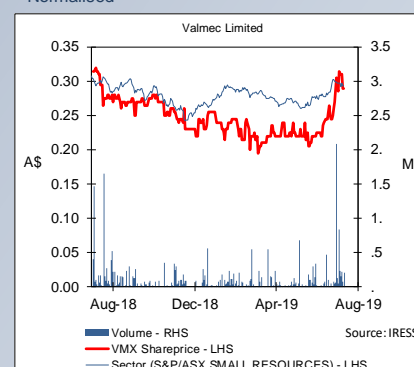
17 Ballantyne Rd.  
Kewdale WA 6105, Australia

Issued Cap.:	125.7m
- fully diluted	126.9m
M'ket Cap:	\$36.5m
- fully diluted	\$36.8m
Net Cash (FY19e):	-\$0.6m

	FY17a	FY18a	FY19e
Op Cash Flw	0.8	-2.8	1.5
Free Cash Flw	-5.7	-0.5	9.0
NPAT (A\$m)	1.6	4.2	4.4
NPAT (A\$m)*	1.6	4.2	4.4
EPS (\$, bas)	1.9	4.1	3.5
EV / EBITDA	8.9x	5.3x	4.6x
DPS (\$)	-	-	-
Franking	100%	100%	100%
Dividend Yield	0.0%	0.0%	0.0%
N.D. / equity	28%	0%	2%

Source: Hartleys Research

\*Normalised



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Hartleys has provided corporate advice within the past 12 months to Valmec Limited for which it has earned fees.

## VALMEC LIMITED (VMX)

### Strong FY19, better FY20 expected

Valmec Limited ('VMX' or the 'Company') have recently released expected FY19 revenue and EBITDA. Revenue is expected to be circa \$110m versus Hartleys prior estimate of \$107m and their reported 1H19 number of \$48m.

EBITDA is expected to be circa \$8m versus Hartleys \$7.2m and 1H19 of \$3.2m. A greater proportion of revenue from the Service segment boosted the margin in the second half.

The Order Book is \$80m, the same level as at the half year result. This is obviously a solid result, with margins ahead of our expectations. The Order Book looks sufficient to underwrite a FY20 revenue number well in excess of \$100m.

We have revised our FY19 numbers to reflect this update from the Company, our FY20 estimates remain largely unchanged.

#### Key Chart: Earnings Changes

Profit & Loss (\$m)	FY18		FY19F		FY20F		
	Actual	Old	New	% diff	Old	New	% diff
Revenue	103.2	106.6	109.8	3.1%	134.7	135.7	0.7%
EBITDA	7.0	7.2	8.0	10.7%	9.1	9.2	0.7%
EBIT	5.8	6.3	7.1	12.2%	8.0	8.0	-0.3%
NPAT	4.2	3.8	4.4	14.4%	5.4	5.3	-1.4%
Net Debt (net cash)	0.1	-3.4	0.6	116.8%	-9.2	-8.4	-8.4%
EPS	4.1	3.0	3.5	14.4%	4.3	4.2	-1.4%
DPS	0.0	0.0	0.0	0.0%	0.0	0.0	0.0%

Source: VMX and Hartleys Forecasts

### Retain Speculative Buy and Upgrade Price Target

We have upgraded our 12-month target price to 60c (from 48c) to reflect partially the solid result in FY19, but also the fact we expect the next 12 months now to be even better than this. Consequently, we maintain our Speculative Buy Recommendation. VMX offers investors a somewhat unique investment proposition. A small listed company with high leverage to the developing Australian wide gas sector, without the risk associated with an explorer and/or developer.

Demand for its products and services by the gas sector will be driven by a multitude of factors including;

1. Continued growth overall in Gas Demand.
2. Further depletion in current sources of supply and need to replace this production.
3. Increased demand for compression as sources of gas increasingly are more remote from demand centres.
4. Increased demand for compression as new sources of supply are increasingly from unconventional reservoirs.
5. A new wave of LNG developments as existing contracts expire.

# SUMMARY MODEL

Valmec Ltd. (VMX)						
<b>Company Information</b>						
Date	7 Aug 2019	17 Ballantyne Rd. Kewdale WA 6105, Australia Ph: +61 (08) 9266 8888 Fax: +61 (08) 9226 8890 <a href="http://www.valmec.com.au">www.valmec.com.au</a>				
Share Price	\$0.290					
52 Week High-Low	\$0.37 - \$0.19					
Market Cap (\$m)	\$36.5					
Enterprise Val (\$m)	\$36.6					
Ordinary Shares	125.7					
Fully Diluted Shares	126.9					
<b>Valuation</b>						
ASX Small Industrials		Target Multiple	Weight	Value		
1yr forward P/E		16.5x	35%	\$0.69		
1yr forward EV/EBITDA		9.2x	30%	\$0.66		
DCF		10%	35%	\$0.46		
<b>12 Months Price Target</b>						
<b>\$0.60</b>						
Fully diluted P / E (6/19F) at price target 17.4x						
Fully diluted P / E (6/20F) at price target 14.3x						
EV/EBITDA (6/19F) at price target 10.2x						
EV/EBIT (6/19F) at price target 11.4x						
<b>Multiples (\$/price at \$0.29)</b>						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
P / E (basic, weighted)	2.3x	127.6x	15.3x	7.9x	8.3x	6.8x
P / E (diluted, weighted, norm NPAT)	21.1x	127.6x	15.3x	7.1x	8.3x	6.9x
P / E (full dil mkt cap / norm. NPAT)	59.7x	197.9x	23.7x	8.8x	8.4x	6.9x
Dividend Yield	10.3%	0.0%	0.0x	0.0x	0.0%	0.0%
Group Free Cash Flow (f.c.f.) / EV	-0.5%	-5.3%	0.0x	-0.2x	-1.2%	24.7%
Equity f.c.f. / Mkt Cap	-2.9%	-5.3%	0.0x	-0.2x	7.0%	16.5%
Norm f.c.f. / Mkt cap	-2.9%	-5.3%	0.0x	-0.2x	7.0%	16.5%
Mkt cap / operating cash flow	16.6x	-40.2x	43.1x	-13.2x	23.6x	3.7x
EV/EBITDA multiple	28.3x	12.7x	8.9x	5.3x	4.6x	4.0x
EV/EBIT multiple	501.1x	21.9x	12.2x	6.3x	5.2x	4.6x
Price / Book Value	1.5x	1.5x	1.4x	1.1x	1.2x	1.0x
Price / NTA	1.3x	1.7x	1.5x	1.1x	1.4x	1.2x
<b>Ratios</b>						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Return on Average Equity	5.1%	1.2%	9.5%	17.2%	14.2%	16.1%
Return on Assets	2.1%	0.6%	4.1%	8.6%	8.1%	9.5%
ND / ND + Equity	25.5%	40.4%	28.2%	0.4%	1.9%	-24.1%
Net Interest Cover (EBIT)	0.1	1.7	3.8	6.1	7.2	14.7
<b>Free Cash Flow Analysis</b>						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Net Operating Cash Flow	2.2	-0.9	0.8	-2.8	1.5	9.8
Capex (Reported)	-2.4	-1.0	-0.4	-3.1	-2.0	-0.8
Group Free Cash Flow (rep'ted)	-0.2	-1.9	0.4	-5.9	-0.5	9.0
Fixed Debt Repayments	-0.9	0.0	0.3	-2.7	3.0	-3.0
Equity Free Cash Flow (rep'ted)	-1.1	-1.9	0.7	-8.6	2.5	6.0
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow (normalised)	-1.1	-1.9	0.7	-8.6	2.5	6.0
Capex (inc HP) / depreciation	174%	77%	41%	230%	156%	47%
<b>Unpaid Capital (options)</b>						
<b>Year Expires</b>	<b>Number (m)</b>	<b>\$m unpaid</b>				
Unlisted Performance	0.34					
Various	0.88	\$ 0.3				
30-Sep-19	-	\$ -				
<b>Directors &amp; Senior Management</b>						
	<b>S'holders</b>	<b>(m)</b>	<b>%</b>			
Mr Stephen Zurhaar (Non-Exec Chairman)	Stephen Lazarakis	17.04	13.6%			
Mr Steve Dropulich (MD)	Stephen Zurhaar	16.23	12.9%			
Mr Harry Singh (CFO & CS)	Vincent Goss	15.49	12.3%			
Mr Vincent Goss (NED)	Annash Pty Ltd	10.26	8.2%			
Mr Stephen Lazarakis (NED)	Troy Harry	7.09	5.6%			
Mr Peter Iancov (NED)	Steve Dropulich	6.40	5.1%			
Analyst: Aiden Bradley Phone: +61 8 9268 2876						
Sources: IRESS, Company Information, Hartleys Research						
Last Updated 7 August 2019						
<b>Speculative Buy</b>						
<b>Profit &amp; Loss (\$m)</b>	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Backlog (year-end)		62.3	72.0	61.0	80.0	85.0
<b>Revenue Summary</b>						
Revenue	50.5	50.8	72.9	103.2	109.8	135.7
EBITDA	1.3	2.9	4.1	7.0	8.0	9.2
Margin %	2.6%	5.7%	5.6%	6.7%	7.3%	6.8%
<b>Group Revenue</b>						
	50.5	50.8	72.9	103.2	109.8	135.7
growth	0.7%	0.7%	43.5%	41.6%	6.4%	23.5%
Adj. EBITDA - Group	1.3	2.9	4.1	7.0	8.0	9.2
- growth	-59.7%	122.4%	42.7%	69.4%	14.5%	15.0%
EBITDA / Sales	2.6%	5.7%	5.6%	6.7%	7.3%	6.8%
Depreciation	-1.4	-1.3	-1.1	-1.4	-1.3	-1.6
Adj. EBIT	0.1	1.7	3.0	5.8	7.1	8.0
EBIT / Sales	0.1%	3.3%	4.1%	5.7%	6.4%	5.9%
Net interest	-0.8	-1.0	-0.8	-1.0	-1.0	-0.5
Normalised Pretax Profit	-0.8	0.7	2.2	4.9	6.1	7.4
Pre tax abnormal	7.3	0.0	0.0	-0.6	0.0	0.0
Reported Pretax Profit	6.6	0.7	2.2	4.3	6.1	7.4
Reported Tax	1.4	-0.5	-0.7	-0.7	-1.7	-2.1
tax rate	-20.9%	72.2%	30.0%	16.2%	28.0%	28.0%
Reported Profit to equity	5.8	0.2	1.6	3.8	4.4	5.3
abnormal	5.1	0.0	0.0	-0.4	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0	1.0
Normalised NPAT to equity	0.6	0.2	1.6	4.2	4.4	5.3
Norm. Net Profit / Sales	1.2%	0.4%	2.1%	4.1%	4.0%	3.9%
Reported EPS (basic, weighted)	12.8	0.2	1.9	3.7	3.5	4.2
- growth	-96%	-98%	734%	93%	-4%	21%
Normalised EPS (dil, wghtd)	1.4	0.2	1.9	4.1	3.5	4.2
- growth	-100%	-83%	734%	117%	-15%	21%
DPS (cps)	3.0	0.0	0.0	0.0	0.0	0.0
Franking	100%	100%	100%	100%	100%	200%
Payout Ratio	217.9%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Cashflow Statement (\$m)</b>						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
EBITDA	1.3	2.9	4.1	7.0	8.0	9.2
Working Capital Change	-1.5	-3.2	-3.2	-6.4	-3.7	3.2
Cash from Operations	1.8	0.1	2.3	-1.1	4.2	12.4
Net interest Paid	-0.8	-1.0	-0.8	-1.0	-1.0	-0.5
Tax Paid	1.2	0.0	-0.7	-0.7	-1.7	-2.1
Net Operating Cash Flow	2.2	-0.9	0.8	-2.8	1.5	9.8
Capital Expenditure	-2.4	-1.0	-0.4	-3.1	-2.0	-0.8
Asset Sales	0.3	0.0	1.0	0.2	0.0	0.0
Other (inc Investments)	0.0	0.0	0.0	0.0	0.0	0.0
Net Investing Cash Flow	-2.1	-1.0	0.6	-2.9	-2.0	-0.8
Proceeds from Equity Issues	0.0	0.0	0.0	10.4	0.0	0.0
Net Change in Debt & Leases	-0.3	-2.1	-0.9	-1.0	3.0	-3.0
Dividends Paid	-0.4	-0.4	0.0	0.0	0.0	0.0
Net Financing Cash Flow	-0.7	-2.5	-0.9	9.4	3.0	-3.0
Movement in Cash	-0.6	-4.4	0.5	3.7	2.5	6.0
<b>Balance Sheet (\$m)</b>						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Cash	2.9	0.6	2.3	2.7	5.3	11.3
Receivables	11.4	13.3	19.4	29.0	21.7	23.0
Inventories	2.9	4.8	7.0	7.1	8.7	9.3
Other	0.7	3.4	0.3	0.6	0.6	0.6
Total Current Assets	17.9	22.0	29.1	39.5	36.3	44.2
Property, Plant & Equipment	9.0	5.9	7.0	10.6	11.3	10.5
Intangibles	1.9	1.9	1.9	3.5	3.5	3.5
Other	4.9	4.2	3.5	1.6	1.6	1.6
Total Non Current Assets	15.8	11.9	12.4	15.8	16.5	15.6
Total Assets	33.7	33.9	41.5	55.2	52.7	59.8
Accounts Payable	9.9	10.5	15.7	19.0	14.9	20.1
Interest Bearing Liabilities	5.4	5.9	4.4	1.1	4.1	1.1
Other	1.3	1.0	1.4	1.6	1.6	1.6
Total Current Liabilities	16.6	17.4	21.5	21.8	20.6	22.8
Accounts Payable	0.0	0.0	0.0	0.0	0.0	0.0
Interest Bearing Liabilities	1.5	1.0	2.7	1.8	1.8	1.8
Other	0.0	0.0	0.0	0.0	0.0	0.0
Total Non Current Liabilities	1.5	1.0	2.7	2.0	2.0	2.0
Total Liabilities	18.1	18.4	24.3	23.8	22.6	24.8
Net Assets	15.6	15.5	17.2	31.5	30.1	35.0
Net Asset Value / Share (\$)	0.19	0.19	0.21	0.25	0.24	0.28
NTA / Share (\$)	0.22	0.17	0.19	0.27	0.21	0.25
Net Debt (net cash)	4.0	6.3	4.9	0.1	0.6	-8.4

## HIGHLIGHTS

Valmec Limited ('VMX' or the 'Company') have recently released expected FY19 revenue and EBITDA.

Revenue is expected to be circa \$110m versus Hartleys prior estimate of \$107m and their reported 1H19 number of \$48m.

EBITDA is expected to be circa \$8m versus Hartleys \$7.2m and 1H19 of \$3.2m.

A greater proportion of revenue from the Service segment boosted the margin in the second half.

We have revised our FY19 numbers to reflect this update from the Company, our FY20 estimates remain largely unchanged.

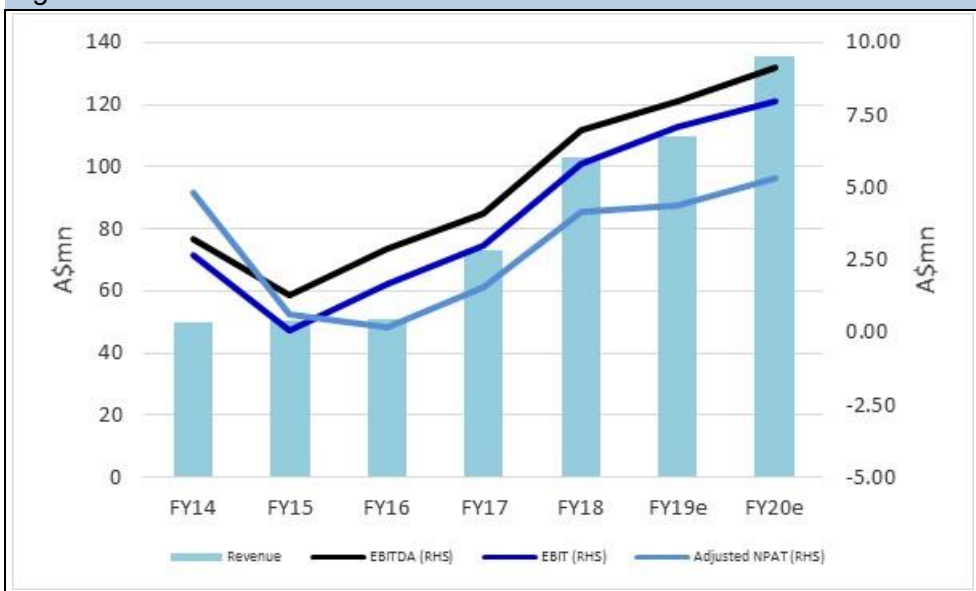
**Fig. 1: Earnings Changes**

Profit & Loss (\$m)	FY18	FY19F			FY20F		
	Actual	Old	New	% diff	Old	New	% diff
Revenue	103.2	106.6	109.8	3.1%	134.7	135.7	0.7%
EBITDA	7.0	7.2	8.0	10.7%	9.1	9.2	0.7%
EBIT	5.8	6.3	7.1	12.2%	8.0	8.0	-0.3%
NPAT	4.2	3.8	4.4	14.4%	5.4	5.3	-1.4%
Net Debt (net cash)	0.1	-3.4	0.6	116.8%	-9.2	-8.4	-8.4%
EPS	4.1	3.0	3.5	14.4%	4.3	4.2	-1.4%
DPS	0.0	0.0	0.0	0.0%	0.0	0.0	0.0%

Source: VMX and Hartleys Estimates

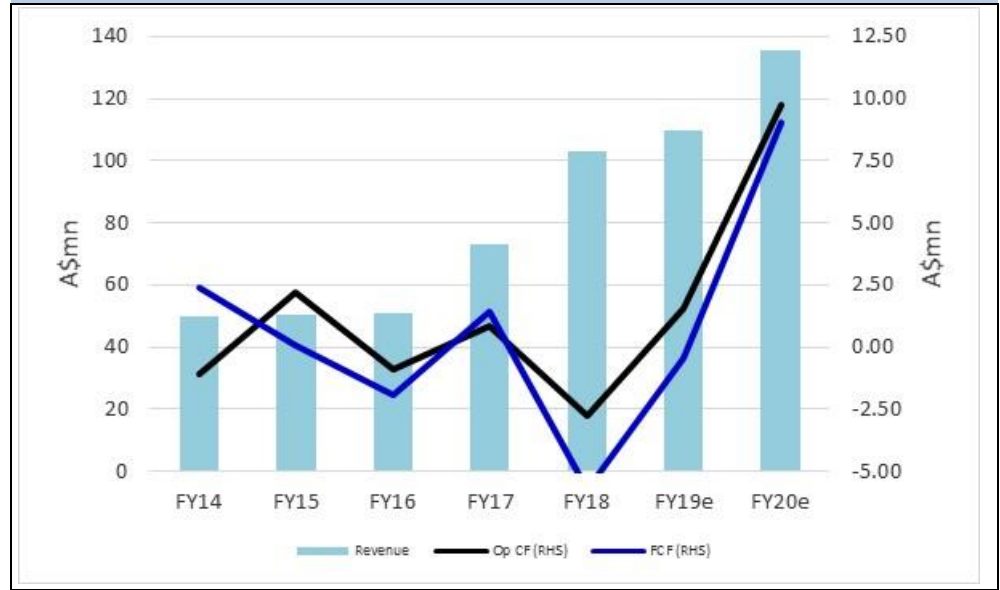
The Order Book is \$80m, the same level as at the half year result. This is obviously a solid result, with margins ahead of our expectations. The Order Book looks sufficient to underwrite a FY20 revenue number well in excess of \$100m.

**Fig. 2: Revenue and EBITDA**



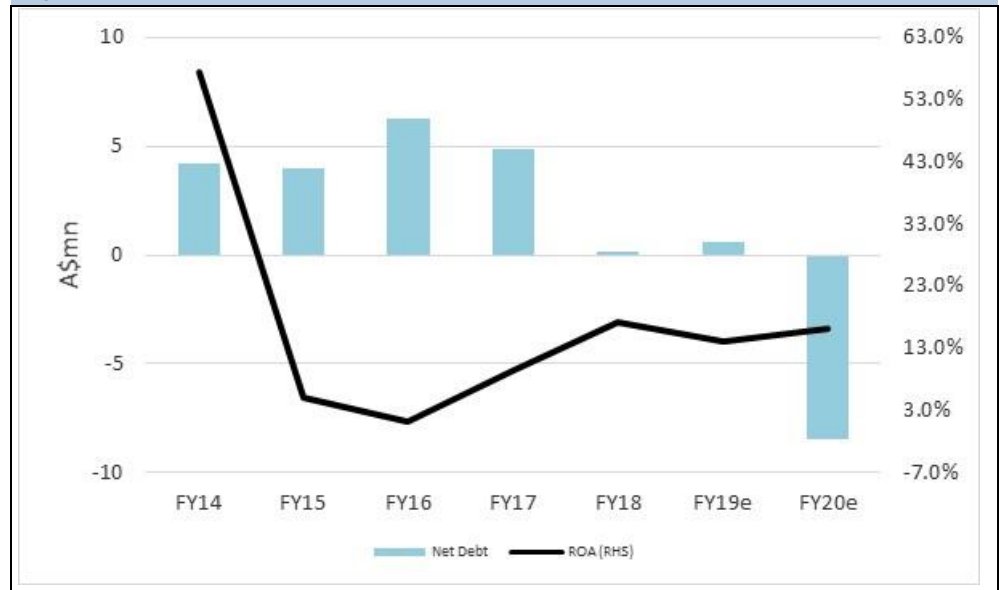
Source: VMX and Hartleys Estimates

**Fig. 3: Revenue and FCF**



Source: VMX and Hartleys Estimates

**Fig. 4: Net Debt and ROA**



Source: VMX and Hartleys Estimates

## RECOMMENDATION & RISKS

We have upgraded our 12-month target price to 60c (from 48c) to reflect partially the solid result in FY19, but also the fact we expect the next 12 months now to be even better. Consequently, we maintain our Speculative Buy Recommendation.

VMX offers investors a somewhat unique investment proposition. A small listed company with high leverage to the developing Australian wide gas sector, without the risk associated with an explorer and/or developer.

**Fig. 5: Valuation and Price Target**

Valuation			
	Target Multiple	Weight	Value
ASX Small Industrials			
1yr forward P/E	16.5x	35%	\$0.69
1yr forward EV/EBITDA	9.2x	30%	\$0.66
DCF	10%	35%	\$0.46
<b>12 Months Price Target</b>			<b>\$0.60</b>
<i>Fully diluted P / E (6/19F) at price target</i>			17.4x
<i>Fully diluted P / E (6/20F) at price target</i>			14.3x
<i>EV/EBITDA (6/19F) at price target</i>			10.2x
<i>EV/EBIT (6/19F) at price target</i>			11.4x

Source: VMX and Hartleys Estimates

## INVESTMENT THESIS & RECOMMENDATION

VMX offers investors highly leveraged exposure to the developing Australian gas sector. Demand for its products and services by the gas sector will be driven by a multitude of factors including;

1. Continued growth overall in Gas Demand.
2. Further depletion in current sources of supply and need to replace this production.
3. Increased demand for compression as sources of gas increasingly are more remote from demand centres.
4. Increased demand for compression as new sources of supply are increasingly from unconventional reservoirs.
5. A new wave of LNG developments as existing contracts expire.

VMX's revenue outlook will also be boosted by a substantive increase in its more reliable recurring revenue from servicing and maintaining existing installed equipment and facilities.

A natural progression for VMX as it increases in scale is to shift to become an owner/operator of the gas equipment it installs. This presents a very large opportunity for VMX to not only develop another revenue stream (BOOM, BOOT, Contract Compression) but leverage of this model to win further EPC work. This build, own, operate, (lease) and maintain model has become the standard industry structure in North America, driven by customer demand to shift infrastructure of their balance sheets while also improving the efficiency of the plant. We believe capital constrained gas producers in Australia would be equally keen to further shift the

midstream cost of gas production and supply away from front capital towards ongoing operating expenditure (i.e. moving their cost from Capex to Opex).

While VMX is now increasingly focused on the gas sector and compression particularly, it has retained exposure to increasing infrastructure spending in Australia through its experience in a broad range of civil and multidiscipline construction scopes. VMX offers civil, earthworks, underground services, concrete and building works in the residential, commercial and industrial market sectors.

## Successful Small Caps: VMX a model case

**We believe successful small-cap companies have a combination of a focused, well thought out strategy combined with the competitive advantages to pursue it and the right management (with incentives aligned with shareholders) in place to implement it.**

### Strategy

VMX is increasingly focused on the growing opportunities in the Australian energy sector. With proven experience and a background in design and construction of gas compression and gas processing projects and brownfields contracting, the VMX team can now also offer a technologically diverse and competitive range of energy packaging, transport and processing solutions. The acquisition of Exterran (Australia) Pty Ltd in January 2015, provides access to proven engineered solutions in production facilities including oil and gas processing and treatment and natural gas compression that complete their “one stop shop” customer option delivery model, including financing, BOOM and BOOT offerings.

### Competitive Advantage

VMX have an experienced senior team of management and staff has more than 25 years of Civil / Earthworks, Structural, Mechanical, Piping (SMP) and Electrical and Instrumentation (E&I) project and construction experience, carried out in remote, regional and metropolitan greenfield and brownfield locations. Exterran is one of the leading gas compression companies globally and VMX is the exclusive agent for Exterran gas compression products in Australia (although it should be noted that this does not restrict VMX from supplying other 3rd party products and services).

### Management & Alignment

Highly experienced Director and management group each with over 25 years of experience. The Executive Directors previously founded HVAC/HPS Group of Companies (Oil & Gas Services) which was ultimately sold for circa \$55m in 2005 to another leading Global gas compression company, Enerflex Ltd and ANZ Private Equity. In 2011, the same team took control of a civil construction business, Marcon Pty Ltd. and set about building a substantial oil and gas services capacity into the business. Marcon was then acquired by Core Services Group in 2013 and listed on the ASX and subsequently renamed Valmec.

In late 2014, Valmec announced the acquisition of the Australian subsidiary of NYSE listed Exterran. Enerflex (who the team sold their original business to) and Exterran are among the leading firms in Australia specialising in gas compression equipment, production and processing equipment and operations. The local Exterran subsidiary had 50 staff in five offices across Australia. The acquisition of Exterran, allowed the

team greater leverage to the gas sector and complimented their existing compression and related services business in Australia. Importantly for other shareholders the management and employees also have a material equity stake in the business with a number of Senior staff having large shareholdings in the Company.

**Fig. 6: Board and Management**

Directors & Senior Management	S'holders	(m)	%
Mr Stephen Zurhaar (Non-Exec Chairman)	Stephen Lazarakis	17.04	13.6%
Mr Steve Dropulich (MD)	Stephen Zurhaar	16.23	12.9%
Mr Harry Singh (CFO & CS)	Vincent Goss	15.49	12.3%
Mr Vincent Goss (NED)	Annash Pty Ltd	10.26	8.2%
Mr Stephen Lazarakis (NED)	Troy Harry	7.09	5.6%
Mr Peter Iancov (NED)	Steve Dropulich	6.40	5.1%

Source: VMX and IRESS

## RISKS

Given VMX's increasing exposure to the Australian Gas Market, it is reliant on continued growth in gas demand and new sources of supplies being developed.

Given the nature of its business, VMX has modest balance sheet risk and working capital risks that need managing. These risks may increase further as VMX further develops its BOOM and contract compression business models.

There are a number of (mainly North American and Chinese) providers of compression products and services globally, who may pose a future competitive threat to current Australian leaders (Valmec and Enerflex) if they deem the Australian market prospective enough to enter.

There is a high level of competition in the provision of general EPC services in the Oil & Gas and Infrastructure sectors.

## SIMPLE S.W.O.T. TABLE

Strengths	Experienced management team. Strong industry track record in gas sector and compression.
Weaknesses	Exclusive supplier of Exterran products in Australia. Still a relatively small player. Concentrated customer base.
Opportunities	Balance Sheet and Working Capital requirements. Growing demand for Gas Compression in Australia. Infrastructure spending looks like it will continue to grow strongly. Opportunity to own and operate more equipment for customers and develop as a contract compression company.
Threats	Weakening of gas demand and hence demand for VMX's products and services in Australia. Poor execution of contracts. Potential new entrants in gas compression. High levels of competition in Australia in general EPC.

Source: Hartleys Research

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## Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.
Buy	

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