

Ammtec (AEC.ASX)

Tuesday 19 August 2008

Sells PSI stake for US\$25m – moves to net cash.

Ammtec announced it has entered into a binding agreement for the sale of its 68.5% interest in PSI for US\$25m. The sale of the US based resin manufacturing business is expected to be settled in early October following due diligence. Ammtec noted that it received an unsolicited offer from an undisclosed party.

PSI deemed non-core to Ammtec's metallurgical testing operations. PSI is still at the very early stages of commercialisation with significant additional effort and working capital required to develop and market the product. Continuation of this slow and intensive process would be "detrimental" to Ammtec's EPS in the near-term. We believe Ammtec would have eventually needed to raise capital to ramp up PSI.

\$17.1m post-tax gain on sale. We estimate the post-tax gain on sale to be \$17.1m given the carrying value was just \$4.3m. Capital gains tax of \$7.3m is not payable until FY10. Given the solid acquisition pipeline, strong demand for metallurgical consultancy work and Ammtec's high ROE (~40%), we expect the company to reinvest the sale proceeds in future growth rather return capital.

Balance sheet moves to net cash. We forecast Ammtec to have \$19.2m net cash in FY09e. Assuming a target gearing ratio of 20% (similar to previous forecast), Ammtec could borrow a further \$28m, providing the company with ~\$47m capacity for growth.

FY09 EPS guidance upgraded by 18%. Ammtec previously projected a \$1.5m consolidated loss in FY09 from PSI. To account for the sale, management upgraded FY09 EPS guidance by 18% from 40 cps to 47 cps. The implied FY09 operating EBITDA margin guidance was increased by 130 basis points from 32.4% to 33.7%.

Revised forecasts. Our FY09e and FY10e EPS forecasts have been increased by 16% and 18% respectively.

We maintain our Buy recommendation and set our revised price target to \$6.42/share. Ammtec remains undervalued in our view, trading on attractive metrics with FY09e EV/EBITDA of 5x, PER of 9.5x, a fully franked dividend yield of 9% and a free cash flow yield of 6%. We view the PSI sale as positive as it is immediately accretive and significantly strengthens the balance sheet for future growth.

Year to June (\$m)	2008a	2009e	2010e	2011e	2012e
Revenue	37.4	58.0	68.0	74.8	80.9
% change	43%	43%	55%	17%	10%
EBITDA	12.0	19.5	22.9	25.2	27.2
EBITDA margin	32.0%	33.5%	33.7%	33.7%	33.7%
NPAT rep	6.7	29.5	14.9	16.0	17.4
NPAT adj*	6.6	12.4	14.9	16.0	17.4
EPS adj* ¢	29.5	47.3	56.4	60.6	65.9
% change	25%	60%	19%	7%	9%
Dividend ¢	25.0	41.8	37.8	40.6	44.2
PER x	15.3	9.5	8.0	7.4	6.8
EV/EBITDA x	9.2	5.1	4.6	4.1	3.6
Yield	5.6%	9.3%	8.4%	9.0%	9.8%

* Figures adjusted for NRIs and amortisation of intangibles

Source: Company, Foster Stockbroking

Metals & Mining

Rating: Buy
 (previous): Buy

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Share price: \$4.50
 Price target: \$6.42
 (Previous) \$5.39
 NPV per share \$6.10
 Risk: Medium

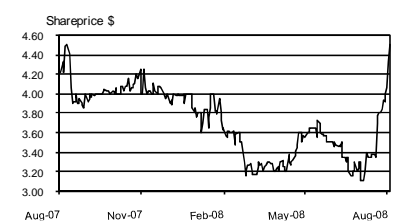
Shares on issue (m): 25.3
 Shares on issue (diluted) (m): 26.1
 Free float: 100%
 Average daily volume ('000): 12.3

Market cap (\$m): 117.3
 FY09e Enterprise value (\$m): 104.9
 FY09e Net debt (\$m): -12.4
 FY09e Gearing (ND/ND+E): -26%
 FY09e S'holders equity (\$m): 60.2
 FY09e NTA per share (\$): 1.39

Forecast: 2009
 Free cash flow (\$m): 32.1
 Return on average equity: 26%
 Net interest cover: nm

Forecast: 2010
 Free cash flow (\$m): 8.3
 Return on average equity: 25%
 Net interest cover: nm

Shareprice (\$):



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PSI SALE FETCHES US\$25M

Ammtec announced it has entered into a binding agreement for the sale of its 68.5% interest in PSI for US\$25m. The sale of the US based resin manufacturing business is expected to be settled in early October following due diligence. Ammtec noted that it received an unsolicited offer from an undisclosed party.

Management deemed PSI as non-core to Ammtec's metallurgical testing operations. PSI is still at the very early stages of commercialisation with significant additional effort and working capital required to develop and market the product. Continuation of this slow and intensive process would be "detrimental" to Ammtec's EPS in the near-term. We believe Ammtec would have eventually needed to raise capital to ramp up PSI.

We estimate the post-tax gain on sale to be \$17.1m given the carrying value was just \$4.3m. We assume an exchange rate of \$0.87 cents per USD and capital gains tax of \$7.3m (at 30%) which is not payable until FY10.

Given the solid acquisition pipeline, strong demand for metallurgical consultancy work and Ammtec's high ROE (~40%), we expect the company to reinvest the sale proceeds in future growth rather than return capital to shareholders. Although Ammtec has been busy expanding its capacity in Western Australia, the company has identified the need for further expansions to meet prevailing and projected high demand.

We forecast Ammtec to have \$19.2m net cash in FY09e (\$0.73 cents per share). Assuming a target gearing ratio of 20% (similar to previous forecast), Ammtec could borrow a further \$28m, providing the company with ~\$47m capacity for growth spend.

Ammtec previously projected a \$1.5m consolidated loss in FY09 from PSI. To account for the sale, management upgraded FY09 EPS guidance by 18% from 40 cps to 47 cps. FY09 operating EBITDA guidance increased by 4% from \$18.0m to \$18.7m, implying a 130 basis point lift in the FY09 EBITDA margin from 32.4% to 33.7%.

We did not anticipate PSI to turn profitable within the next three years. The successful commercialisation of this business remained 'blue sky' to our valuation.

REVISED FORECASTS

Our FY09e and FY10e Sales Revenue forecasts remain unchanged. We are comfortable with our FY09e Sales Revenue forecast of \$58.0m being 4% above management's guidance, which we view as conservative.

We have increased our FY09e EBITDA margin forecast by 70 basis points to 33.5%, 20 basis points below implied guidance of 33.7% post PSI. Our FY10e EBITDA forecast increases to 33.7%. The margin uplift reflects the reduced operating costs associated with PSI. Our revised FY09e EBITDA forecast of \$19.5m is 4% above guidance of \$18.7m (excludes interest income).

We assume that the gross cash proceeds of \$28.7m from the PSI sale earn interest at 7.5% per annum. As a result, our previous FY09e net interest expense forecast of \$1.5m becomes net interest income of \$0.6m with FY10e net interest income of \$1.0m.

Our FY09e and FY10e effective tax rate forecasts have been revised down from 33% to 32% to reflect the impact of the PSI sale. The PSI losses we only partially tax deductible.

These changes, which are displayed overleaf, increase our FY09e EPS by 16% and our FY10e EPS by 18%.

Forecast changes (\$m)

	FY09			FY10		
	NEW	OLD	Diff	NEW	OLD	Diff
Sales Revenue	58.0	58.0	0%	68.0	68.0	0%
EBITDA	19.5	19.0	2%	22.9	21.8	5%
EBITDA Margin	33.5%	32.8%	2%	33.7%	32.1%	5%
D & A tang	1.8	1.8	2%	2.0	2.0	2%
EBITA	17.6	17.2	2%	20.9	19.7	6%
Amort intang	0.0	0.0	nm	0.0	0.0	nm
EBIT	17.6	17.2	2%	20.9	19.7	6%
EBIT Margin	30.4%	29.7%	2%	30.7%	29.0%	6%
Net int exp / (inc)	-0.6	1.5	nm	-1.0	1.2	nm
PBT	18.2	15.7	16%	21.9	18.5	18%
Tax exp	5.7	5.2	10%	7.0	6.2	13%
NPAT pre minorities	12.4	10.5	18%	14.9	12.3	21%
Minorities	0.0	-0.2	nm	0.0	-0.2	nm
NPAT pre sig items	12.4	10.7	16%	14.9	12.5	19%
Significant items	17.1	0.0	nm	0.0	0.0	nm
NPAT reported	29.5	10.7	176%	14.9	12.5	19%
NPAT adjusted*	12.4	10.7	16%	14.9	12.5	19%
EPS adjusted	47.3	40.7	16%	56.3	47.6	18%

* NPAT adjusted for significant items and amortisation of intangibles
Source: Company; FSB estimates

VALUATION

Our revised forecasts and the increased cash from the sale increase our NPV by 27% to \$6.10/share and our one-year forward valuation by 19% to \$6.42/share. We retain our WACC of 12% and our terminal growth rate of 3%.

Valuation

	NPV now		NPV in one year	
	\$m	\$ Per share	\$m	\$ Per share
Business value	1141.1	5.37	156.7	5.95
Net debt	-19.2	-0.73	-12.4	-0.47
NPV	160.3	6.10	169.1	6.42

Source: Company; FSB estimates

RECOMMENDATION

We view the strategic rationale for the PSI sale as sound. The commercialisation of PSI was slow and resource intensive and, in our opinion, Ammtec did not have sufficient capital or manpower to fully ramp up the business. Ammtec now has a strong balance sheet to fund future growth initiatives focused on metallurgical testing.

We maintain our Buy recommendation and set our revised price target to \$6.42/share. There is currently 43% upside to our price target which reflects our one-year forward valuation. Ammtec remains undervalued in our view, trading on attractive metrics with FY09e EV/EBITDA of 5x, PER of 9.5x, a fully franked dividend yield of 9% and a free cash flow yield of 6%. We expect the stock to re-rate on the back of positive earnings announcements and growth initiatives.

Ammtec Ltd (AEC)

Full Year Ended 30 June

Profit and Loss (\$m)	2008a	2009e	2010e	2011e
Sales Revenue	37.4	58.0	68.0	74.8
Other Revenue	0.1	0.1	0.1	0.1
Total Revenue	37.5	58.1	68.1	74.9
EBITDA	12.0	19.5	22.9	25.2
EBITDA margin (%)	32.0	33.5	33.7	33.7
D & A tangibles	1.1	1.8	2.0	2.2
EBITA	10.9	17.6	20.9	23.0
EBITA margin (%)	29.2	30.4	30.7	30.7
Amortisation intangibles	0.0	0.0	0.0	0.0
EBIT	10.9	17.6	20.9	23.0
EBIT margin (%)	29.2	30.4	30.7	30.7
Net Interest exp / (income)	0.7	(0.6)	(1.0)	(0.5)
Profit before tax	10.2	18.2	21.9	23.5
Tax exp / (benefit)	3.4	5.7	7.0	7.5
NPAT pre minorities	6.8	12.4	14.9	16.0
Minority Interests	-0.2	0.0	0.0	0.0
NPAT pre sig items	6.6	12.4	14.9	16.0
Significant items	0.1	17.1	0.0	0.0
NPAT reported	6.7	29.5	14.9	16.0
NPAT adjusted *	6.6	12.4	14.9	16.0
EPS adj ¢	29.5	47.3	56.4	60.6

* NPAT adjusted for significant items and amortisation of intangibles

Cash Flow (\$m)	2008a	2009e	2010e	2011e
EBITDA	12.0	19.5	22.9	25.2
Net Interest	-0.7	0.6	1.0	0.5
Tax	-3.4	-5.7	-7.0	-7.5
Δ Working Capital	-4.8	-4.2	-2.1	-1.5
Other	3.9	3.0	2.0	1.7
Operating Cashflow	8.0	13.1	9.4	18.4
Capex	-5.6	-6.0	-5.5	-5.5
Net Acquisitions	-16.2	28.7	0.0	0.0
Asset Sales	0.4	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Investing Cashflow	-21.5	22.7	-5.5	-5.5
Equity proceeds	14.5	0.0	0.0	0.0
Debt proceeds	4.7	0.0	2.0	0.0
Debt repayment	-0.6	0.0	0.0	0.0
Dividends paid	-5.1	-8.2	-10.7	-10.0
Other	0.0	1.1	0.0	0.0
Financing Cashflow	13.5	-7.2	-8.7	-10.0
Net Cashflow	0.0	28.6	-4.8	2.9

Ratios	2008a	2009e	2010e	2011e
EPS rep ¢	30.0	112.4	56.4	60.6
EPS adj ¢	29.5	47.3	56.4	60.6
EPS adj growth (%)	25.4	60.5	19.2	7.3
PER x	15.3	9.5	8.0	7.4
EV/EBITDA x	9.2	5.1	4.6	4.1
EV/EBIT x	10.1	5.6	5.1	4.5
Payout ratio (%)	72.0	66.2	65.0	65.0
DPS Total ¢	25.0	41.8	37.8	40.6
Yield (%)	5.6	9.3	8.4	9.0
Average RoE (%)	24.3	64.1	25.6	25.3
Average RoA (%)	27.0	24.3	23.0	24.0
Gearing (ND/ND+E) (%)	20.7	-52.2	-26.1	-30.3
Net interest cover x	16.1	nm	nm	nm
ND/EBITDA x	0.8	-1.0	-0.5	-0.6
NTA (\$ per share)	0.57	1.24	1.39	1.62
WA # Shares Diluted (m)	22.5	26.3	26.3	26.3

Source: Company; FSB estimates

Half Year Ended 31 Dec

Profit and Loss (\$m)	1H08a	2H08a	1H09e	2H09e
Sales Revenue	16.1	21.3	26.0	32.0
Other Revenue	0.1	0.0	0.1	0.1
Total Revenue	16.2	21.3	26.0	32.1
EBITDA	4.9	7.1	8.7	10.8
EBITDA margin (%)	30.6	33.2	33.5	33.6
D & A tangibles	0.4	0.7	0.9	0.9
EBITA	4.5	6.4	7.8	9.8
EBITA margin (%)	28.2	29.9	30.0	30.7
Amortisation intangibles	0.1	0.0	0.0	0.0
EBIT	4.4	6.5	7.8	9.8
EBIT margin (%)	27.6	30.4	30.0	30.7
Net Interest exp / (income)	0.3	0.4	(0.3)	(0.3)
Profit before tax	4.2	6.1	8.1	10.1
Tax exp / (benefit)	1.4	2.0	2.6	3.2
NPAT pre minorities	2.8	4.0	5.5	6.9
Minority Interests	-0.1	-0.1	0.0	0.0
NPAT pre sig items	2.7	3.9	5.5	6.9
Significant items	0.0	0.1	17.1	0.0
NPAT reported	2.7	4.0	22.6	6.9
NPAT adjusted *	2.9	3.8	5.5	6.9
EPS adj ¢	13.3	16.2	21.2	26.1

* NPAT adjusted for significant items and amortisation of intangibles

Balance Sheet (\$m)	2008a	2009e	2010e	2011e
Cash	0.0	28.6	23.9	26.8
Receivables	9.7	14.6	17.2	18.9
Inventories	1.9	2.8	3.3	3.6
PPE	21.3	21.2	24.7	27.9
Intangibles	21.4	21.4	21.4	21.4
Investments	0.0	0.0	0.0	0.0
Other	0.9	1.0	1.0	1.0
Total Assets	55.2	89.7	91.4	99.7
Accounts payable	5.0	7.4	8.7	9.5
Provisions	0.0	0.0	0.0	0.0
Tax liabilities	2.4	3.8	4.6	4.9
Debt	9.4	9.4	11.4	11.4
Other	2.2	13.1	6.6	7.7
Total Liabilities	19.1	33.7	31.3	33.6
Reserves and capital	26.0	27.1	27.1	27.1
Retained earnings	10.0	28.9	33.1	39.0
Minorities	0.2	0.0	0.0	0.0
Total Equity	36.2	56.0	60.2	66.1

Divisions (\$m)	2008a	2009e	2010e	2011e
WA	26.9	40.4	48.5	53.9
TAS	3.2	3.4	3.5	3.6
NSW	1.8	1.9	2.0	2.1
SA	1.2	1.2	1.3	1.4
Total Met Revenue	33.1	47.0	55.3	60.9
Marc	4.3	11.0	12.6	13.9
Other	0.1	0.1	0.1	0.1
Total Revenue	37.5	58.1	68.1	74.9

Valuation	now		one year	
	\$m	\$ ps	\$m	\$ ps
Business value	141.1	5.37	156.7	5.95
Net debt	-19.2	-0.73	-12.4	-0.47
NPV	160.3	6.10	169.1	6.42

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