

Ammtec (AEC.ASX)

Friday 8 August 2008

Solid FY08 result, FY09 guidance a nice surprise

Ammtec reported a record profit with adjusted FY08 NPAT of \$6.6m, up 73% yoy. This was 7% below our forecast of \$7.1m due to higher than expected D&A and tax expenses. Sales Revenue and EBITDA were in line with our forecasts.

Solid operating leverage was achieved with 50% EBITDA growth (FY08 EBITDA of \$11.9m) on 43% Sales Revenue growth (FY08 Sales Revenue of \$37.4m). The EBITDA margin expanded 160 basis points to 31.8% over the period.

Strong organic growth. The strong growth in revenues and earnings was attributable to robust demand for metallurgical consultancy work, particularly in Western Australia (72% of FY08 Sales) and a four month contribution from the Marc acquisition. Organic Sales and earnings growth was solid at 26% yoy.

Capacity expansions provide upside. The earnings growth was largely achieved from existing capacity. Ammtec has been investing in capacity expansions which are yet to be fully realised, providing significant future growth potential. The new WA assay facility, the largest in the Southern Hemisphere, is now complete and expansion plans for Marc and a number of other business lines are well progressed.

Guidance supports bullish outlook. Management provided FY09e guidance of 40cps Basic EPS; \$10.0m NPAT, \$18.0m EBITDA; and \$55.6m revenue. Our recent meeting with management further reinforced our strong positive conviction regarding Ammtec's growth prospects. The company also noted that the integration of Marc has been very successful with the client base intact and no staff lost.

Revised forecasts. Our FY09e EPS forecast has been reduced by 4% while our FY10e forecast has been increased by 12%.

We maintain our Buy recommendation and set our revised price target to \$5.39/share. There is currently 42% upside to our price target which reflects our one-year forward valuation. Ammtec is trading on an attractive FY09e PER of 9x with a fully franked yield of 9%. Ammtec also appears undervalued considering the Amdel trade sale price of 9x FY09 EBITDA. This multiple implies a \$6.06 valuation for AEC. We forecast strong near-term growth driven by robust demand and capacity expansions.

Year to June (\$m)	2007a	2008a	2009e	2010e	2011e
Revenue	26.2	37.4	58.0	68.0	74.8
% change	11%	43%	55%	17%	10%
EBITDA	7.9	11.9	19.0	21.8	23.9
EBITDA margin	30.2%	31.8%	32.8%	32.0%	32.0%
NPAT rep	4.8	6.9	10.7	12.6	13.9
NPAT adj	4.6	6.3	10.7	12.6	13.9
EPS adj (c)	22.4	27.9	40.7	47.6	52.6
% change	-14%	24%	46%	17%	11%
Dividend (c)	22.0	25.0	34.5	31.9	35.3
PER (x)	16.9	13.6	9.3	8.0	7.2
EV/EBITDA (x)	10.2	8.0	5.9	5.2	4.6
Yield (%)	5.8%	6.6%	9.1%	8.4%	9.3%

Figures adjusted for NRIs and amortisation of intangibles

Source: Company, Foster Stockbroking

Metals & Mining

Rating: Buy
 (previous): Buy

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Share price: \$3.80
 Price target: \$5.39
 (Previous) \$5.75
 NPV per share \$4.80
 Risk: Medium

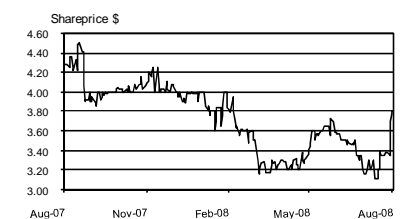
Shares on issue (m): 25.3
 Shares on issue (diluted) (m): 26.1
 Free float: 100%
 Average daily volume ('000): 11.7

Market cap (\$m): 99.1
 FY08e Enterprise value (\$m): 111.2
 FY08e Net debt (\$m): 12.1
 FY08e Gearing (ND/ND+E): 23.8
 FY08e S'holders equity (\$m): 38.8
 FY08e NTA per share (\$): 0.58

Forecast: 2009
 Free cash flow (\$m): 2.7
 Return on average equity: 29%
 Net interest cover: 11.5

Forecast: 2010
 Free cash flow (\$m): 7.7
 Return on average equity: 31%
 Net interest cover: 16.4

Shareprice (\$):



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FY08 RESULT OVERVIEW

Ammtec reported a record profit with adjusted FY08 NPAT of \$6.6m, up 73% yoy. This was 7% below our forecast of \$7.1m due to higher than expected D&A and tax expenses. Reported NPAT of \$6.9m (pre-minorities) was 2% ahead of guidance provided in February 2008. Sales Revenue and EBITDA were in line with our forecasts and were 2% ahead of guidance.

Solid operating leverage was achieved with 50% EBITDA growth (FY08 EBITDA of \$11.9m) on 43% Sales Revenue growth (FY08 Sales Revenue of \$37.4m). The EBITDA margin expanded 160 basis points to 31.8% over the period.

The strong growth in revenues and earnings was attributable to robust demand for metallurgical consultancy work, particularly in Western Australia (72% of FY08 Sales) and a four month contribution from the Marc acquisition. Organic Sales and earnings growth was 26% yoy. The WA met lab delivered a strong 2H08 with revenue up 9% on the first half and up 41% on the pc.

A snapshot of the result versus our forecasts is shown below:

1H08 Actual result vs FSB forecast (\$m)

	1H08 Actual	1H08 FSB	Diff	1H07 Actual	PCP Diff
Sales Revenue	37.4	37.6	-1%	26.2	43%
EBITDA	11.9	11.9	0%	7.9	50%
EBITDA margin	31.8	31.6	1%	30.2	5%
D & A tangibles	1.1	1.0	7%	0.5	114%
EBITA	10.8	10.9	-1%	7.2	51%
Amort intangibles	0.0	0.2	-100%	0.0	nm
EBIT	10.8	10.7	1%	7.2	51%
EBIT margin	29.0	28.5	2%	27.5	6%
Net interest exp	0.7	0.7	-3%	0.0	nm
PBT	10.2	10.0	2%	7.2	41%
Tax	3.4	3.2	7%	2.3	47%
NPAT rep	6.7	6.9	-2%	4.8	39%
Minorities	-0.2	0.0	nm	0.0	nm
NPAT rep (pre min)	6.9	6.9	0%	4.8	43%
NPAT adj	6.6	7.1	-7%	4.6	43%
EPS adj c	29.5	31.1	-5%	22.4	31%

Source: Company, FSB estimates

Record Dividend

Ammtec declared a final dividend of 14 cents per share to be paid in October, taking the full year dividend to 25 cents per share, 7% above our forecast and up 14% yoy. This represents a payout ratio of 69%. Management stated that the commitment to a record dividend at this level reflects the continued optimism of the Board to the ongoing success of the company.

DRP

The company announced the implementation of a Dividend Reinvestment Plan (DRP) which will be offered at a 5% discount to the weighted average market price during the five days prior to and including the closing date of 30 September 2008.

FY08 HIGHLIGHTS

- **Record earnings with solid margin expansion**
- **Benefits of the continuing capacity expansions yet to be realised**
- **Increased interest in PSI to 68.5%**
- **Acquisition of MARC for ~\$12m with a successful integration**
- **Expansion of Marc facilities about to commence (300% expansion)**
- **\$10m capital raising completed and \$4.2m raised from SPP**
- **Better utilisation of the balance sheet with debt taken on board**

GROWTH INITIATIVES

In response to strong demand, Ammtec has been investing in capacity expansions. These are largely yet to be fully realised, providing significant future growth potential. In FY08, the company spent \$5.6m in capex, more than half of which was growth capex on capacity expansions. We forecast FY09e capex of \$6.5m.

The company provided the following update on its expansion initiatives:

WA Met Lab Expansions:

- Completed a 200% capacity expansion of the flotation section;
- Completed a 300% expansion of its comminution capabilities for crushing and grinding;
- Ongoing expansion of pilot plants;
- Progressing a 400% capacity expansion and relocation of the hydromet capabilities for uranium and copper leaching; &
- Plans to expand the gold section by 200%.

The new WA assay lab is now complete although Ammtec has identified the need for further capex on the lab (we estimate around \$1.5m) to enhance services.

The new assay lab provides Ammtec with a strategic advantage for winning new metallurgical consultancy work. Strong volumes have blown out outsourced assay turnarounds to 4-6 weeks. Thus, the ability to conduct assay tests in house allows Ammtec to offer clients much quicker project completion estimates.

Marc Environmental Solutions expansion:

- Plans to expand the factory and office space by 300% in the near term;
- Plans for a major expansion to automaton and sampling and dust collection capabilities; &
- Plans to recruit senior staff to help facilitate growth.

Purity Systems Inc (PSI);

- Continuing development of new resins and refinement of the technology;
- Boosted PSI staff by appointing a MD to help achieve sales growth;
- Continuing work with Redbank Mines on PSI's first commercial project; &
- Ammtec noted that there are two other possible projects on the horizon in Australia.

BULLISH OUTLOOK

Our recent meeting with management further reinforced our strong positive conviction regarding Ammtec's growth prospects. Demand for metallurgical consultancy work remains very strong, particularly from the large scale iron ore expansions in WA. The company's increased capacity and new services should enable it to fully capitalise on this booming activity. Marc has been integrated successfully with the client base intact and no staff lost. The PSI resin business remains 'blue sky' in our valuation. Whilst commercialisation of new technology can be a slow process, PSI has the potential to be larger than Ammtec.

FY09 GUIDANCE

Management provided FY09e guidance of 40cps Basic EPS; \$10.0m NPAT, \$18.0m EBITDA; and \$55.6m revenue. This is the first time the company has provided full year guidance. We believe management have been conservative and significant upside exists from further expansions and large project wins.

AMDEL TRADE SALE HIGHLIGHTS VALUE IN AMMTEC

In May 2008, French testing and verification company, Bureau Veritas, acquired one of Ammtec's nearest competitors, Amdel Holdings Pty Ltd, from Champ Ventures. The sale price was rumoured to be in excess of \$400m, implying a solid FY09 EBITDA multiple of 9x based on Bureau Veritas' earnings projections for Amdel (FY09 EBITDA of \$44.6m on revenues of \$186.5m). In 2005 Champ Ventures sponsored a MBO of Amdel from Healthscope (HSP) for \$60m. A number of other minerals testing businesses were subsequently bolted on (including IML, Ultra Trace and Labmark). An IPO was flagged as the preferred exit method prior to the equity market downturn.

Ammtec is currently trading on just 5.9x FY09 EBITDA. Applying the Amdel transaction multiple of 9x to Ammtec implies a valuation of \$6.06 per share. There is currently 59% upside to this valuation. Although Amdel is more than twice the size of Ammtec in revenue terms, Ammtec has the PSI business which has strong future earnings potential. Thus, we believe Ammtec is worth at least 8x forward EBITDA (\$5.33 valuation).

REVISED FORECASTS

We have increased our FY09e and FY10e Sales Revenue forecasts by 7% and 9% respectively. This reflects extra capacity and continued robust demand. 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 120 basis points to 32.8%, 40 basis points above guidance of 32.4%. Our revised FY09e EBITDA forecast of \$19.0m is 6% above guidance. We have also increased our D&A, net interest and tax rate estimations going forward. Our revised FY09e reported NPAT (pre minorities) forecast of \$10.7m is 7% above management's guidance.

We have assumed a 30% DRP take up with an issue price of \$3.60. This translates to \$1.1m cash and 0.3m new shares, equivalent to an annualised 1.2% increase in the ordinary shares on issue.

These changes, which are displayed overleaf, decrease our FY09e EPS by 4% and increase our FY10e EPS by 12%.

Forecast changes (\$m)

	FY09			FY10		
	NEW	OLD	Diff	NEW	OLD	Diff
Sales Revenue	58.0	54.4	7%	68.0	62.6	9%
EBITDA	19.0	17.2	11%	21.8	20.1	8%
EBITDA Margin	32.8%	31.6%	4%	32.0%	32.1%	0%
D & A tang	1.8	1.1	66%	2.0	1.2	70%
EBITA	17.2	16.1	7%	19.7	18.9	4%
Amort intang	0.0	0.2	-100%	0.0	0.2	-100%
EBIT	17.2	15.9	8%	19.7	18.6	6%
EBIT Margin	29.7%	29.2%	2%	29.0%	29.7%	-2%
Net interest exp	1.5	0.7	114%	1.2	1.1	9%
PBT	15.7	15.2	3%	18.5	17.5	6%
Tax exp	5.2	4.6	14%	6.2	5.3	16%
NPAT rep	10.5	10.6	-1%	12.3	12.2	1%
Minorities	-0.2	-0.2	0%	-0.2	-0.2	0%
NPAT rep (pre min)	10.7	10.8	-1%	12.6	12.4	1%
NPAT adj	10.7	10.8	-1%	12.6	12.4	1%
EPS adj	40.7	42.6	-4%	47.6	42.6	12%

Source: Company; FSB estimates

VALUATION

Our revised forecasts and our increased WACC (up 150 basis points to 12%) have reduced our NPV by 8% to \$4.80/share and our one-year forward valuation by 5% to \$5.39/share. We retain our terminal growth rate of 3%.

Valuation

	NPV now		NPV in one year	
	\$m	\$ Per share	\$m	\$ Per share
Business value	138.5	5.26	154.4	5.85
Net debt	12.1	0.46	12.2	0.46
NPV	126.4	4.80	142.2	5.39

Source: Company; FSB estimates

RECOMMENDATION

We view Ammtec’s FY08 result as strong, with solid organic growth and margin expansion. We remain bullish on the company’s growth prospects and continue to believe the stock is undervalued. Management have historically been highly conservative and the FY09 guidance should provide the market with more confidence in Ammtec’s near term earnings potential.

Ammtec’s Perth facility is the largest metallurgical lab in the Southern Hemisphere. We are attracted to the company’s strong market position in a niche industry fully leveraged to the resources boom. Metallurgical testing and consulting are essential components of bankable feasibility studies and AEC’s expertise also allows for significant operating efficiency gains for mineral processing plants.

We maintain our Buy recommendation and set our revised price target to \$5.39/share. There is currently 42% upside to our price target which reflects our one-year forward valuation. Ammtec is trading on an attractive FY09e PER of 9x with a fully franked yield of 9%. Ammtec also appears undervalued considering the Amdel trade sale price of 9x FY09 EBITDA. This multiple implies a \$6.06 valuation for AEC. We forecast strong near-term growth driven by robust demand and capacity expansions.

Ammtec Ltd (AEC)

Full Year Ended 30 June

Profit and Loss (\$m)	2007a	2008a	2009e	2010e
Sales Revenue	26.2	37.4	58.0	68.0
Other Revenue	0.2	0.1	0.1	0.1
Total Revenue	26.4	37.5	58.1	68.1
EBITDA	7.9	11.9	19.0	21.8
EBITDA margin (%)	30.2	31.8	32.8	32.0
D & A tangibles	0.7	1.1	1.8	2.0
EBITA	7.2	10.8	17.2	19.7
EBITA margin (%)	27.5	29.0	29.7	29.0
Amortisation intangibles	0.0	0.0	0.0	0.0
EBIT	7.2	10.8	17.2	19.7
EBIT margin (%)	27.5	29.0	29.7	29.0
Net Interest exp / (income)	0.0	0.7	1.5	1.2
Profit before tax	7.2	10.2	15.7	18.5
Tax exp / (benefit)	2.3	3.4	5.2	6.2
NPAT rep	4.8	6.7	10.5	12.3
Minority Interests	0.0	-0.2	-0.2	-0.2
NPAT rep (pre min)	4.8	6.9	10.7	12.6
NPAT adj	4.6	6.6	10.7	12.6
EPS adj ¢	22.4	29.5	40.7	47.6

Cash Flow (\$m)	2007a	2008a	2009e	2010e
EBITDA	7.9	11.9	19.0	21.8
Net Interest	0.0	-0.7	-1.5	-1.2
Tax	-2.3	-3.4	-5.2	-6.2
Δ Working Capital	0.1	-4.8	-4.1	-2.0
Other	1.1	4.0	3.0	2.0
Operating Cashflow	6.1	8.0	11.2	14.4
Capex	-4.2	-5.6	-6.5	-5.5
Net Acquisitions	-0.4	-16.2	0.0	0.0
Asset Sales	0.0	0.4	0.0	0.0
Other	0.0	0.0	0.0	0.0
Investing Cashflow	-4.6	-21.5	-6.5	-5.5
Equity proceeds	0.6	14.5	0.0	0.0
Debt proceeds	0.0	4.7	2.0	2.0
Debt repayment	-0.4	-0.6	0.0	0.0
Dividends paid	-4.5	-5.1	-7.4	-9.0
Other	0.0	0.0	1.1	0.0
Financing Cashflow	-4.3	13.5	-4.3	-7.0
Net Cashflow	-2.8	0.0	0.3	1.9

Ratios	2007a	2008a	2009e	2010e
EPS rep c	23.5	30.8	40.7	47.6
EPS adj c	22.4	29.5	40.7	47.6
EPS adj growth (%)	-13.5	31.4	38.0	17.0
PER x	16.9	12.9	9.3	8.0
EV/EBITDA x	10.2	8.0	5.9	5.2
EV/EBIT x	11.3	8.8	6.5	5.7
Payout ratio	93.1	69.0	69.1	65.0
DPS Total c	22.0	25.0	34.5	31.9
Yield (%)	5.8	6.6	9.1	8.4
Average RoE (%)	25.2	24.0	28.6	31.0
Average RoA (%)	30.8	26.8	28.4	28.0
Gearing (ND/ND+E) (%)	12.3	20.7	23.8	22.3
Net interest cover x	nm	16.0	11.5	16.4
ND/EBITDA x	0.3	0.8	0.6	0.6
NTA (\$ per share)	0.64	0.57	0.58	0.72
WA # Shares Diluted (m)	20.6	22.5	26.3	26.4

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	26.1	32.1
EBITDA	5.0	6.9	8.5	10.5
EBITDA margin (%)	30.7	32.7	32.8	32.9
D & A tangibles	0.4	0.7	0.8	1.0
EBITA	4.6	6.3	7.7	9.5
EBITA margin (%)	28.4	29.4	29.7	29.7
Amortisation intangibles	0.1	0.0	0.0	0.0
EBIT	4.5	6.4	7.7	9.5
EBIT margin (%)	27.8	29.9	29.7	29.7
Net Interest exp / (income)	0.3	0.4	0.8	0.8
Profit before tax	4.2	6.0	7.0	8.8
Tax exp / (benefit)	1.5	1.9	2.3	2.9
NPAT rep	2.8	3.9	4.6	5.8
Minority Interests	-0.1	-0.1	-0.1	-0.1
NPAT rep (pre min)	2.7	4.2	4.5	6.2
NPAT adj	2.8	3.8	4.5	6.2
EPS adj ¢	13.4	16.1	17.2	23.5

Balance Sheet (\$m)	2007a	2008a	2009e	2010e
Cash	0.0	0.0	0.3	2.2
Receivables	4.8	9.7	14.6	17.2
Inventories	0.2	1.9	2.8	3.3
PPE	14.6	21.3	26.0	29.5
Intangibles	4.7	21.4	21.4	21.4
Investments	0.6	0.0	0.0	0.0
Other	0.7	0.9	1.0	1.0
Total Assets	25.5	55.2	66.2	74.6
Accounts payable	1.6	5.0	7.5	8.9
Provisions	0.0	0.0	0.0	0.0
Tax liabilities	0.3	2.4	4.1	4.8
Debt	2.7	9.4	12.4	14.4
Other	1.6	2.2	3.5	4.1
Total Liabilities	6.3	19.1	27.5	32.2
Reserves and capital	11.3	26.0	27.1	27.1
Retained earnings	7.9	10.0	11.5	15.1
Minorities	0.0	0.2	0.2	0.2
Total Equity	19.2	36.2	38.8	42.4

Divisions (\$m)	2007a	2008a	2009e	2010e
WA	19.9	26.9	40.4	48.5
TAS	2.9	3.2	3.4	3.5
NSW	2.2	1.8	1.9	2.0
SA	1.3	1.2	1.2	1.3
Total Met Revenue	26.2	33.1	47.0	55.3
Marc	0.0	4.3	11.0	12.6
PSI Resin	0.0	0.0	0.0	0.0
Other	0.2	0.1	0.1	0.1
Total Revenue	26.4	37.5	58.1	68.1

Valuation	now		one year	
	\$m	\$ ps	\$m	\$ ps
Business value	138.5	5.26	154.4	5.85
Net debt	12.1	0.46	12.2	0.46
NPV	126.4	4.80	142.2	5.39

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