

## AMMTEC LIMITED

### FY2010 boosted by Strong 2H Result

AEC has released an unaudited FY2010 result at the high end of expectations, with a 4% increase in profit on a 1% fall in Revenue. However, with the dilution from the recent equity raisings, EPS fell by 25%. AEC has announced a 1.5¢ increase in FY2010 dividends, with a proposed final dividend of 11¢ ps fully franked.

This result reflects a strong recovery in the 2H FY2010, with a 52.9% profit increase to record levels, after a 29.6% fall in 1H FY2010. The stronger 2H FY2010 result was due to:

- A recovery in Q4 FY2010 in Metallurgical Testing division to pre-GFC levels, underpinned by recent significant investments in new technology and expanded and enhanced facilities.
- A strong recovery in its MARC division, especially in dust suppression.

The Balance Sheet remained strong post equity raisings in FY2010, with gearing of only 4.4%.

### AEC Response

AEC has released its Target Statement, advising shareholders to reject the Campbell Brothers (CPB) bid of cash of \$3.35 ps, or a scrip alternative of 2 CPB shares for every 17 AEC shares, on the basis of:

- The bid undervalues AEC and doesn't take account of the its strong industry position, its significant recent investment, with acquisition multiple below recent comparable acquisitions.
- The bid discounts the improved trading outlook in FY2011. AEC has provided a guidance range for FY2011 of a net profit increase of 55% to 80% on a revenue increase of 35% to 46%.

At the offer price, these forecasts place AEC on a PE of 9.5x to 11.0x, increasing to 10.3x to 12.0x at the current price.

- The bid fails to reflect the strategic value of AEC to CPB, the financial and operational benefits that would flow from the acquisition and the valuation impact from CPB's higher earnings capitalisation rates.

### Expect a higher bid

We continue to believe this is an opening offer from CPB and will probably require an offer above \$4.00 ps to succeed. This view is based on:

- The growth potential within AEC and its leading market position.
- A valuation basis, with the bid well below market and recent transactional valuations.
- The strategic value that AEC would generate for CPB.

Meanwhile, the value of the share alternative has increased with a stronger CPB price, now at the equivalent of \$3.63 ps for AEC. This follows CPB forecasts of a strong 1H FY2011 result, confirmed at its recent AGM.

### Recommendation

We retain a BUY, with expectations of a higher bid and the benefits of the arbitrage of the AEC price to the CPB share alternative.

## AEC.ASX

## BUY

28 July, 2010

Price	\$3.61
Target price	\$3.99
Valuation	\$3.99
Target valuation method	PE Relative

GICS sector	Metals & Mining
12 mth Price range	\$1.83 - 3.55
Avg monthly t/o	m 1.0
Market Capitalisation	\$m 140.6
Shares on issue	m 37
Enterprise value	\$m 143

Year Ended June 30		09A	10A	11E	12E
Operating revenue	\$m	55.5	54.3	74.8	78.7
EBITDA	\$m	12.9	12.8	19.8	20.8
EBITDA margin	%	23.4	23.6	26.5	26.5
EBIT	\$m	11.2	10.7	17.2	18.0
EBIT margin	%	20.3	19.7	23.0	23.0
Adjusted NPAT	\$m	<b>6.9</b>	<b>7.2</b>	<b>11.3</b>	<b>11.9</b>

EPS adj	¢	27.1	20.3	30.9	32.4
EPS adj growth	%	-12.6	-25.0	52.0	4.9
DPS	¢	16.0	17.5	25.5	27.0
Franking	\$	100	100	100	100
PER	x	13.3	17.7	11.7	11.1
Dividend yield	%	4.4	4.8	7.1	7.5
NTA/share	\$	1.51	1.63	1.55	1.8

EV/EBITDA	x	8.3	11.2	7.4	0.0
P/OCF	x	10.7	13.7	9.5	9.0
ROA	%	18.1	14.0	20.0	20.2
ROE	%	16.0	11.2	16.9	17.0
Interest cover (EBIT)	x	9.1	35.7	34.4	36.1

### AEC v XSI (Small Industrial Index)



### Activities

Mining services, incl metallurgical and mineral testing  
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Current Price **\$3.61**

**Profit & Loss**

Year Ended Jun 30		2009a	2010a	2011e	2012e
Sales Revenue	\$m	55.5	54.3	74.8	78.7
Expenses	\$m	-42.6	-41.5	-55.0	-57.9
EBITDA	\$m	12.9	12.8	19.8	20.8
Depreciation & Amortisation	\$m	-1.7	-2.1	-2.6	-2.8
EBIT	\$m	11.2	10.7	17.2	18.0
Interest	\$m	-1.2	-0.3	-0.5	-0.5
Pre Tax Profit	\$m	10.0	10.4	16.7	17.5
Tax	\$m	-3.5	-3.6	-5.4	-5.7
Minorities	\$m	0.0	0.0	0.0	0.0
<b>Normalised Profit</b>	<b>\$m</b>	<b>6.9</b>	<b>7.2</b>	<b>11.3</b>	<b>11.9</b>
Adjustments					
Sig Items & Costs	\$m	0.0	0.0	0.0	0.0
<b>Reported Profit</b>	<b>\$m</b>	<b>6.9</b>	<b>7.2</b>	<b>11.3</b>	<b>11.9</b>

**Cash Flow**

Year Ended Jun 30		2009a	2010a	2011e	2012e
<b>Operating EBITDA</b>	<b>\$m</b>	<b>12.9</b>	<b>12.8</b>	<b>19.8</b>	<b>20.8</b>
Net Interest Paid	\$m	-1.2	-0.3	-0.5	-0.5
Tax Paid	\$m	-3.5	-3.6	-5.4	-5.7
Chg WorkCap & Other	\$m	3.7	-4.8	-0.5	-2.4
<b>Operating Cash Flow</b>	<b>\$m</b>	<b>11.9</b>	<b>4.1</b>	<b>13.4</b>	<b>12.2</b>
Capex	\$m	-5.6	-15.0	-1.5	-1.6
<b>Free Cash Flow</b>	<b>\$m</b>	<b>6.3</b>	<b>-10.9</b>	<b>11.9</b>	<b>-3.2</b>
Acquisitions/Asset Sales	\$m	-2.1	0.0	0.0	0.0
Dividends Paid	\$m	-4.7	-5.5	-8.5	-9.0
Equity	\$m	0.1	20.2	0.0	0.0
Debt	\$m	0.8	-3.6	-1.7	-0.4
Other	\$m	0.0	0.0	0.0	0.0
<b>Change in Net Cash</b>	<b>\$m</b>	<b>0.4</b>	<b>0.2</b>	<b>1.7</b>	<b>-12.6</b>

**Growth**

		2009a	2010a	2011e	2012e
Revenue	%	47.1	-1.6	37.8	5.0
EBIT	%	3.3	-4.4	60.7	4.9
Normalised Profit	%	-0.6	4.0	57.7	5.0
EPS	%	-12.6	-25.0	52.0	4.9

**Ratios**

		2009a	2010a	2011e	2012e
EBITDA / Sales	%	23.4	23.6	26.5	26.5
EBIT / Sales	%	20.3	19.7	23.0	23.0
Effective Tax Rate	%	34.8	34.6	32.4	32.4
Interest Cover	x	9.1	35.7	34.4	36.1

**Per Share**

		2009a	2010a	2011e	2012e
Issued Shares (Weighted Avg)	m	25.5	36.5	36.6	36.6
EPS	¢ ps	27.1	20.3	30.9	32.4
Operating Cash Flow ps	cps	33.8	26.3	38.0	39.9
Free Cash Flow	¢ ps	25.4	-31.1	32.6	29.0
DPS	¢ ps	16.0	17.5	25.5	27.0
Franking	%	100.0	100.0	100.0	100.0
Dividend Payout Ratio	%	59.0	86.0	82.5	83.3

**Parameters**

		2009a	2010a	2011e	2012e
PE Ratio	x	13.3	17.7	11.7	11.1
Enterprise Value / EBITDA	x	8.3	11.2	7.4	0.0
Enterprise Value / Profit	x	15.5	20.0	12.9	0.0
Cash Flow ratio	x	10.7	13.7	9.5	9.0
Dividend Yield	%	4.4	4.8	7.1	7.5

**Segments**

		2009a	2010a	2011e	2012e
<b>Sales Revenue (A\$m)</b>					
Metallurgical Testing	\$m	38.2	39.7	47.0	48.6
Marc	\$m	16.6	14.5	25.4	27.2
PSI	\$m	0.1	0.0	2.7	3.0
<b>EBITDA (A\$m)</b>					
Metallurgical Testing	\$m	12.9	11.8	15.3	15.9
Marc	\$m	1.7	2.7	4.8	5.0
PSI	\$m	-1.5	-1.5	0.0	0.2
<b>EBITDA MARGIN (%)</b>					
Metallurgical Testing	%	33.7	29.7	35.8	32.7
Marc	%	10.3	18.6	20.8	18.4
PSI	%	na	na	0.0	6.7
<b>EBITDA GROWTH (%)</b>					
Metallurgical Testing	%	17.6	-8.4	29.7	3.9
Marc	%	43.8	57.6	77.8	4.2

**Balance Sheet**

		2009a	2010a	2011e	2012e
Cash	\$m	0.5	2.7	3.4	4.6
Receivables	\$m	9.7	15.4	16.5	17.1
Inventory	\$m	2.2	2.5	2.7	2.8
Other Current Assets	\$m	0.2	0.6	0.6	0.2
<b>Current Assets</b>	<b>\$m</b>	<b>12.7</b>	<b>21.2</b>	<b>23.1</b>	<b>24.5</b>
Property, Plant & Equipment	\$m	32.6	39.7	41.1	43.0
Intangibles	\$m	23.3	22.1	23.5	23.5
Other NC Assets	\$m	1.0	1.4	0.0	0.0
<b>Non Current Assets</b>	<b>\$m</b>	<b>55.9</b>	<b>63.2</b>	<b>64.6</b>	<b>66.5</b>
<b>Total Assets</b>	<b>\$m</b>	<b>68.6</b>	<b>84.4</b>	<b>87.7</b>	<b>91.1</b>
Payables	\$m	7.6	8.7	9.5	7.9
Current Debt	\$m	1.6	1.6	1.4	1.5
Other Current Liabilities	\$m	2.6	3.5	3.5	3.8
<b>Current Liabilities</b>	<b>\$m</b>	<b>11.8</b>	<b>13.8</b>	<b>14.4</b>	<b>14.9</b>
Non Current Debt	\$m	7.5	3.9	2.4	1.9
Other NC Liabilities	\$m	6.3	2.7	4.0	4.5
<b>Non Current Liabilities</b>	<b>\$m</b>	<b>13.8</b>	<b>6.5</b>	<b>6.4</b>	<b>6.4</b>
<b>Total Liabilities</b>	<b>\$m</b>	<b>25.6</b>	<b>20.3</b>	<b>20.8</b>	<b>21.3</b>
<b>Shareholder Funds</b>	<b>\$m</b>	<b>43.0</b>	<b>64.1</b>	<b>66.9</b>	<b>69.8</b>

**Ratios**

		2009a	2010a	2011e	2012e
Receivables turn	x	5.7	3.5	4.5	4.6
Net Debt	\$m	8.6	2.8	0.4	0.0
Gearing (D:D+E)	%	19.9	4.4	0.7	0.0
Net Assets	\$	1.68	1.76	1.66	1.91
Net Tangible Assets	\$	1.51	1.63	1.55	1.78
Price to Book Value	x	214.3	205.7	238.8	189.2
Return On Assets	%	18.1	14.0	20.0	20.2
Return on Equity	%	16.0	11.2	16.9	17.0

**VALUATION**

Valuation Method	¢ps	Premium/Discount (%)
PE Relative	401.1	11.1
DCF	399.0	10.5

**Major Shareholders**

		Shareholding	%
Perpetual	m	2.4	6.6%
Directors	m	1.4	3.8%
Top 20	m	9.1	25.0%

FY2010 result

FY2010 result at high end of expectations

The result was at the high end of expectations, driven by a strong 2H FY2010 recovery:

Profit & Loss				Balance Sheet					
	\$m	2009	2010	% Ch		\$m	2009	2010	% Ch
Total Revenue		55.5	54.5	-1.9	Current Assets		12.7	21.2	
Expenses		-42.6	-41.7	-2.2	Non Current Assets		55.9	63.2	
Operating Profit		12.9	12.8	-0.7	Total Assets		68.6	84.4	23.1
Depreciation		-1.7	-2.1		Current Liabilities		11.8	13.8	
EBIT		11.2	10.7	-4.4	Non Current Liabilities		13.8	6.5	
Interest		-1.2	-0.3		Total Liabilities		25.6	20.3	-20.7
Pre-Tax profit		10.0	10.4	4.5	<b>Shareholder Funds</b>		<b>43.0</b>	<b>64.1</b>	49.2
Tax		-3.5	-3.6		Return on Equity (%)		16.0	11.2	
Minorities		0.0	0.0		Return on Assets (%)		18.1	14.0	
<b>Net Profit</b>		<b>6.9</b>	<b>7.2</b>	<b>4.0</b>	Net Debt (\$m)		8.6	2.8	-67.3
Significant Items		0.0	0.0		Gearing D:D+E (%)		19.9	4.4	
<b>Reported Profit</b>		<b>6.9</b>	<b>7.2</b>	<b>4.0</b>	Interest Cover (x)		9.1	35.7	
EBIT Margins (%)		20.3	19.7		Net Debt / EBITDA (x)		0.7	0.2	
Effective Tax Rate (%)		34.8	34.6		Current ratio (x)		1.1	1.5	
EPS (cps)		27.1	20.3	-25.0	NTAV (cps)		151.1	163.3	8.1
Cash Flow (cps)		33.8	26.3	-22.1	Price / Book (x)		2.1	2.0	
EV: EBITDA (x)		8.0	10.9		5 Yr Tot S'Holder Returns (% pa)		16.2	14.0	
DPS (cps)		16.0	17.5	9.4	5 Yr CAGR Rev (%)		36.9	25.8	
Franking (%)		100.0	100.0		5 Yr CAGR EBIT (%)		29.7	15.6	
Dividend Payout Ratio (%)		59.0	86.0		5 Yr CAGR EPS (%)		21.3	2.8	

Key Features

Stronger 2H, 46% above 1H FY2010

- A stronger 2H FY2010, with revenue and EBIT increasing by 22% and 46% above 1H FY2010.
- The EBITDA fall of 0.7% comprised:
  - A weak 1H FY2010, with EBITDA falling by 29.6% to \$5.2m on a 17.9% fall in Revenue to \$24.5m.
  - A record 2H FY 2010, with EBITDA increasing by 38.1% to \$7.6m, on a 17.6% increase in revenue to \$29.8m, with a return to pre-GFC volume conditions in Q4 FY2010. It should be noted that this is in comparison to a particularly weak pcp.
- The Pre-Tax profit increase of 4.5% was due to a \$0.9m fall in interest, with the lower debt resulting from the \$18.6m placement and SPP during FY2010.
- The 25% fall in EPS reflects the dilution from the equity raising.
- AEC has indicated it will pay a Final Dividend of 11¢ ps Fully Franked if the bid is not successful; resulting is a Dividend Payout Ratio of 86%. The CPB bid has a no dividend provision. AEC retains over \$8m in surplus Franking Credits.
- While net debt and gearing fell with the raising, this will increase modestly in 1H FY2011, with completion of the plant expansion.

A record 2H FY2010, with a return to Pre-GFC volumes in Q4

**Divisional**

Division	Revenue			EBITDA			Margin	
	2009	2010	% Ch	2009	2010	% Ch	2009	2010
Metallurgical Testing	38.2	39.7	3.9	12.9	11.8	-8.4	33.7	29.7
Marc	16.6	14.5	-12.5	1.7	2.7	57.6	10.3	18.6
PSI	0.1	0.0	-100.0	-1.5	-1.5	-2.5	n.a.	n.a.
<b>Total</b>	<b>54.9</b>	<b>54.2</b>	<b>-1.3</b>	<b>13.1</b>	<b>13.0</b>	<b>-0.4</b>	<b>23.8</b>	<b>24.0</b>

**Metallurgical Testing**

The revenue growth comprised a 6.6% fall in 1H FY2010, offset by a 15.8% increase in the 2H FY2010, with 2H FY2010 9% higher than the 1H FY2010. The strong revenue growth was concentrated on its WA facility, which grew at 8%, with the benefits of new technology, expansion and enhancement of its facilities. The margin decline was a combination of the lower 1H FY2010 revenue and revenue recognition milestones for expanded 2H FY2010 workload.

**MARC Technologies**

The improved result was due to a 2H recovery in revenue of 27.6%, 60% above 1H FY2010, resulting in a return to profits and a \$2.3m increase in 2H FY2010 over 1H FY2010. This was due to increasing demand for its dust suppression systems.

**PSI**

The continued losses follow AEC's continued investment in building the business.

**Outlook**

AEC has provided a guidance range for FY2011 for:

- Revenue of \$73m to \$79m, an increase of 35% to 46% over FY2010.
- EBITDA of \$19.6m to \$22.2m, an increase of 53% to 73% over FY2010.
- Net Profit \$11.1m to \$12.9m, an increase of 55% to 80% over FY2010.

**Metallurgical Testing**

Strong demand in 2H FY2010 has continued into 1H FY2011, with AEC forecasting a 14.3% to 28.2% increase in Revenue to \$45.4m to \$50.9m, resulting in a 28.8% to 49.1% increase in EBITDA to \$15.2m to \$17.6m. This anticipates an increase in margins from 29.8% in FY 2010 to above pre-GFC margins of 35.1%.

This growth is a combination of continued growth in overseas operations (33% of revenue in FY2010) and in Western Australia, especially with completion of the expanded facilities in December 2010. Only a minimal impact on Australian growth is expected from the Mineral Resources Rental Tax.

**MARC Technologies**

AEC has forecast a revenue increase of 75% to \$25.4m in FY2011, with 52% of forecast revenue already contracted and a further 26% under negotiation. This growth is mainly in the area of dust extraction systems for the iron ore producers and automated wet and dry sampling techniques for mineral processing. This is expected to result in a 77% increase in EBITDA to \$4.8m, returning to Pre-GFC margins

**PSI**

AEC expects PSI to be profit neutral in FY2011, with 40% locked in from the recent \$1.5m waste recovery contract win in China. AEC has had increased potential customer interest, including a significant US mining opportunity.

**Metallurgy volume recovery during FY2010**

**Demand returns for MARC in Q4**

**AEC forecasts strong growth in Revenue, EBITDA and Profit for FY2011**

**Strong growth for Metallurgy in FY2011 and a return to pre-GFC margins**

**MARC to benefit from a recovery in capex spend**

**Removal of PSI losses with new contract(s)**

## Takeover Bid

**Share alternative worth \$3.63 at current CPB price bid worth**

On 18/5/2010, CPB announced an intention to make a takeover bid for AEC at \$3.35 ps, comprising an all cash offer or a scrip alternative of 2 CPB shares for every 17 AEC shares (\$3.63 at the current CPB price). When announced, the cash offer was at a 33% premium to the pre bid market price and a 24% premium to the 20 day VWAP.

The bid is conditional on 90% acceptance and confirmation of forecasts for FY2010 of Revenue, EBITDA and EBIT of \$52.5m, EBITDA of \$12.4m and EBIT of \$10.3m, which have been met.

## Bidder's Statement

CPB's bid is based on:

**Bid Premium** - The cash offer was at a 33% premium to the pre-announced bid price and a 24% premium to the 20 day VWAP. At \$3.35, the offer is at a 12.4x FY2009 EPS, but 16.5x FY2010 and a 10.4x Enterprise Value / EBITDA ratio. However, the PE falls to 11.1x – 9.6x and the Enterprise Value / EBITDA to 6.7x – 5.9x on AEC FY2011 forecasts.

**Flexibility** – the opportunity to receive a certain cash value or participate in the growth of the expanded group.

**Benefit of CPB share ownership** - CPB is a more diversified group, by operations and geography, with a strong growth record and outlook. CPB share also offer increased liquidity.

**Uncertainty on AEC** – AEC forecasts have been unreliable, with the possibility of a share price fall, should the bid fail.

## AEC Response

AEC has rejected the bid as inadequate on the following basis:

**Bid multiple below recent comparable acquisition**

**Valuation** - The bid undervalues AEC and doesn't account for the opportunities from the recent and current expansion. The acquisition multiple is significantly below recent comparable transactions, such as the acquisition of Amdel by Bureau Veritas and the CPB acquisition of Pearl Street.

**Strategic Value** - The offer price doesn't reflect the strategic value of AEC to CPB, including its leading industry position expansion and cross sell opportunities and synergies.

**Growth Outlook** - The offer does not take account of the expected improved trading in FY2011 and growth opportunities. AEC has provided a guidance range for FY2011 for:

- Revenue of \$73m to \$79m, an increase of 35% to 46% over FY2010.
- EBITDA of \$19.6m to \$22.2m, an increase of 53% to 73% over FY2010.
- Net Profit \$11.1m to 12.9m, an increase of 55% to 80% over FY2010.
- A Franking credit balance of \$8.1m

**Projects strong Revenue, EBITDA and profit growth for FY2011**

This profit forecast puts AEC on a PE of 9.6x to 11.10x at the offer price of \$3.35.

**Shareholder Value** - Acceptance of the share alternative would result in a lower earnings and dividend yield.

**Bid remains conditional on 90% acceptance**

**Uncertainty on Bid** - The offer is highly conditional, including a 90% minimum acceptance condition. AEC directors, who hold 3.8%, have indicated that they intend to reject the bid. There is no certainty the AEC price will fall post bid.

### Forecasts

For FY2011, due to conservatism and the difficulty in forecasting AEC earnings beyond the normal 3-6 month time horizon, we have assumed forecasts at the lower end of AEC's forecast range. We have also assumed a dividend payout ratio of 85%.

For FY2012, we have assumed a 5% increase in revenue and similar EBITDA margins.

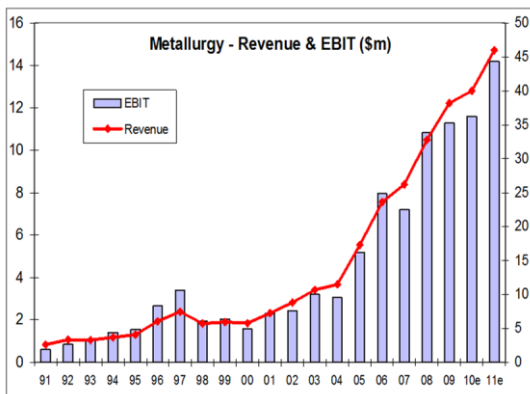
### Comment

We continue to believe this is an opening offer from CPB and will probably require an offer around or above \$4.00 to succeed. This view is based on:

**Strategic Value** - We see AEC as an important strategic acquisition for CPB, given its growth opportunities, performance record and global status.

**Forecasts** - The forecast FY2011 PE and EV/EBITDA ratios of 10.9x and 7.0x and a Yield of 7.6% fully franked, using our conservative forecasts at the bid price, increasing to 11.7x and 7.4x, and a yield of 7.1% at the current price.

**Bid will need to be increased above \$4.00 to succeed**



While the size of the growth in revenue and margins may be under question, given the need to defend the bid, there is enough evidence of a recovery in the sector to warrant a significant profit increase for FY2011, especially if AEC can announce expected contracts.

Also, the key metallurgical testing area has shown continued growth over long periods, (see chart on left) with:

- Over 33% of revenue now offshore.
- Around 49% of Australian revenue is related to current operating mines.
- Revenue is spread across a variety of commodities, including iron ore (37%), base metals (16%), gold (28%), nickel (6%) and uranium, with different fundamentals and price drivers.

**Valuation** – Recent comparable valuations, suggest a higher valuation is realistic. In the case of Pearl Street, CPB increased its bid by 33% to achieve an acceptance recommendation.

**Current Trading** – While AEC is currently trading at around the share alternative valuation, its trading at a 8.3% premium to the cash offer.

**Outlook Statement** – CPB's outlook statement at its AGM was generally positive, supporting further price strength for CPB:

- CPB is expecting a solid 1H FY2011 result with guidance of a 65% to 79 % increase in Profit to \$63m to \$68m, helped by recent acquisitions and a recovery in sample volume.
- However, it was exhibiting some caution on the 2H result, due to:
  - Seasonal factors.
  - Increasing cost pressures associated with recent expansion.
  - The continuing impact of a strong A\$.
  - Weakness in the Reward earnings and problems in laboratory services in Russia and China.
- The 2H Outlook provides some incentive for the AEC acquisition, as it would increase EPS yield.

**CPB Share Price** – With recent price strength and the arbitrage on the share alternative, CPB could increase the share component without impacting significantly on the earning yield gain from the acquisition. We would also expect an increase in the cash component to a level where it becomes a viable alternative to the share offer.

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RATING

BUY – anticipated stock return is greater than 10%  
 SELL – anticipated stock return is less than -10%  
 HOLD – anticipated stock return is between -10% and +10%  
 SPECULATIVE – High risk with stock price likely to fluctuate by 50% or more

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