VERITAS SECURITIES LIMITED

EQUITY RESEARCH

AMMTEC LIMITED

AEC Provides guidance for FY2011 in response to Campbell Brothers takeover bid

AEC has provided profit guidance for strong profit growth in FY2011, as part of an initial rejection of the intended $3.35 ps takeover bid by Campbell Bros Ltd (CPB).

On 18/5/2010, CPB announced an intention to make a takeover bid for AEC at $3.35 ps, comprising either an all cash offer or a scrip alternative of 2 CPB shares for every 17 AEC shares ($3.34 at current prices). The bid is conditional on 90% acceptance and confirmation of FY2010 forecasts.

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 16.8x forecast FY2010 after a placement and SPP during 1H FY2010, and a 9x Enterprise Value / EBITDA ratio.

AEC Response

AEC intends to reject the bid as inadequate on the following basis:

- The bid undervalues AEC and doesn't take account of the expected significantly improved trading in FY2011. AEC has provided a guidance range for FY2011 of:
  - Revenue of $73m to $79m, an increase of 39% to 50%.
  - EBITDA of $19.6m to $22.2m, an increase of 58% to 80%.
  - Net Profit of $11.1m to 12.9m, an increase of 60% to 87%.

  At the offer price, these forecasts place AEC on a PE of 9.5x to 11.0x.

- 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.

Key Components of the forecast increases in FY2011 are:

- Continued growth in its core metallurgical testing business with a growing order book, supported by expanded operations and services.
- A strong recovery from Marc, which had suffered from lower capex in the resources and heavy industrial sectors. Marc already has 52% of budget revenue for FY2011, with a further 26% under negotiation.
- A move to cash flow neutral by PSI in FY2011 (-$1.5m in FY2010), with contracts under negotiation for 100% of budgeted revenue. PSI is expected to be profitable in FY2012.

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

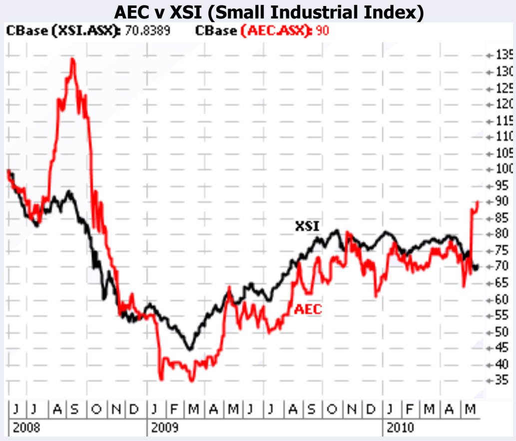
AEC.ASX BUY

31 May, 2010

Price		$3.25
Target price		$4.02
Valuation		$4.12
Target valuation method		PE Relative
GICS sector		Metals & Mining
12 mth Price range		$1.83 - 3.36
Avg monthly t/o	m	0.8
Market Capitalisation	$m	119.4
Shares on issue	m	36
Enterprise value	$m	121

Year Ended June 30		08A	09A	10E	11E
Operating revenue	$m	37.7	55.5	54.6	72.6
EBITDA	$m	11.9	12.9	12.5	20.0
EBITDA margin	%	31.7	23.4	23.0	27.6
EBIT	$m	10.8	11.2	10.7	18.1
EBIT margin	%	28.9	20.3	19.7	24.9
Adjusted NPAT	$m	**6.9**	**6.9**	**6.9**	**11.9**
EPS adj	¢	31.0	27.1	19.9	32.7
EPS adj growth	%	30.9	-12.6	-26.6	64.3
DPS	¢	25.0	16.0	16.5	23.0
Franking	$	100	100	100	100
PER	x	10.5	12.0	16.3	9.9
Dividend yield	%	7.7	4.9	5.1	7.1
NTA/share	$	1.26	1.51	1.66	1.77
EV/EBITDA	x	6.9	7.2	9.7	6.2
P/OCF	x	9.1	9.6	12.9	8.5
ROA	%	26.8	18.1	13.9	20.4
ROE	%	19.1	16.0	10.6	17.2
Interest cover (EBIT)	x	16.0	9.1	23.8	36.1

AEC v XSI (Small Industrial Index)



Activities

Mining services, mainly metallurgical and mineral testing

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ANNTEC

Current Price **$3.33**

Profit & Loss

Year Ended Jun 30		2008a	2009a	2010e	2011e
Sales Revenue	$m	37.7	55.5	54.6	72.6
Expenses	$m	-25.8	-42.6	-42.1	-52.6
EBITDA	$m	11.9	12.9	12.5	20.0
Depreciation & Amortisation	$m	-1.1	-1.7	-1.8	-2.0
EBIT	$m	10.8	11.2	10.7	18.1
Interest	$m	-0.7	-1.2	-0.5	-0.5
Pre Tax Profit	$m	10.2	10.0	10.3	17.6
Tax	$m	-3.4	-3.5	-3.4	-5.7
Minorities	$m	0.0	0.0	0.0	0.0
Normalised Profit	$m	**6.9**	**6.9**	**6.9**	**11.9**
Adjustments					
Sig Items & Costs	$m	0.0	0.0	0.0	0.0
Reported Profit	**$m**	**6.9**	**6.9**	**6.9**	**11.9**

Growth		2008a	2009a	2010e	2011e
Revenue	%	43.0	47.1	-1.4	33.1
EBIT	%	50.6	3.3	-4.4	68.7
Normalised Profit	%	42.9	-0.6	-0.3	72.8
EPS	%	30.9	-12.6	-26.6	64.3

Ratios		2008a	2009a	2010e	2011e
EBITDA / Sales	%	31.7	23.4	23.0	27.6
EBIT / Sales	%	28.9	20.3	19.7	24.9
Effective Tax Rate	%	33.6	34.8	33.0	32.4
Interest Cover	x	16.0	9.1	23.8	36.1

Per Share		2008a	2009a	2010e	2011e
Issued Shares (Weighted Avg)	m	25.3	25.5	36.3	36.4
EPS	¢ ps	31.0	27.1	19.9	32.7
Operating Cash Flow ps	cps	35.8	33.8	25.1	38.0
Free Cash Flow	¢ ps	12.5	25.4	-22.3	29.4
DPS	¢ ps	25.0	16.0	16.5	23.0
Franking	%	100.0	100.0	100.0	100.0
Dividend Payout Ratio	%	80.6	59.0	82.9	70.4

Parameters		2008a	2009a	2010e	2011e
PE Ratio	x	10.7	12.3	16.7	10.2
Enterprise Value / EBITDA	x	7.0	7.7	10.3	6.6
Enterprise Value / Profit	x	12.1	14.4	18.8	11.2
Cash Flow ratio	x	9.3	9.9	13.3	8.8
Dividend Yield	%	7.5	4.8	5.0	6.9

Segments		2008a	2009a	2010e	2011e
Sales Revenue (A$m)					
Metallurgical Testing	$m	32.7	38.2	40.0	46.0
Marc	$m	4.2	16.6	14.0	24.0
PSI	$m	0.0	0.1	0.4	2.2
EBIT (A$m)					
Metallurgical Testing	$m	10.4	11.3	11.6	14.2
Marc	$m	1.2	1.6	0.3	3.2
PSI	$m	-0.6	-1.5	-1.6	0.0
EBIT MARGIN (%)					
Metallurgical Testing	%	31.7	29.5	29.0	30.9
Marc	%	27.9	9.7	1.8	13.3
PSI	%	n.a	n.a	n.a	n.a
EBIT GROWTH (%)					
Metallurgical Testing	%	29.0	8.7	2.8	22.4
Marc	%		38.2	-84.5	1180.0
PSI	%		167.3	3.7	-100.0

Cash Flow

Year Ended Jun 30		2008a	2009a	2010e	2011e
Operating EBITDA	$m	11.9	12.9	12.5	20.0
Net Interest Paid	$m	-0.7	-1.2	-0.5	-0.5
Tax Paid	$m	-3.4	-3.5	-3.4	-5.7
Chg WorkCap & Other	$m	-4.8	3.7	-1.4	-1.6
Operating Cash Flow	$m	3.0	11.9	7.3	12.2
Capex	$m	-5.2	-5.6	-15.0	-1.5
Free Cash Flow	$m	-2.3	6.3	-7.7	10.7
Acquisitions/Asset Sales	$m	-16.2	-2.1	0.0	0.0
Dividends Paid	$m	-5.1	-4.7	-5.4	-7.6
Equity	$m	14.5	0.1	20.2	0.0
Debt	$m	4.1	0.8	-5.5	-0.8
Other	$m	0.0	0.0	0.0	0.0
Change in Net Cash	**$m**	**-5.0**	**0.4**	**1.5**	**2.3**

Balance Sheet		2008a	2009a	2010e	2011e
Cash	$m	0.0	0.5	2.1	3.3
Receivables	$m	9.7	9.7	9.8	13.0
Inventory	$m	1.9	2.2	2.4	2.6
Other Current Assets	$m	0.2	0.2	0.2	0.2
Current Assets	**$m**	11.7	12.7	14.2	18.9
Property, Plant & Equipment	$m	21.3	32.6	47.7	49.4
Intangibles	$m	22.2	23.3	23.5	23.5
Other NC Assets	$m	0.0	0.0	0.0	0.0
Non Current Assets	**$m**	43.5	55.9	71.2	72.9
Total Assets	**$m**	55.2	68.6	85.4	91.8
Payables	$m	3.5	7.6	6.4	8.2
Current Debt	$m	1.1	1.6	1.6	1.4
Other Current Liabilities	$m	4.2	2.6	3.7	4.5
Current Liabilities	**$m**	8.8	11.8	11.7	14.1
Non Current Debt	$m	8.3	7.5	2.0	1.4
Other NC Liabilities	$m	2.0	6.3	7.2	7.4
Non Current Liabities	**$m**	10.3	13.8	9.2	8.8
Total Liabilities	**$m**	19.1	25.6	20.9	23.0
Shareholder Funds	**$m**	**36.2**	**43.0**	**64.6**	**68.8**

Ratios		2008a	2009a	2010e	2011e
Receivables turn	x	3.9	5.7	5.6	5.6
Net Debt	$m	9.5	8.6	1.5	0.0
Gearing (D:D+E)	%	26.1	19.9	2.4	0.0
Net Assets	$	1.43	1.68	1.78	1.89
Net Tangible Assets	$	1.26	1.51	1.66	1.77
Price to Book Value	x	232.6	197.6	187.3	176.0
Return On Assets	%	26.8	18.1	13.9	20.4
Return on Equity	%	19.1	16.0	10.6	17.2

VALUATION

Valuation Method	¢ps	Premium/Discount (%)
PE Relative	401.9	20.7
DCF	412.5	23.9

Major Shareholders

		Shareholding	%
Perpetual	m	2.4	6.7%
Directors	m	1.1	3.0%
Top 20	m	9.1	25.2%

Takeover Bid

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 ($3.34 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.

At $3.35, the offer is at a 12.4x FY2009 EPS, but 16.8x forecast FY2010 after a placement and SPP during 1H FY2010, and a 9x Enterprise value / EBITDA ratio.

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. While AEC expect to meet recent broker expectations, its FY2010 profit may fall short of the above condition, impacted by projected defence costs associated with the takeover bid.

AEC Response

AEC intends to reject the bid as inadequate on the following basis:

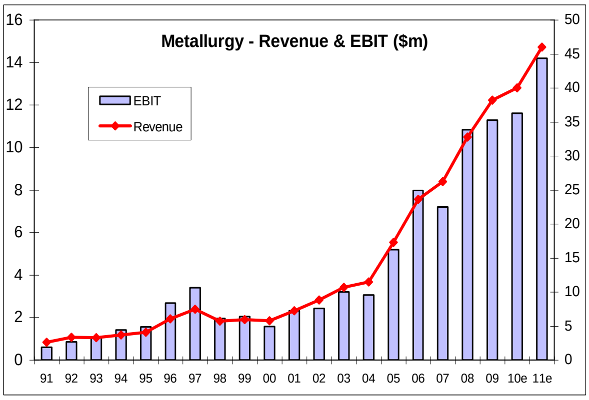
Projects strong Revenue, EBITDA and profit growth for FY2011

- The bid undervalues AEC and doesn't account for expected improved trading in FY2011. AEC has provided a guidance range for FY2011 for:
  - Revenue of $73m to $79m, an increase of 39% to 50% over FY2010.
  - EBITDA of $19.6m to $22.2m, an increase of 58% to 80% over FY2010.
  - Net Profit $11.1m to 12.9m, an increase of 60% to 87% over FY2010.

  This profit forecast puts AEC on a PE of 9.5x to 11.0x at the offer price of $3.35.
- The bid fails to reflect the strategic value of AEC to CPB and the financial and operational benefits that would flow from the acquisition, including material cost and revenue synergies, and the opportunities to replicate AEC's operations overseas
- Potential benefits from CPB's higher earning capitalisation rates (ie PEs of 22.0x for FY2010).

Forecasts

The above forecasts are based on:



Metallurgy

Growth in its core metallurgical testing revenue of over 15%, with a growing order book, supported by expanded operations and services. This will be boosted by the opening of its new hydro-metallurgy laboratory in December 2010 and a further expansion of its mineralogy operations. The improved environment was confirmed by CPB's outlook statement.

While the size of the growth may be under question, given the need to defend the bid, and with uncertainty of the proposed Resources Super Profits Tax, the metallurgical testing area has shown continued growth over long periods, (see chart of left) with:

- Between 20% and 30% of revenue offshore.
- Around 50% of Australian revenue is related to current operating mines.
- Revenue is spread across a variety of commodities, including iron ore (30%), base metals (20%), gold (25%) and nickel (15%), with different fundamentals and price drivers.

Marc

Strong recovery in Marc profits for FY2011

- A strong recovery from Marc, which had been severely restricted by lower capex of the resources and heavy industrials sector. Marc already has 52% of budget revenue for FY2011, with a further 26% under negotiation.
- Marc is expected to generate a profit of over $3.0m, in line with the pre-acquisition profit of $3.1m and the contribution of $0.9m for the first 4 month post acquisition in February 2008. This has been helped by a wider focus to include dust suppression and collection and an increasing focus on the oil and gas sector.

PSI (72%)

PSI to break even in FY2011

A move to cash flow neutral by PSI in FY2011 (a loss of around $1.5m in FY2010), with contracts under negotiation for US$1.8m expected early FY2011, equivalent of 100% of budgeted revenue. PSI is expected to be profitable in FY2012.

Comment

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

Bid will need to be increased above $4.00 to succeed

We continue to believe this is an opening offer from CPB and will probably require an offer above $4.00 to succeed. This view is based on forecast FY2011 PE and EV/EBITDA ratios of 10.3x and 6.7x and a Yield of 6.9% fully franked, using mid range forecasts at the current bid price. While the large growth could be viewed with some scepticism, there is enough evidence of a recovery in the sector to warrant significant increases for FY2011, especially if AEC can announce expected contracts.

This view on valuations is supported by recent acquisitions:

- The acquisition in May 2008 of Amdel, AEC's major Australian based competitor, by Bureau Veritas, on an EBITDA acquisition multiple of 9.0x.
- The acquisition of Pearl Street by CPB on an Enterprise Value / EBITDA multiple of 10.6x.
- The acquisition by Ecowise by CPB on an Enterprise Value / EBITDA multiple of over 8x, based on annualised results for the 4 months to 31/3/10.

It should be noted that CPB increased its bid for Pearl Street by 33% to achieve an acceptance recommendation.

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Clay Melbourn +61 2 8252 3220	Brent Mitchell +61 3 8605 4830
Stephen Murphy +61 8 9380 8351	

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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