EDISON

Medserv

H118 results

Pieces fitting into place

Industrial support services

Medserv has demonstrated the success of its broadened geographic reach with strong H118 revenue growth and improved profitability. With the required investment in equipment and personnel complete, we see greater momentum and improved profitability in H218. We maintain our forecasts.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/16	32.8	(1.3)	(2.1)	0.0	N/A	N/A
12/17	28.8	(3.6)	(5.6)	0.0	N/A	N/A
12/18e	36.0	(1.4)	(1.4)	2.0	N/A	1.9
12/19e	39.3	2.2	4.7	2.0	22.3	1.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H118

Medserv reported group revenues of €18.14m (H117: €13.62m), up 33.2% on the stronger contribution from operations in Malta and Cyprus in its Integrated Logistics Support Services (ILSS) operations. Group EBITDA of €3.40m (H117: €2.87m) represented an 18.5% uplift. The company invested €5.42m in equipment, mainly related to the start-up operation in Egypt. With this in place, H218 performance will reflect increased income from this project. Performance in Oil Country Tubular Goods (OCTG) was held back by weakness in Oman, but this is expected to improve in H218. Group H118 loss per share of 4.5c (H117: 6.8c loss) improved by 33.8% and should see a stronger H218 result with the improved profit contribution expected from both divisions. Net debt increased to €53.0m (FY17: €49.2m). The company has maintained FY18 guidance and we have maintained our forecasts.

On track to deliver growth

End-market dynamics are clearly playing to Medserv's strengths. The company has a broad geographic reach across Europe, the Middle East and Africa. This is reflected in a growing order backlog and ongoing tendering activity that now includes West Africa, which is an emerging supplier of energy. Medserv has taken action to review and adapt its portfolio to best address market opportunities and has completed the investment required in Cyprus and Egypt, whereas the operations in Iraq are under consideration. Medserv sees strong projected growth over 2018 to 2020 and we expect the company to build on its H118 performance as the year progresses, supported by the current order book, with further growth in FY19. Medserv is still seeking a strategic purchaser for all or part of the majority shareholding and, while there was no update at the H118 report, we believe there is no time pressure.

Valuation: Backlog underpins uplift

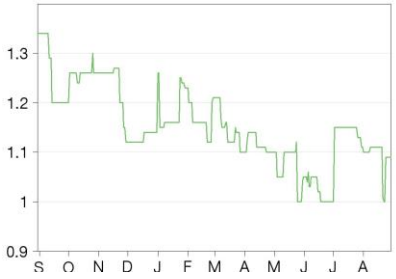
The new territories coming on stream support revenue growth for 2018-20 and we forecast financial performance in FY18 to support a dividend. While we maintain our forecasts, through the passage of time our DCF-based fair value moves up to €1.56 per share, from €1.51 before.

30 August 2018

Price	**€1.09**
Market cap	**€59m**

Net debt (€m) at 30 June 2018	53.0
Shares in issue	53.7m
Free float	35%
Code	MDS
Primary exchange	Malta SE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(3.5)	3.8	(18.4)
Rel (local)	(1.1)	3.9	(11.7)
52-week high/low		€1.3	€1.0

Business description

Medserv is a Malta-based provider of integrated offshore logistics and services in support of drilling operations in the Mediterranean. The acquisition of the METS companies in February 2016 diversified the company into onshore steel tube stockholding and servicing for countries in the Middle East.

Next events

Q3 results	November 2018

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H118 results and outlook

Highlights of the H118 results are outlined in the following table:

Exhibit 1: Medserv H118 financial summary

€m (half year to June)	H117*	H118	% change
Revenue by division			
Integrated Logistics Support Services (ILSS)	5.76	11.32	96.56
Oil Country Tubular Goods (OCTG)	7.55	6.58	(12.85)
Photovoltaic farm	0.31	0.24	(22.81)
Group revenues	**13.62**	**18.14**	**33.17**
Gross profit	1.03	1.15	12.20
Gross margin (%)	7.55%	6.36%	
EBITDA by division			
Integrated Logistic Support Services (ILSS)	0.21	1.90	817.92
Oil Country Tubular Goods (OCTG)	2.35	1.26	(46.44)
Photovoltaic farm	0.31	0.24	(22.81)
Group EBITDA	**2.87**	**3.40**	**18.54**
Depreciation	(2.83)	(3.40)	
Amortisation	(1.39)	(1.03)	
Unrealised FX differences	0.20	0.23	
Provision for impairment on Trade Receivables		(0.21)	
Operating profit (as reported)	**(1.16)**	**(1.02)**	**(12.02)**
Net finance costs	(2.20)	(1.66)	
Operating profit before tax (as reported)	**(3.35)**	**(2.67)**	**(20.28)**
Tax	(0.50)	0.06	
Operating profit from continuing operations (as reported)	**(3.85)**	**(2.61)**	**(32.23)**
EPS (c)	(6.80)	(4.50)	(33.82)
DPS	0.00	0.00	
Net debt	47.22	53.00	

Source: Company reports. Note: *Restated on an IFRS 15 and IFRS 16 basis.

Integrated Logistics Support Services (ILSS) (62% group sales)

ILSS reported H118 revenues of €11.32m (H117: €5.76m), with increased contributions from Malta and Cyprus, plus Egypt on stream from the start of FY18. By comparison, the results from H118 in Malta are already higher than its FY17 revenue and EBITDA contributions as projects that came on line during H118 are driving this positive uplift.

Going forward, FY18 revenue forecasts in ILSS continue to be supported by growth prospects across a number of geographies. Activity in Malta, Cyprus and Egypt is driving the growth, which should continue its current level of contribution to the group as the majority of new equipment acquired for the Egypt operations are now in place.

Medserv is employing its shore base logistics and engineering services to address the needs of the offshore Libya, Bahr Essalam Phase 2 project. Work here is progressing well as customer ENI's strategic plan is to increase offshore production volumes. This has the potential to include two new structures (A & E structures), indicating the scale of the work and demands on Medserv's services.

In Cyprus, as disclosed previously, Medserv has closed down its storage facility in Larnaca and consolidated its operations at Limassol. The additional logistics facilities required in Limassol by a second customer have been established, with the set-up cost incurred in H118. Drilling activity for this customer is scheduled for Q418. As a reminder, the Calypso lean gas discovery offshore Cyprus is believed to be 'Zohr-like'; Zohr, offshore Egypt, is the largest gas field in the Mediterranean. The new find should provide an extended drilling programme, offering greater visibility and improved returns from Cyprus now from multiple customers.

There is no change to operations in Portugal, which remain in mothball mode, as environmental issues persist regarding offshore exploratory drilling. Hence performance here is expected to remain flat year-on-year.

In Egypt, Medserv has commenced its three-year c €10m contract to provide integrated logistics support services to an international oil company (IOC) for the production phase of offshore operations. The company admits that the initial phase of equipment procurement and sourcing personnel has been challenging but is now complete. H218 will benefit from this being completed. The contract in Egypt is long term and very important to Medserv, and should lead to additional activity with other IOCs. In the future, Medserv could build OCTG opportunities into the offering in this country.

Oil Country Tubular Goods (OCTG) (36% of group revenues)

OCTG reported H118 revenues of €6.58m (H117: €7.55m), largely reflecting a slower H118 performance in Oman. Weak performance was visible in Q118 in the country and this continued in Q218. However, H218 performance is expected to be stronger, underpinned by order backlog, including the long-term supply chain management Sumitomo contract. As we discussed before, it is possible the company will consolidate its operations within the newly opened Duqm facility.

Growth from Medserv's United Arab Emirates operations has been strong, as orders picked up for the premium threading activity, building visibility in this area. Meanwhile, Iraq remains affected by domestic issues. While this business unit has seen some periods of strength, this has not proved continuous. While the number of land rigs mobilised in country and the current order book suggest activity levels will improve, there remains some concern over this area. Although Medserv holds the premium sole threading licence in the country, it is undertaking a considered inspection and review of this business, which will be completed by the year end.

Looking forward, Medserv is in a tender for the provision of machine shop services in Uganda, which as a long-term contract could bring greater visibility to the division and predictability to its financial performance. For the division as a whole, in spite of the weaker start to the year, we believe the current order book supports managements and our FY18 expectations.

Photovoltaic Farm (PV) (2% of group sales)

PV reported H118 revenues of €0.24m down from €0.31m in H117. FY18 revenue is still expected to remain constant year-on-year at c €0.5m.

Outlook

While FY17 presented a number of challenges to the oil & gas industry, Medserv's H118 report continues the trends identified in May, when we indicated that FY18 has started strongly for ILSS, while OCTG had a weaker start. Medserv sees strong projected growth over 2018 to 2020. The business is working in each of its divisions to build its geographic presence and deliver technical expertise. Medserv is active and profitable in six out of its seven operating bases and expects to build on its H118 performance as the year progresses, with a stronger performance in OCTG in particular. We believe that the company's current order book supports FY18 expectations, which have been maintained and are set out in Exhibit 2. The company continues to expect further growth in FY19. We have maintained our forecasts and continue to believe that stronger group performance should allow dividend payments to return in FY18.

Exhibit 2: Q118, H118 reported and Medserv's estimates for revenue and EBITDA

€m	Q118	Q218	H118	FY17	Medserv's FY18 outlook	% FY change
ILSS	4.9	6.4	11.3	14.0	18.4	31.4
OCTG	3.3	3.3	6.6	14.3	17.8	24.5
PV Farm	0.1	0.1	0.2	0.5	0.5	0.0
Group revenues	8.3	9.8	18.1	28.8	36.7	27.4
Group EBITDA	1.4	2.0	3.4	4.4	6.8	54.5
EBITDA margin (%)	16.9	20.3	18.7	15.3	18.5	20.9

Source: Company reports

There was no strategic update at the H118 report on the future shareholder structure. As a reminder, Anthony Diacono will continue to chair the board of directors; however, Anthony Diacono and executive director Anthony Duncan, beneficial owner of Malampaya Investments, have announced their intention to source a strategic purchaser for all or part for their shareholdings (in total 65.5% of issued share capital). The process is still at an early stage and it is important to note there is no time or financial pressure to sell.

Valuation

We continue to employ a capped DCF approach to valuation, which encompasses a six-year explicit forecast projection with a zero growth scenario anticipated in our terminal value calculation. We have used a cost of equity of 11%, which gives us a calculated WACC of 8.2%. Our core assumptions return a DCF value of €1.56 per share, up from €1.51 per share. As our estimates are unchanged, this reflects the progression time and continues to present upside to the current share price given the growth prospects of the business.

Exhibit 3: Financial summary

€m	2015	2016	2017	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	42.7	32.8	28.8	36.0	39.3
Cost of Sales	(29.9)	(22.9)	(18.2)	(21.8)	(22.9)
Gross Profit	12.8	9.9	10.6	14.2	16.4
EBITDA	10.3	5.0	3.7	6.5	10.5
Operating Profit (before amort. and except.)	7.6	1.6	(1.2)	1.6	5.4
Intangible Amortisation	0.0	0.0	0.0	0.0	0.0
Exceptionals	(0.1)	(1.2)	(4.501)	(3.2)	(3.1)
Other	(0.2)	0.0	0.0	0.0	0.0
Operating Profit	7.3	0.4	(5.7)	(1.6)	2.3
Net Interest	(1.5)	(2.8)	(2.4)	(3.1)	(3.3)
Profit Before Tax (norm)	6.1	(1.3)	(3.6)	(1.4)	2.2
Profit Before Tax (FRS 3)	5.8	(2.5)	(8.1)	(4.6)	(0.9)
Tax	(1.3)	5.4	0.4	0.5	0.1
Profit After Tax (norm)	4.8	4.1	(3.2)	(1.0)	2.3
Profit After Tax (FRS 3)	4.5	3.0	(7.7)	(4.2)	(0.9)
Average Number of Shares Outstanding (m)	46.1	52.8	53.7	53.7	53.7
EPS - normalised (c)	9.7	(2.1)	(5.6)	(1.4)	4.7
EPS - normalised and fully diluted (c)	9.7	(2.1)	(5.6)	(1.4)	4.7
EPS - (IFRS) (c)	8.9	5.9	(14.0)	(7.3)	(1.2)
Dividend per share (c)	4.3	0.0	0.0	2.0	2.0
Gross Margin (%)	30.1	30.2	36.8	39.5	41.7
EBITDA Margin (%)	24.1	15.1	12.8	18.0	26.7
Operating Margin (before GW and except.) (%)	17.9	4.8	-4.2	4.6	13.8
BALANCE SHEET					
Fixed Assets	24.0	51.4	46.4	44.2	42.1
Intangible Assets	0.0	17.2	14.5	13.2	12.1
Tangible Assets	24.0	34.3	31.9	31.0	30.1
Investments	0.0	0.0	0.0	0.0	0.0
Current Assets	57.1	70.0	106.9	108.6	111.0
Stocks	0.0	1.3	1.2	1.5	1.7
Debtors	12.2	12.8	12.2	14.0	15.3
Cash	1.0	6.2	3.6	2.6	5.6
Other	43.9	49.7	89.8	90.4	88.3
Current Liabilities	(13.3)	(8.3)	(9.4)	(7.7)	(8.3)
Creditors	(9.5)	(7.2)	(7.3)	(7.7)	(8.3)
Short term borrowings	(3.8)	(1.1)	(2.0)	0.0	0.0
Long Term Liabilities	(56.7)	(86.8)	(115.8)	(122.2)	(123.8)
Long term borrowings	(22.4)	(52.1)	(50.8)	(57.2)	(58.9)
Other long term liabilities	(34.3)	(34.7)	(65.0)	(65.0)	(65.0)
Net Assets	11.1	26.4	28.1	22.9	20.9
CASH FLOW					
Operating Cash Flow	10.4	0.6	1.8	(0.5)	8.1
Net Interest	(1.5)	(2.8)	(2.4)	(3.1)	(3.3)
Tax	(1.3)	5.4	0.4	0.5	0.1
Capex	(3.8)	(1.7)	(2.6)	(2.3)	(2.5)
Acquisitions/disposals	(2.6)	(34.5)	0.0	0.0	0.0
Financing	0.5	11.2	0.6	0.0	0.0
Dividends	(2.0)	0.0	0.0	0.0	(1.1)
Net Cash Flow	(0.3)	(21.8)	(2.3)	(5.4)	1.4
Opening net debt/(cash)	24.9	25.2	47.0	49.2	54.6
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(0.0)	0.0	0.0	(0.0)	(0.0)
Closing net debt/(cash)	25.2	47.0	49.2	54.6	53.2

Source: Company reports, Edison Investment Research

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