Medserv

Trading update

Trading update highlights Q4 delays

Industrial support services

Medserv's trading update has highlighted project delays that will see H217 miss expectations. A lower Q4 drilling contribution from Cyprus and activity in Iraq falling off Q3 levels prompt us to reduce our FY17 forecasts. However, contracted projects underpin our FY18 estimates and we leave them unchanged.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/15	42.7	6.1	9.7	4.3	13.1	3.4
12/16	32.8	(1.3)	(2.1)	0.0	N/A	N/A
12/17e	28.2	(2.8)	(6.4)	0.0	N/A	N/A
12/18e	42.3	5.8	9.5	3.8	13.4	3.0

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

Q4 trading to miss expectations

Medserv's trading statement indicates H217 earnings will be lower than forecast due to delays in both divisions. Within Integrated Logistics Support Services (ILSS), drilling activity is expected to begin in Cyprus from mid-December, instead of a full quarter's contribution. While delays here reduce the project contribution in FY17, the company has given greater clarity over the number of wells expected to be drilled within the next 12 months. Meanwhile, in the Oil Country Tubular Goods (OCTG) division, the strong pick-up in activity seen in Iraq in Q3 did not continue into Q4, as the IOCs negotiate next steps. We still expect inspection and machine shop demand to grow in the region, supporting FY18 forecasts. We lower our FY17 group revenue forecast to €28.2m from €30.3m, and increase our pre-tax loss forecast to €2.8m from €2.3m. We leave our FY18 estimates unchanged as we view these as delays, not reduced demand.

Robust order pipeline keeps FY18 on track

Medserv sees strong projected growth over the 2018 to 2020 timeframe. The business is working tirelessly in each of its divisions to build its geographic presence and deliver technical expertise. Project timing has been challenging in Q417; however, the overall direction of travel for FY18 remains good. We expect to see further contracts announced early in FY18.

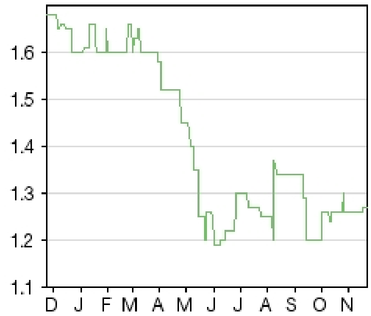
Valuation: Growth not in the price

We adjust our FY17 estimates for the lower H217 contribution. However, our FY18 estimates remain unchanged as delayed Q4 activity moves into the new year. As new territories are brought on stream, the potential for the substantial revenue growth for the 2018-20 period reiterated in the trading statement should become more tangible. In turn, this should provide support for our DCF-based fair value, which currently stands at €1.64 per share, from €1.74 before.

22 November 2017

Price	**€1.27**
Market cap	**€68m**
	US$1.18/€
Net debt (€m) at June 2017	47.2
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	0.4	(5.2)	(15.1)
Rel (local)	4.9	(0.6)	(14.5)
52-week high/low		€1.7	€1.2

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

FY results	March 2018

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Edison profile page

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Divisional commentary and outlook

Integrated Logistics Support Services (ILSS)

A key growth driver for this division remains Cyprus. As a reminder, Medserv will support ENI's drilling operations from its new Limassol base (full operation) and its storage facility in Larnaca. The Limassol base will be fully operational in November. However, drilling will now start in mid-December, later than hoped. While this delay is a significant reason for the group missing H2 expectations, the company has given further clarity over drilling volume, with four to five wells expected to be drilled over the next 12 months. In addition, the division has been active in a tender for drilling support for another international oil company (IOC) in the region next year. This would leverage the investment in facilities in the country.

Activity levels remain healthy at the Malta shore base. As we discussed in August, Medserv is engaged in advanced negotiations to locate support bases in new geographical regions that should support longer-term growth. The company has indicated that contracts here would be focused on development and production rather than exploration. The most advanced of these appears to be Egypt with an MOU signed during the current year. Both ENI and the Egyptian authorities regard the Zohr gas field as a priority for development. The negotiations have continued as the scope of services has increased. Contract execution is expected to commence in Q118. In addition, the division is awaiting the results from an outstanding tender from Trinidad, after failing to secure one tender this month.

Again, as we discussed before, the expectation that rigs will be prioritised to other programmes (as above) has led to the continued deferral of the wildcat drilling programme offshore Portugal where the licence runs to early 2019. Hence, Portugal is expected to remain relatively flat in the short term with drilling expected to resume in Q218. Medserv Italy also remains active.

Oil Country Tubular Goods (OCTG)

In August, we noted that Iraq had seen a strong pick-up in activity in Q3 and the company believed that business here should drive revenue and EBITDA growth for the division as inspection and machine shop demand grows. However, that level of activity did not continue into Q4, as the IOCs negotiate next steps. While this lower level of activity has prompted us to lower our FY17 forecast for the division, we expect a return to growth next year.

In general, the OCTG division is considered to be the largest growth driver of the group. The business is building its geographic reach and technical expertise. The trading statement reminds us of the progress underway in Oman, where the second OTG base opened in Duqm with operations starting at the beginning of November. The Nippon & Sumitomo Metal Corporation contract not only adds predictability with a five-year initial period plus five-year extension, but also delivers an attractive operating margin due to better pricing.

Estimates revision, valuation implications

We have revised our FY17 estimates, lowering group FY17 revenue from €30.3m to €28.2m to reflect the lower contribution than expected from drilling in Cyprus in Q4 and the lower level of trading in Iraq in Q4. We have lowered our FY17 EBITDA forecast from €4.3m to €3.4m to reflect the lower overhead recovery with less drilling contribution than expected, which results in a lower EBITDA margin. We have maintained FY18 forecasts unchanged.

Exhibit 1: Medserv estimates revisions

Year to December (€m)	2017e Prior	2017e New	% change	2018e Prior	2018e New	% change
Sales	30.3	28.2	-7.0%	42.3	42.3	0.0%
EBITDA	4.3	3.4	-20.2%	12.5	12.5	0.0%
Depreciation	(3.6)	(3.4)	-7.4%	(3.7)	(3.7)	0.0%
EBITA	0.7	0.1	-90.7%	8.8	8.8	0.0%
PPA Amortisation	(2.5)	(2.4)	0.0%	(1.7)	(1.7)	0.0%
EBIT reported	(1.9)	(2.5)	32.2%	7.1	7.1	0.0%
Underlying PBT	(2.3)	(2.8)	22.8%	5.8	5.8	0.0%
EPS – underlying continuing (c)	(5.3)	(6.4)	22.0%	9.5	9.5	0.0%
DPS (c)	0.0	0.0	0.0%	3.8	3.8	0.0%
Net debt	46.8	46.6	0.3%	48.0	48.7	-1.4%

Source: Edison Investment Research

We continue to employ a capped DCF approach to valuation, which encompasses a six-year explicit forecast projection in our model 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 8.5%. On our reduced FY17 estimates, our core assumptions return a DCF value of €1.64 per share, down from €1.74 per share.

Exhibit 2: Financial summary

€m	2014	2015	2016	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	32.4	42.7	32.8	28.2	42.3
Cost of Sales	(23.2)	(29.9)	(22.9)	(19.5)	(25.8)
Gross Profit	9.2	12.8	9.9	8.7	16.5
EBITDA	5.9	10.3	5.0	3.4	12.5
Operating Profit (before amort. and except.)	4.2	7.6	1.6	0.1	8.8
Exceptionals	(0.0)	(0.1)	(1.2)	(2.4)	(1.7)
Other	(0.1)	(0.2)	0.0	0.0	0.0
Operating Profit	4.1	7.3	0.4	(2.5)	7.1
Net Interest	(1.1)	(1.5)	(2.8)	(2.9)	(2.9)
Profit Before Tax (norm)	3.1	6.1	(1.3)	(2.8)	5.8
Profit Before Tax (FRS 3)	3.0	5.8	(2.5)	(5.3)	4.2
Tax	(0.9)	(1.3)	5.4	(1.1)	(0.4)
Profit After Tax (norm)	2.3	4.8	(1.3)	(3.4)	5.4
Profit After Tax (FRS 3)	2.2	4.5	3.0	(6.4)	3.8
Average Number of Shares Outstanding (m)	46.1	46.1	52.8	53.7	53.7
EPS - normalised (c)	5.0	9.7	(2.1)	(6.4)	9.5
EPS - normalised and fully diluted (c)	5.0	9.7	(2.1)	(6.4)	9.5
EPS - (IFRS) (c)	4.2	8.9	5.9	(12.1)	6.9
Dividend per share (c)	4.3	4.3	0.0	0.0	3.8
Gross Margin (%)	28.4	30.1	30.2	30.8	39.0
EBITDA Margin (%)	18.1	24.1	15.3	12.2	29.6
Operating Margin (before GW and except.) (%)	13.0	17.9	4.8	0.2	20.8
BALANCE SHEET					
Fixed Assets	23.3	24.0	51.4	48.5	46.0
Intangible Assets	0.0	0.0	17.2	15.6	14.3
Tangible Assets	23.3	24.0	34.3	32.8	31.8
Investments	0.0	0.0	0.0	0.0	0.0
Current Assets	57.5	57.1	70.0	62.4	69.8
Stocks	0.0	0.0	1.3	1.1	1.7
Debtors	13.4	12.2	12.8	11.0	16.5
Cash	1.1	1.0	6.2	4.2	3.2
Other	43.0	43.9	49.7	46.1	48.4
Current Liabilities	(15.3)	(13.3)	(8.3)	(6.1)	(9.0)
Creditors	(10.4)	(9.5)	(7.2)	(6.1)	(9.0)
Short term borrowings	(4.9)	(3.8)	(1.1)	0.0	0.0
Long Term Liabilities	(56.1)	(56.7)	(86.8)	(84.8)	(85.0)
Long term borrowings	(21.1)	(22.4)	(52.1)	(50.8)	(51.9)
Other long term liabilities	(35.0)	(34.3)	(34.7)	(33.9)	(33.1)
Net Assets	9.5	11.1	26.4	20.0	21.7
CASH FLOW					
Operating Cash Flow	(1.7)	10.4	6.0	5.7	4.1
Net Interest	(1.1)	(1.5)	(2.8)	(2.9)	(2.9)
Tax	(0.9)	(1.3)	(0.0)	(0.6)	(0.6)
Capex	(13.4)	(3.8)	(1.7)	(1.9)	(2.7)
Acquisitions/disposals	0.0	(2.6)	(34.5)	0.0	0.0
Financing	(0.2)	0.5	11.2	(0.0)	0.0
Dividends	(0.7)	(2.0)	0.0	0.0	0.0
Net Cash Flow	(18.0)	(0.3)	(21.8)	0.3	(2.1)
Opening net debt/(cash)	6.9	24.9	25.2	47.0	46.6
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)	24.9	25.2	47.0	46.6	48.7

Source: Medserv accounts, Edison Investment Research

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