EDISON

Medserv

Interim results

Momentum to build in H2

Industrial support services

While H117 results reflect a slower than expected performance in each of the key divisions, Medserv looks set to deliver sequential improvement in H2. We have lowered FY17 estimates; however, our FY18 estimates remain largely unchanged as momentum from the increased drilling programme from Q417 should continue. The longer-term investment case is underpinned by established contracts for drilling and OCTG services together with workover programmes. In addition, the company is well placed to secure business in new geographic markets to support growth.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/15	42.7	6.1	9.7	4.3	13.8	3.2
12/16	32.8	(1.3)	(2.1)	0.0	N/A	0.0
12/17e	30.3	(2.3)	(5.3)	0.0	N/A	0.0
12/18e	42.3	5.8	9.5	3.8	14.1	2.8

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and retention contracts, and exceptional items.

H117 results

Medserv reported H117 revenues of €13.6m, down from €17.3m in H116, with reported EBITDA of €1.6m, down from €3.6m. Divisionally, Integrated Logistic Support Services (ILSS) reported revenues of €5.8m, with a lower than expected contribution from Malta. The Oil Country Tubular Goods (OCTG) operations of METS reported H117 revenues of €7.5m, up from €6.5m in H116. With a lower H1 contribution, the company has reduced group FY17 revenue guidance from €35.9m to €30.0m. However, H217 could see a sequential improvement as drilling programme support increases.

Momentum building into 2018

The key to growth in H217 and ongoing momentum into 2018 is already contractually locked in. In ILSS, drilling is set to commence in Q417 for Cyprus, supported by Medserv's two facilities in Limassol and Larnaca. In OCTG, while activity in Iraq was lower than expected in H1, activity levels have already picked up strongly in Q3 as workover demand grows following a resumption of production at the main fields. While Medserv continues to deliver in existing markets, the group is pursuing opportunities in new geographies to expand its global presence and support longer-term growth.

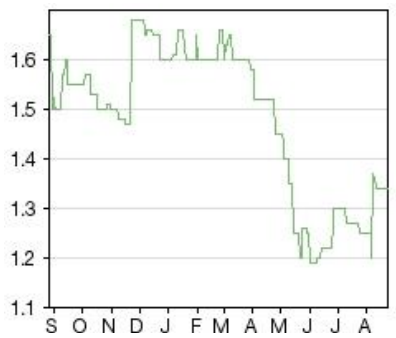
Valuation: Recovery potential not yet rated

We adjust our FY17 estimates for the lower H117 contribution and FY guidance. However, our FY18 estimates remain largely unchanged as the expected Q417 momentum runs into next year. As new territories are brought on stream the potential for the substantial revenue growth for the 2018-2020 period discussed in the interim statement should become more tangible. In turn, this should provide support for our DCF-based fair value which currently stands at €1.74 per share, from €1.83 before.

24 August 2017

Price	**€1.34**
Market cap	**€72m**
	US$1.18/€1
Net debt (€m) at 30 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	4.7	11.3	(19.1)
Rel (local)	6.1	9.9	(23.0)
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

Q3 trading update	November 2017

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Edison profile page

MedservMedserv is a research client of Edison Investment Research Limited

Interim results and outlook

Exhibit 1: Medserv H117 financial summary

€m	H116	H117	% change
Integrated Logistic Support Services (ILSS)	10.59	5.76	-45.6%
Oil Country Tubular Goods (OCTG)	6.45	7.55	17.2%
Photovoltaic farm	0.27	0.31	16.8%
Group revenues	**17.30**	**13.62**	**-21.3%**
Gross profit (adjusted)	**3.38**	**1.17**	**-65.4%**
Gross margin (%)	19.6%	8.6%	
EBITDA	**3.55**	**1.60**	**-54.8%**
Depreciation	(1.70)	(1.81)	6.5%
Operating profit (adjusted)	**1.85**	**(0.21)**	**N/A**
Amortisation	(0.56)	(0.83)	
Operating profit (reported)	1.28	(1.04)	
Exceptional	(0.20)	(0.36)	
Finance costs	(0.81)	(1.50)	
Profit before tax (adjusted)	**1.04**	**(1.70)**	**N/A**
Profit before tax (reported)	0.28	(2.90)	
Net income (ongoing adjusted)	**0.98**	**(2.25)**	**N/A**
Net income (ongoing reported)	0.22	(3.45)	N/A
Net debt	46.95	47.22	0.6%

Source: Company reports

Integrated Logistic Support Services (ILSS)

ILSS reported H117 revenues of €5.8m, down from €10.6m in H116. The division missed H117 expectations largely due to the impact on the Malta base of the temporary cessation of drilling activity offshore Libya from March. This should resume before the end of August and hence should drive a sequential uplift in H217. However, the key growth driver for the division is Cyprus, where drilling is set to commence in Q417. As a reminder, Medserv will support ENI's drilling operations from its new Limassol base (full operation) and its storage facility in Larnaca. Total SA commenced a programme in July (not using Medserv), and this is regarded as a precursor to a start up by ENI in the concessions it won in the December 2016 licencing round.

Looking forward, 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 proximity of the field to the Cyprus blocks is a key driver of the renewed drilling activity there. In addition, the expectation that rigs will be prioritised to these programmes has led to the further deferral of the wildcat drilling programme offshore Portugal where the licence runs to early 2019.Therefore, Portugal is expected to deliver relatively flat performance in the short term.

We have revised our estimates for the division, lowering FY17 revenue from €17.7m to €13.6m.

Oil Country Tubular Goods (OCTG)

OCTG reported H117 revenues of €7.5m up from €6.5m in H116. The division's results were somewhat below expectations on a lower than forecast contribution from Iraq. However, activity in Iraq has already seen a strong pick-up in activity in the Q3 and business here should drive revenue and EBITDA growth for the division as inspection and machine shop demand grows. Meanwhile, the contribution from Oman is expected to remain stable while the UAE should see a small improvement; hence we have made modest adjustments to our estimates for this division.

Estimates revision, valuation implications

We have revised our estimates for the division, lowering FY17 revenue from €17.5m to €16.7m, which reflects a lower contribution from Iraq and a slightly less favourable $/€ profit translation assumption. The revision to revenues substantially drops through to our adjusted EBITDA assumption due to the high level of fixed cost in the operations. Our forecast is reduced by 39% to €4.3m in FY17. However, as activity increases the operational leverage should allow a rapid recovery in profitability. The increase in drilling programmes and workover projects in H217 will provide operational momentum into FY18. In addition, as the company secures business in new geographic markets this will support growth and build visibility for the medium term.

Exhibit 2: Medserv estimates revisions

Year to December (€m)	FY17e			FY18e		
	Old	New	% change	Old	New	% change
Revenues	**35.2**	**30.3**	**-13.8%**	**42.3**	**42.3**	**0.0%**
EBITDA	**7.0**	**4.3**	**-38.8%**	**12.4**	**12.5**	**1.2%**
Depreciation	(3.6)	(3.6)	-0.2%	(3.7)	(3.7)	0.7%
Operating profit (adjusted)	**3.4**	**0.7**	**-80.3%**	**8.7**	**8.8**	**1.5%**
Exceptionals (incl. PPA Amortisation)	(2.5)	(2.5)		(1.7)	(1.7)	
Operating profit (reported)	**0.9**	**(1.9)**	**N/A**	**7.0**	**7.1**	**1.8%**
Profit Before Tax (adjusted)	**0.5**	**(2.3)**	**N/A**	**5.9**	**5.8**	**0.6%**
EPS - underlying continuing (c)	**0.6**	**(5.3)**	**N/A**	**9.6**	**9.5**	**0.7%**
DPS (c)	0.0	0.0		3.8	3.8	
Net debt	45.1	46.8		44.4	48.0	

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 8.2%. On our reduced FY17 estimates, our core assumptions return a DCF value of €1.74 per share, down from €1.83 per share.

Exhibit 3: 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	30.3	42.3
Cost of Sales	(23.2)	(29.9)	(22.9)	(21.0)	(25.8)
Gross Profit	9.2	12.8	9.9	9.3	16.5
EBITDA	5.9	10.3	5.0	4.3	12.5
Operating Profit (before amort. and except.)	4.2	7.6	1.6	0.7	8.8
Exceptionals (incl. PPA Amortisation)	(0.0)	(0.1)	(1.0)	(2.5)	(1.7)
Other	(0.1)	(0.2)	0.0	0.0	0.0
Operating Profit	4.1	7.3	0.5	(1.9)	7.1
Net Interest	(1.1)	(1.5)	(2.8)	(2.9)	(2.9)
Profit Before Tax (norm)	3.1	6.1	(1.3)	(2.3)	5.8
Profit Before Tax (FRS 3)	3.0	5.8	(2.3)	(4.8)	4.1
Tax	(0.9)	(1.3)	5.4	(1.0)	(0.4)
Profit After Tax (norm)	2.3	4.8	(1.3)	(2.7)	5.2
Profit After Tax (FRS 3)	2.2	4.5	3.1	(5.8)	3.7
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)	(5.3)	9.5
EPS - normalised and fully diluted (c)	5.0	9.7	(2.1)	(5.3)	9.5
EPS - (IFRS) (c)	4.2	8.9	5.9	(10.9)	6.7
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	14.2	29.6
Operating Margin (before GW and except.) (%)	13.0	17.9	4.8	2.2	20.8
BALANCE SHEET					
Fixed Assets	23.3	24.0	51.4	48.3	45.9
Intangible Assets	0.0	0.0	17.2	15.6	14.3
Tangible Assets	23.3	24.0	34.3	32.7	31.7
Investments	0.0	0.0	0.0	0.0	0.0
Current Assets	57.5	57.1	70.0	66.8	72.8
Stocks	0.0	0.0	1.3	1.2	1.7
Debtors	13.4	12.2	12.8	11.8	16.5
Cash	1.1	1.0	6.2	7.2	6.2
Other	43.0	43.9	49.7	46.5	48.4
Current Liabilities	(15.3)	(13.3)	(8.3)	(6.5)	(9.0)
Creditors	(10.4)	(9.5)	(7.2)	(6.5)	(9.0)
Short term borrowings	(4.9)	(3.8)	(1.1)	0.0	0.0
Long Term Liabilities	(56.1)	(56.7)	(86.8)	(87.9)	(87.4)
Long term borrowings	(21.1)	(22.4)	(52.1)	(54.0)	(54.2)
Other long term liabilities	(35.0)	(34.3)	(34.7)	(33.9)	(33.1)
Net Assets	9.5	11.1	26.4	20.7	22.3
CASH FLOW					
Operating Cash Flow	(1.7)	10.4	6.0	5.7	5.0
Net Interest	(1.1)	(1.5)	(2.8)	(2.9)	(2.9)
Tax	(0.9)	(1.3)	(0.0)	0.2	(0.6)
Capex	(13.4)	(3.8)	(1.7)	(2.1)	(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)	0.2	(1.3)
Opening net debt/(cash)	6.9	24.9	25.2	47.0	46.8
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	46.8	48.0

Source: Medserv accounts, Edison Investment Research

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