Energy Technologies Ltd

Emerging cable and wire player

Share Price: A$0.29

ASX: EGY
Sector: Industrials
1 October 2019

Energy Technologies (ASX:EGY) is a holding company having investments in three companies–Bambach Wires and Cable Pty Ltd, Dulhunty Poles Pty Ltd and Cogenic Pty Ltd. EGY has restructured Bambach's operations by developing new high-margin products and recently it acquired the assets of rival, Advance Cables. This merger will provide operational efficiencies, expanded customer base and cross-selling opportunities.

Beneficiary of government defense spending

As part of the current budget, the Australian government is expected to spend ~A$100bn in infrastructure projects and A$200 billion in Defence projects over the next 10 years. This is anticipated to accelerate growth opportunities across cable and wire market segments, such as defence, rail and road. These developments are likely to result in significant tailwinds across Bambach's end-markets. EGY, with its vertical and horizontal expansion, through new low-cost modern production site and recapitalised balance sheet, is well equipped to take advantage of these opportunities.

Valuation range of A$0.34–0.44 per share

We value EGY at A$0.34 per share in our base case and A$0.44 in our optimistic case scenario. Substantial value is expected to be generated after Advance Cable equipment and products are brought on stream. As recapitalisation enhances net cash and operational efficiencies lead to high free cash flow generation, there is significant potential for re-rating.

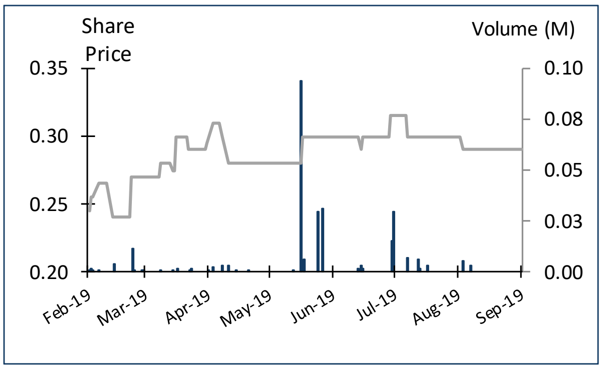
Year to June (AUD)	2017A	2018A	2019A	2020f	2021f
Sales (m)	13.0	15.5	12.7	26.5	42.6
EBITDA (m)	-1.6	-1.2	-2.7	2.9	5.1
Net Profit (m)	-2.9	-3.1	-3.6	1.5	2.9
EBITDA Margin (%)	NM	NM	NM	11.1%	12.1%
RoA (%)	NM	NM	NM	4.6%	7.0%
EPS	-0.90	-0.94	0.04	0.03	0.03
DPS	0.00	0.00	0.00	0.00	0.00
EV/Sales	1.1x	1.0x	2.3x	1.0x	0.6x
EV/EBITDA	-8.9x	-13.8x	-10.6x	8.7x	5.2x
P/E	NM	NM	NM	16.7x	8.7x
Dividend yield %	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company, Pitt Street Research

Market Cap. (A$ m)	25.7
# shares outstanding (m)	85.6
# share fully diluted	85.6
Market Cap Ful. Dil. (A$ m)	25.7
Free Float	100%
High/low since Feb. '19	0.315 / 0.24
Average daily volume (x1,000)	1,810
Website	energytechnologies.com.au

Source: Company, Pitt Street Research

Share price (A$) and avg. daily volume (k, r.h.s.)



Source: Thomson Reuters, Pitt Street Research

Valuation metrics	
DCF fair valuation range (A$)	0.34–0.44
WACC	10%
Assumed terminal growth rate	1-2%

Source: Pitt Street Research

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Please note Pitt Street Research and/or its directors hold stock in Energy Technologies per the date of this report.

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Profit & Loss (A$m)	2017A	2018A	2019A	2020f	2021f	2022f	2023f
Sales Revenue	**13.04**	**15.46**	**12.66**	**26.48**	**42.55**	**48.93**	**53.83**
Operating expenses	-5.10	-5.17	-5.58	-4.47	-7.19	-8.27	-9.10
Adjusted EBITDA	**-1.58**	**-1.17**	**-2.71**	**2.94**	**5.15**	**6.17**	**7.05**
Depn & Amort	-0.28	-0.37	-0.45	-0.64	-1.02	-1.17	-1.29
Adjusted EBIT	**-1.86**	**-1.54**	**-3.16**	**2.30**	**4.13**	**4.99**	**5.76**
Net Interest	-1.12	-1.57	-0.89	-0.28	-0.22	-0.25	-0.22
Profit before tax (before exceptional)	**-2.98**	**-3.12**	**-4.06**	**2.02**	**3.91**	**4.75**	**5.54**
Tax expense	0.02	-0.01	0.09	-0.95	-1.07	-1.30	-1.52
Abnormal + Minorities	-0.01	-0.02	5.34	1.43	-0.03	-0.03	-0.04
NPAT	**-2.94**	**-3.11**	**1.40**	**2.54**	**2.86**	**3.47**	**4.05**

Cash Flow (A$m)	2017A	2018A	2019A	2020f	2021f	2022f	2023f
Profit after tax	-2.96	-3.13	1.39	2.52	2.83	3.44	4.01
Depreciation	0.28	0.37	0.45	0.64	1.02	1.17	1.29
Change in trade and other receivables	-0.61	0.66	-2.06	-0.56	-3.52	-1.40	-1.07
Change in trade payables	1.22	0.82	-1.29	4.84	5.72	2.27	1.74
Other operating activities	-1.19	0.45	0.49	-3.77	-4.40	-1.75	-1.34
Operating cash flow	**-3.25**	**-0.82**	**-1.02**	**3.67**	**1.65**	**3.74**	**4.64**
Capex (- asset sales)	-2.15	-1.38	-5.21	-1.59	-2.55	-2.94	-3.23
Other investing activities	0.00	0.00	0.03	0.00	0.00	0.00	0.00
Investing cash flow	**-2.15**	**-1.38**	**-5.18**	**-1.59**	**-2.55**	**-2.94**	**-3.23**
Dividends	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Equity raised (repurchased)	0.00	0.00	2.85	0.00	0.00	0.00	0.00
Debt drawdown (repaid)	6.09	1.69	1.74	0.00	0.00	0.00	0.00
Other financing activities	0.00	0.00	1.45	0.00	0.00	0.00	0.00
Net change in cash	**0.69**	**-0.51**	**-0.16**	**2.08**	**-0.90**	**0.80**	**1.41**
Cash at End Period	0.70	0.19	0.03	2.11	1.21	2.01	3.42
Net Debt (Cash)	11.85	14.21	2.54	0.46	1.36	0.56	-0.85

Balance Sheet (A$m)	2017A	2018A	2019A	2020f	2021f	2022f	2023f
Cash	0.70	0.19	0.03	2.11	1.21	2.01	3.42
Total Assets	14.43	14.17	24.89	32.25	40.81	46.52	52.28
Total Debt	12.55	14.40	2.57	2.57	2.57	2.57	2.57
Total Liabilities	18.40	21.06	8.17	13.02	18.74	21.02	22.76
Shareholders' Funds	-3.97	-6.88	16.71	19.23	22.06	25.50	29.52

Ratios	2017A	2018A	2019A	2020f	2021f	2022f	2023f
Net Debt/Equity (%)	NM	NM	15.2%	2.4%	6.2%	2.2%	NM
Interest Cover (x)	NM	NM	NM	8.2	18.8	20.3	25.9
Return on Equity (%)	NM	NM	NM	7.7%	13.0%	13.6%	13.7%

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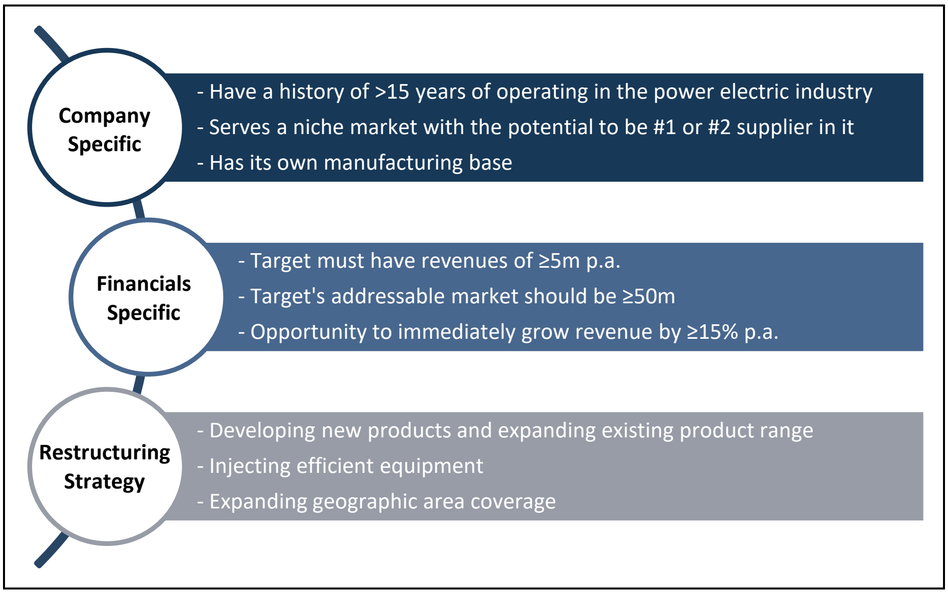
Introducing Energy Technologies (ASX:EGY)

Energy Technologies Ltd (ASX:EGY) is a Sydney-based, holding company that generally invests in distressed manufacturing businesses in the electric power industry. EGY's strategy is to invest in businesses in the electricity domain that have a history of more than 15 years, and those that offer the potential to capture significant market share in the niche segments they serve through process revamping (Figure 1). Currently, EGY provides cabling and wire solutions through its wholly owned subsidiary – Bambach Wires and Cables (BWC) – to niche segments such as rail and road signalling cables.

Figure 1: Investment checklist



Source: Company, Pitt Street Research

Creating value through investing - the EGY way

Dulhunty Power shows how management can grow shareholder value over time

EGY's investment history provides evidence of the management's capability to identify ailing businesses with significant growth prospects and restructuring their operations to help them realise potential. A case in point is EGY's investment in Dulhunty Power, which the company acquired in 2003. As a result of the value created by EGY through expansion in Dulhunty's operations over a span of ~7 years, it was able to sell the business in 2011, at a premium, for A$17m (or ~A$0.49 cents per share). Presently, EGY is pursuing the same strategy with BWC, the investment it made after exiting Dulhunty Power.

In order to create value, EGY employs various organic and inorganic growth strategies, including product line expansion, developing new products, acquisition of similar businesses, expanding geographical coverage and injecting efficient equipment. Notably, in line with its growth strategies, EGY recently acquired the assets of the Advance Cables business on the back of the substantial synergies presented by merging its operations with the BWC business.

Unlocking synergies through Advance Cables acquisition

EGY is currently in the process of merging the assets of Advance Cables, which it acquired in January 2019, with its wholly owned subsidiary BWC. Advance Cables has been operating in the cables industry since 1980s. Its equipment offers significant production capacity and efficiencies. Despite this, Advance Cables' margins suffered due to a high AUD prior to 2018 enabling cheap imports from China and India, as well as a lack of product development. By combining operations, BWC stands to benefit from the expanded and more efficient production capacity, while Advance Cables product and customer base will provide an extended product portfolio as well as an enhanced customer network (Figure 2).

EGY has substantial upside potential

We believe that EGY's proven track record of past investments supports its ability to successfully turn around the loss-making operations of BWC. Moreover, the synergies from the acquisition of Advance Cables, relocation to a lower-cost and modern production location, and recapitalisation of erstwhile debt-heavy balance sheet, offers further upside potential to BWC.

Figure 2: BWC's customer portfolio

Source: Company

Ten reasons to consider Energy Technologies

The new Rosedale site markedly boosts Bambach's production capacity

1) The acquisition of Advance Cables assets is expected to provide capacity and revenue synergies to EGY The combined product mix, customer base, improvement in cash flows and removal of duplicate overheads are all expected to prove highly beneficial to EGY's current business.

2) Post the completion of the asset acquisition, the combined market share of EGY's cable operations has the ability to rapidly increase to 3% (from the current 1%) of the Australian electric cables and wire market.

3) As part of the deal plan, both Bambach and Advance Cables would move their equipment to a common site in Rosedale, Victoria. As a result of the combination of the assets, the combined production capacity of Bambach would increase 9x, to 250 tonnes per month.

4) In addition to the economies of scale and higher production efficiency from state-of-the-art equipment, the new facility will enjoy the benefits of lower rental expenses. Furthermore, EGY recently engaged with Swinburne University to explore a virtual manufacturing system, which would streamline operations at the new site, by deploying the methodologies of Industry 4.0.

5) The federal government's A$2.9m grant to EGY, under the Regional Jobs and Investment Program, has aided in the setting up of the new facility in Victoria.

6) Under the recapitalisation programme initiated in early 2019, EGY was able to extinguish ~A$9.9m and ~A$4m of current and non-current liabilities, respectively, from its books. This was facilitated by an equity-for-debt swap, under which EGY's current debt holders agreed to convert the outstanding debt into company's equity.

7) Further, EGY would be able to fund its working capital needs on the back of facilities enabled by the extinguishment of debt and proceeds from the issuance of equity giving rise to a strong balance sheet. This is expected to significantly alter the current situation where EGY loses ~A$0.5m in sales orders per month due to inadequate working capital.

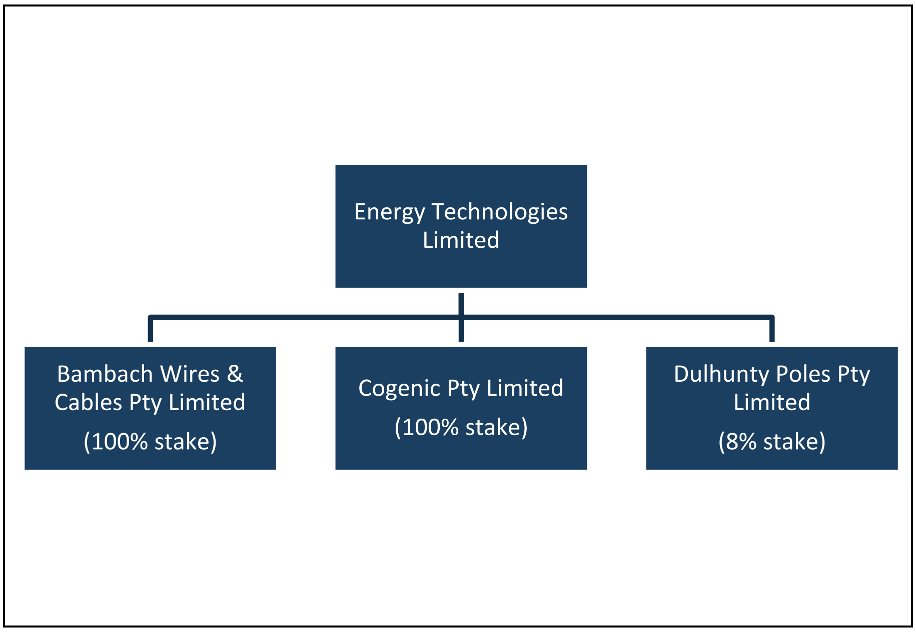
8) The Australian wire and cable market is expected to experience tailwinds from the increase in government spend on infrastructure – budgetary allocation of ~A$100bn for infrastructure spend to be incurred over the next 10 years and a defence spend of over 200 billion. In our view, this increase in spend provides a significant upside potential to EGY's current operations.

Bambach's specialised niche products are less susceptible to cheap imports

9) Currently, the domestic wire and cable market suffers intense competition from low-priced imports, especially from China. However, the continued fall in AUD, which is expected to last in the short run, would offset the advantage of cheap imports. Additionally many of the Bambach Cable products are specialised niche products made to order and as such not attractive to large offshore commodity manufacturers.

10) We believe that as National Broadband Network (NBN) continues to expand its network in Australia, the demand for Dulhunty's Titan poles will also grow in tandem.

Figure 3: EGY structure



Source: Company, Pitt Street Research

Organisation Structure

EGY, an investment vehicle, is a listed holding company that operates through three subsidiaries – Bambach Wires & Cables Pty Ltd (BWC), Cogenic Pty Ltd (Cogenic) and Dulhunty Poles Pty Ltd (Dulhunty) (Figure 3). While the first two are wholly owned subsidiaries, EGY holds a strategic stake in Dulhunty.

Bambach Wires & Cables Pty Ltd (BWC)

EGY bought Bambach for only A$1m cash down

Established in 1936, BWC is an Australia-based manufacturer of specialised industrial cables. It provides low- and medium-voltage cabling products, including braids, data and instrumentation cables, lighting cables, traffic cables, rail cables, defence cables and telephone cables, primarily for end industries such as mining, rail and defence. In July 2012, EGY acquired 100% stake in BWC for a cash consideration of A$1m.

BWC operates through manufacturing facilities in Sydney and recently Rosedale Victoria. In addition to this, it has offices and warehousing facilities in Melbourne, Adelaide, Newcastle, Brisbane and Perth.

At the time of its acquisition, BWC was primarily engaged in the mining sector. Due to the mining downturn just after acquisition, BWC's monthly sales orders from one customer alone tumbled from A$300k to A$40–50k per month.

Consequently, upon completion of the acquisition, EGY's management set about reverse restructuring the operations of BWC with the aim of expanding its market share through organic growth. EGY's management has always trailed the long-term, macro-level view of where various end industries are headed and accordingly developed products targeted at those industries. As a result, BWC's product portfolio underwent substantial expansion (Figure 4), when it started developing products for specific high-growth industries, such as transport infrastructure and defence.

Figure 4: Key products

Braids and terminated braids	
Railway specific cable	
High temperature	
Data and instrumentation	
Marine specific	
Halogen free cables	
Low voltage	
Mining specific	
Telephone cable	
Traffic cable	

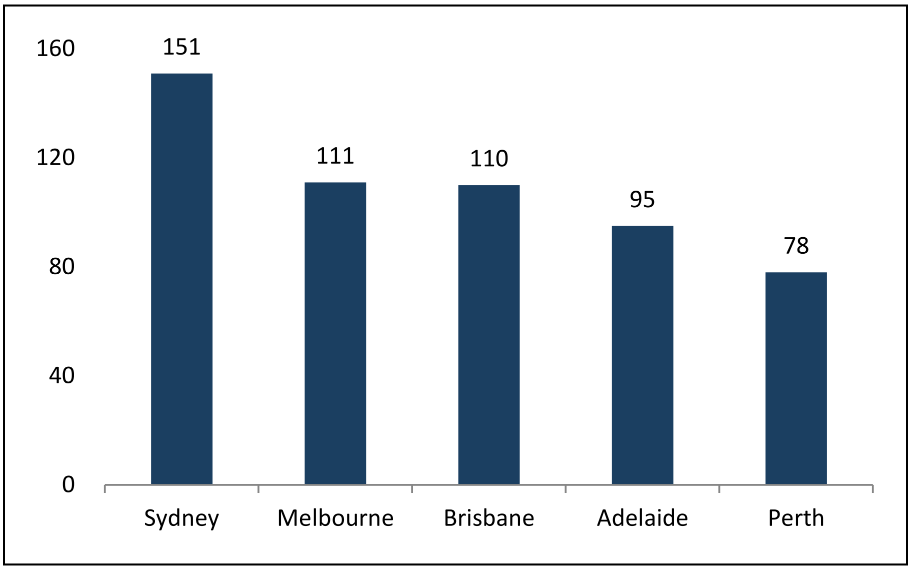
Source: Company

Sydney manufacturing plant under distress

Higher rent and lack of adequate funding rendered the Sydney site operationally inefficient

The legacy manufacturing site for BWC, located in Brookvale, Sydney, turned into a costly venture for the company due to its production and operational inefficiencies. Sydney has historically been an expensive market in terms of rent, as evidenced by the net rent rates reported by Colliers in its industrial review report for 1H'19 (Figure 5). Higher rent (~A$750krising to A$900 per annum) for the Brookvale facility resulted in a pressure on BWC's margins.

Figure 5: Industrial rents in major Australian cities in 1H'19 (US$ per sq. meter)



Source: Colliers International's Industrial First Half 2019 report

Moreover, the Brookvale site (Figure 6) lacked the required workspace and had outdated equipment. The site was not efficiently equipped to competitively manufacture the newly developed products.

Figure 6: BWC's Brookvale Site

Source: Company

While EGY's current strategy of focussing on product development secures long-term growth for BWC, it does not create immediate cash flow to meet working capital requirements. As a result, the Brookvale site did not have the required efficiency to deliver the sales growth and profits the industry has to offer.

Due to insufficient production capacities (particularly for larger cable sizes) and working capital, BWC would incur sometimes sizeable sales order losses. The solution to these inefficiencies came in the form of regional grants as well as EGY's recapitalisation programme (details provided later in the report).

Cogenic Pty Ltd (Cogenic)

EGY's smallest subsidiary, Cogenic Pty Ltd, holds the rights to a modular co-generation distributed energy system. Under a distributed generation system, electricity is created at or near the site of usage. The system was generated by Cogenic itself, using significant amounts of capital. EGY took 100% stake in Cogenic, with the aim of leveraging the IP pertaining to the energy system to further expand into other areas of renewable energy and maybe even in energy storage.

Dulhunty Poles Pty Ltd (Dulhunty)

Prior to 2011, EGY was listed on the ASX as DUL (Dulhunty Power Ltd.), representative of the 50.82% stake in Dulhunty Power International Ltd (DPIL), which accounted for the bulk of its total revenue. EGY acquired the company in 2003, when DPIL was operating in China as a manufacturer of overhead fittings for power lines. The managment then set about reverse restructuring the business to make it profitable. Over the course of seven years, EGY managed to expand the Chinese factory, as well as build two more manufacturing plants (in Thailand and Malaysia) and an assembling unit in Australia. On the back of growth in the business' potential, DPIL attracted bids from three companies and was ultimately sold to MacLean Power LLC in 2011, for A$17m.

Dulhunty poles enjoy substantial advantage over traditional wood and concrete poles

Currently, EGY holds a strategic stake in Dulhunty Poles Pty Ltd. Established in 2009, Dulhunty Poles engages in providing poles for the electric industry. The company manufactures Titan Poles in a purpose-built manufacturing plant located in Moolap, Victoria, which allows the construction of poles with a height of up to 17 meters.

Dulhunty began production in 2011, and currently has an installed base of ~10,000 poles across Australia, French Polynesia and New Zealand. The poles are built using patented materials, and are used in various applications including, power distribution, street lighting, marine piles, subtransmission and communication.

Titan Poles - What sets them apart?

Dulhunty's engineered cement poles (Titan Poles) hold several advantages over traditional wood and concrete poles, as well as poles made with steel reinforcing. Some of the key advantages are as follows:

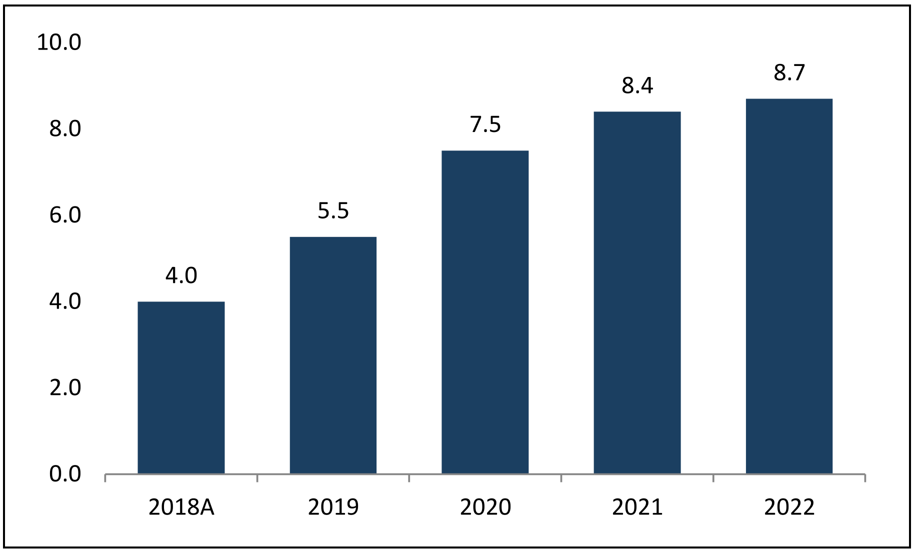
- **Fireproof**: Unlike their wooden counterparts, Titan Poles are almost completely fireproof, evidenced by tests conducted under the UL94 [1] flammability test standard and the Energy Network Association of Australia's protocol. The ability of Titan Poles to withstand fire allows utility companies access to difficult terrains that are prone to fires (intended and accidental), such as Darkes Forest in NSW.
- **Lightweight**: As Dulhunty poles and piles are hollow inside, they are lightweight compared with wood and concrete poles, and this facilitates ease in transport, especially in areas where helicopters are the only means

[1] UL94 is a test standard developed by the Underwriters Laboratories of the US for determining the flammability of plastic materials used for parts in devices and applications.

for inserting poles. Moreover, because Dulhunty piles are hollow, they have a higher strength-to-weight ratio than the traditional eucalyptus hardwood used in marine piles, resulting in need for less force to embed the pile in the seabed.

- **Flexible design**: Dulhunty's manufacturing process permits a high degree of flexibility in design, including variations in diameters and the strength of poles produced. In case the standard solutions do not meet the needs of the utility, the customer has the option of collaborating with the company's engineers to produce the specific solution.
- **Rust, spall and corrosion resistant**: Titan poles do not contain any steel, sand or stone component, and hence are not prone to rust, spall or corrosion.
- **Non-Conductive:** Importantly Titan poles are non-conductive and as such provide a far safer and less problematic distribution network than concrete poles.

Figure 7: NBN's activated premises projections (in million)



Source: NBN Corporate Plan 2019-22

NBN advantage for Titan Poles

NBN needed Titan Poles in order to roll out in suburban Melbourne

National Broadband Network (NBN), a government business enterprise (GBE) in Australia, aims to provide Australians access to fast broadband at affordable prices while incurring the least-possible cost. NBN's current expansion into the suburbs of Melbourne requires the installation of new taller poles, the demand for which is being met by Titan Poles. With the advent of 5G, the demand for wireless infrastructure is expected to grow. Under NBN, as the infrastructure roll-out intensifies in Australia, demand for Dulhunty's Titan Poles is expected to increase.

We believe that NBN's goal to connect 8 million homes and businesses to its network by 2020 provides a huge opportunity for Dulhunty Poles. As of June 2018, there were 4 million activated premises on the NBN network. As per NBN's Corporate Plan 2019–22, this number is expected to reach 8.7 million by 2022, translating to a CAGR of 21% from 2018 to 2022 (Figure 7).

EGY's initiatives to revamp operations

Recapitalisation proposal: turnaround plan in full swing

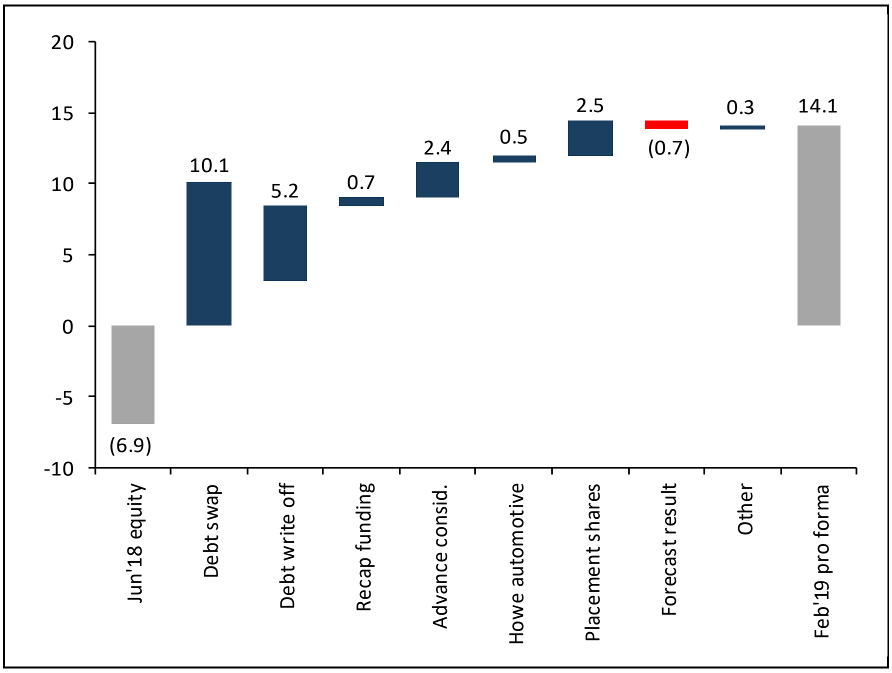
The inefficient and expensive Sydney plant is impeding EGY's realisation of its growth potential

Operational inefficiencies at BWC's Sydney manufacturing facility led to erosion of equity. Due to the substantial interest and rent expenses, EGY reported net losses over the past five years. As a result, the company's equity was severely impacted and stood at –A$6.9m as of 30 June 2018, compared with A$100k as of 30 June 2014. As a result of inadequate funding, BWC has not been able to take advantage of growth in its key addressable markets. While the business has the required products, it lacks the output capacity to competitively manufacture them.

Because the key stakeholders continue to maintain strong conviction in the business, the board, management and debt holders agreed to a recapitalisation proposal with the following key terms:

- Conversion of EGY's consolidated debt into ordinary shares.
- Acquisition of plant and equipment, and other business assets of Advance Cables Pty Ltd.
- Relocation of production facilities from Sydney to regional Victoria.
- Issuance of new shares via private placement to raise ~A$5m.

Figure 8: Pro forma equity bridge (in A$m)



Source: Company, Pitt Street Research

Conversion of existing debt improves EGY's balance sheet as well as working capital position

EGY has utilised the equity placement proceeds to fund the establishment of a new site in Rosedale (Victoria) and for working capital requirements. This proposal was approved by EGY's shareholders on 13 February 2019, and provides a much-needed breather to its operations in terms of the following fundamental benefits:

- **Improved balance sheet**: The conversion of existing debt to equity would substantially improve EGY's equity, taking it from –A$6.9m (as of June 2018) to +A$13m (Figure 8).

- **Increased production capacity**: As the company gains access to Advance Cables' highly efficient equipment, BWC's production capacity would increase substantially from 30 tonnes to 250 tonnes per month.
- **Enhanced production efficiency**: Though BWC has developed many new products, it lacks the tools for their production at the legacy site. The transition to the new site is expected to enhance the production efficiency for the BWC range of products by 250%.
- **Expanded product range**: The acquisition of the assets of Advance Cables would result in the expansion of EGY's product range and market presence.
- **Revenue and margin growth**: The combined operations of BWC and Advance Cables will aid the development of a sustainable workforce, as well as provide EGY access to a larger market, thereby improving both revenue and margins.

The board expects the implementation of the recapitalisation plan to result in a profitable and growing business within the coming 12 months and deliver strong returns to shareholders.

Debt for equity swap

Under the recapitalisation programme, lenders took a 27–55% haircut on the outstanding amount

As part of the recapitalisation EGY's debenture, convertible notes and loan holders agreed to swap the outstanding debt for equity (Figure 9). As agreed with the lenders, shares were issued to them at a corresponding discount of 45-73%, which resulted in extinguishment of ~A$9.9m and ~A$4m of current and non-current liabilities, outstanding as of 31 December 2018. As a result of the conversion, EGY issued 57.2m of new shares in February 2019, at a share price of A$0.20 per share.

Subsequently, in the same month, EGY announced a private placement of 23.65m of new shares, thereby generating A$4.7m in proceeds. Notably, A$2m of these proceeds were deployed towards the acquisition of plant and equipment from Advance Cables.

We believe the remaining proceeds from equity issuance provide the company enough firepower to fund the transition to a new site in Victoria, along with funding for a better working capital management.

Figure 9: EGY's recapitalisation plan

	Pre - Recapitalisation			Post - Recapitalisation			
	Security	$ Total Value	Conversion Ratio	Post $ value	# shares	Ownership %	Effective Cost Price
Existing security holders	Senior secured loans	10.8	73.1%	8.0	40.0	48.3%	0.27
Existing security holders	Junior secured loans	0.4	57.0%	0.2	1.0	1.2%	0.35
Existing security holders	Unsecured financing	4.1	44.7%	1.9	9.5	11.5%	0.44
Existing security holders	**Total Debt**	**15.3**	**65.9%**	**10.1**	**50.5**	**60.9%**	**0.30**
Existing security holders	Existing shareholders (0.2c)	0.7	43.1%	0.3	1.5	1.8%	0.46
Existing security holders	Recent funding	0.8	100.0%	0.8	3.9	4.7%	0.20
Existing security holders	**Total EGY security holders**	**16.8**	**66.5%**	**11.2**	**55.9**	**67.4%**	**0.30**
New shareholder	Advance			2.4	12.0	14.5%	0.20
New shareholder	Howe Automotive Ltd (ASX:SFC)			0.5	2.5	3.0%	0.20
New shareholder	**Placement shareholders**			**2.5**	**12.5**	**15.1%**	**0.20**
New shareholder	**Total new equity**			**5.4**	**27.0**	**32.6%**	**0.20**
	Post recap market cap @ 20c			**16.6**	**82.9**	**100.0%**	**-**
	Recapitalisation finance			1.0			
	Cash			(2.2)			
	Total new equity			**15.4**			

Source: Company

Grant from federal government to ensure a smooth transition to Rosedale site

EGY's transmission to Victoria supports the government's objective to spur economic growth

In April 2018, BWC secured a Regional Jobs and Investment Program (RJIP) grant of A$2.9m (across two tranches) from the federal government for the establishment of a cable manufacturing plant in the Latrobe Valley of Victoria. The government's intention behind this grant is to support long-term sustainable employment for local workforce. The grant also aims to enhance quality standards of end products, so that Australian-made items remain competitive vis-à-vis cheap imports.

This grant has been utilised by BWC to cover the costs of new and modern equipment, building refurbishment, commissioning of the new unit, workforce training, etc. The grant period ends on 30 June 2020, and payments are capped at A$1.45m per financial year (EGY received the first tranche in December 2018).

Notably, the award of this grant and commissioning of the new unit triggered discussions between BWC and Advance Cables to combine their business operations. We are of the view that the combination of the two businesses will unlock substantial synergies for EGY in terms of reduction in operational costs and expansion in production capacity.

Advance Cables' Asset Purchase: Need of the hour

Advance Cable's superior production capacity and potential for margin improvement made it ripe for acquisition by EGY

In January 2019, EGY acquired the equipment, inventory and brand name of Advance Cables, a Victoria-based cable manufacturer, for an EV of A$3.9m, in a cash and stock deal.

Advance Cables focusses on the manufacturing of PVC, rubber and polyethylene electrical cables for the buildings, white goods, irrigation and automotive industries. The focus of the product portfolio has been on production of high-volume, low-margin general cables for the residential and commercial building construction industry.

At the time of acquisition, Advance Cables operated out of its Dandenong facility, which was capable of processing 250 tonnes of finished product per month (vs. BWC's production capacity of 30 tonnes). The business achieved revenue of A$39m in FY2018, with a gross profit margin of ~5% (Figure 10).

Figure 10: Financials snapshot of Advance Cables (A$)

Year to June	2016A	2017A	2018A
Sales (m)	44.77	38.61	39.06
Gross Profit (m)	3.41	2.66	2.09
EBITDA (m)	1.43	0.79	-0.01
Gross Margin (%)	7.6%	6.9%	5.4%
EBITDA margin (%)	3.2%	2.0%	NA

Source: Company, Pitt Street Research

Advance Cables' profitability, in recent times, has been on the lower side owing to its non-aligned product mix and reliance on wholesaler customers. Moreover, lack of strategic direction to pursue more profitable products and under-resourced sales force has handicapped Advance Cables' growth. Removing unprofitable and low-margin product lines, in line with EGY's plan post acquisition of the business assets, would aid in achieving a much higher gross profit margin (~10%) on a pro forma basis.

Synergies from the acquisition

Combined operations are expected to drive significant production and operational efficiencies, leading to improved profitability

The combination of BWC and Advance Cables will provide EGY access to greater sales channels and a more diversified customer base, including opportunities to cross-sell (Figure 11). The acquisition is expected to improve production and bring in inventory efficiencies as a result of economies of scale. This will be driven by the relocation of the manufacturing facilities of BWC and Advance Cables to a common location in Rosedale, Latrobe Valley, Victoria. Since the new site will have access to higher-efficiency equipment of Advance Cables, the production capacity for BWC products would increase over 6x, from 30 tonnes to 250 tonnes per month. The acquired equipment will also allow the combined entity to have a wider product line – ability to manufacture cables of up to 400mm compared with the current 120mm. The new combined entity will have an enhanced raw material procurement power, thus improving returns.

The deal is also expected to drive a significant reduction in fixed and variable costs, leading to a higher combined gross margin of >23%. The combined operations would remove the duplication of expenses and possibly help realise savings worth >A$5m.

Figure 11: Acquisition of Advance Cables: Transaction Rationale

Scale & Production	Sales & Diversification
• Superior plant and equipment will deliver significant improvement in gross margins on the existing range of BWC manufactured products. • 6x uplift in production capacity from 30 to 250 tonnes per month. • Equipment will allow production of cables up to 400mm (BWC currently limited to 120mm). • Improved production and inventory efficiencies, due to economies of scale. • Low cost site with scope for large scale expansion.	• Selling synergies and greater sales channels for combined product ranges. • Larger, more diversified customer base - strong cross selling potential. • Focus on higher margin specialised customer direct product range but with "one stop shop" large scale project capability. • Maximisation of existing BWC warehouse/sales branch network for both sales and inventory market proximity. • Margin improvement on Advance Cables product lines by offering cut to order from stock.
Financial	**Strategic & Operational**
• Achieve a significant reduction in fixed and variable costs and higher utilisation - enables increase in combined gross margin to 23%+. • Achieve forecast revenue of $20m+ and EBITDA pre one-off items of ~$1m+ in FY20, rising to $44m and $6m respectively in FY21. • Costs savings of $5m+ on combined operations. • Removing duplication of selling, general and administrative expenses.	• Focus on higher margin specialised products and positioning as premier manufacturer of specialised and industrial cables in Australia. • Significant advantage for defence contracts reliant on local specialised manufacture and infrastructure projects requiring local content. • Wide range of cables and fast reliable delivery. • Ability to build and maintain direct end user customer relationships. • Improvement of cash flow, procurement and buying power.

Source: Company, Pitt Street Research

Relocation to Rosedale to be fully commissioned by 2019-end

With the refurbishment and installation work complete, the new site has started production of Advance Cables' products from July 2019

In order to benefit from the RJIP grant, the company secured and commenced refurbishment work at a new site in Rosedale, Victoria. EGY entered into a triple net lease agreement with the owners (Howe Leather) for 10 years. The company will have an option to buy the new site for A$3.2m throughout the term with a 3% p.a. price escalation clause. The company expects to have a workforce of ~35 employees at this site by the end of FY2020.

As per EGY's transition plans for the new site, the equipment and assets of Advance Cables would be the first to be transferred to the Rosedale facility, while the Sydney facility would continue to operate simultaneously. Upon commencement of production at the Rosedale site, initiated in August 2019 with full production by 2019-end , EGY will start dissembling and mobilising equipment from Brookvale to its new site.

Work at the new Rosedale facility is almost in the final stages, with a number of machines installed. The first three months of CY19 saw the completion of the renovation work at the new site, including the installation of new roofing and lighting. The facility's extensive offices also underwent complete refurbishment, while the factory floor was subject to substantial concrete repairs.

The power infrastructure is substantially completed and the initial commissioning of the facility's first full production line has occurred. Since the current machines installed at Rosedale are those of Advance Cables, the first line of production at the new facility is manufacturing Advance branded air conditioning cable. By end August production will be expanded to include various rail and traffic cables.

Figure 12: New Rosedale Site

Source: Company

Site relocation to bring in operational efficiencies

Expanded workspace, lower rent and superior equipment are expected to drive operational efficiency at the new site

The Rosedale site (Figure 12) is significantly larger than the existing Brookvale site (120 acres with a factory area of 9,000 sq m) and will lead to a material increase in production capacity and efficiency, and reduction in logistic complexity. Operating from the new facility will significantly reduce operating cost – rent will be A$330k p.a. compared with A$500k and A$750k p.a. for Advance Cables and BWC, respectively.

The greater floor space provides the opportunity to install larger and more sophisticated equipment, which in turn will reduce labour input to attain gross margins of more than 23%. The larger space also provides sufficient legroom for future expansion.

The new site, located ~180km from Melbourne's chief business district (CBD), enjoys access to a population catchment of ~180k, which includes a significant base of skilled labour and machine operators.

Further, the higher throughput from modern equipment is expected to reduce the lead time to less than four weeks. This provides EGY a substantial edge over its competitors, most of which are restricted to lead times of 8-12 weeks and longer.

EGY to leverage the advantages of Industry 4.0

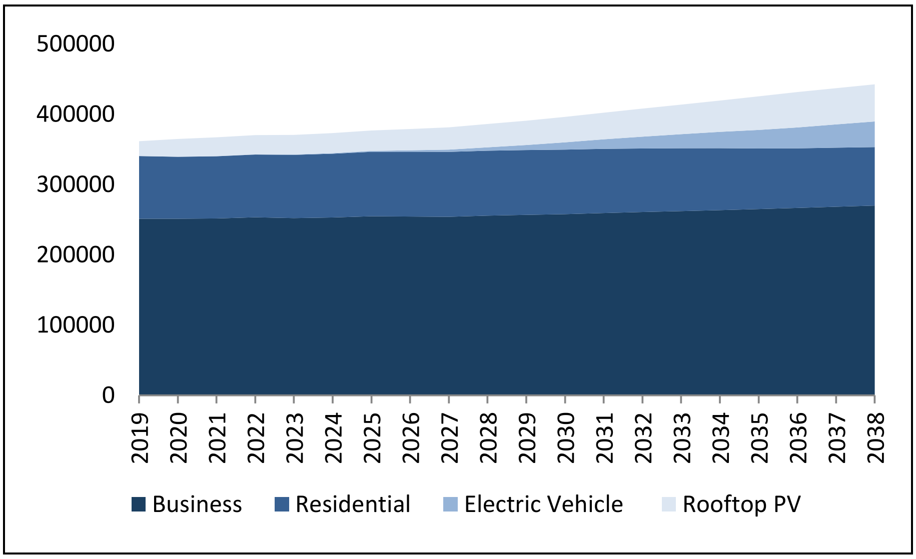
In order to take advantage of the significant benefits presented by Industry 4.0, BWC has joined hands with Melbourne-based Swinburne Univeristy of Technology, for the development of a virtual manufacturing system (VMS). The intent of the partnership is to enhance the application of the Industry 4.0 methodology in BWC's manufacturing process.

Partnership with Swinburne University will likely unlock substantial potential to improve the manufacturing process

Under the partnership, a Swinburne team would collaborate with BWC's production and quality managers to develop an application for the company's VMS project. Though the plan entails about two years for full development and implementation of VMS, the company expects to simulataneously realise benefits from technical advancements as the system is developed.

With the deployment of the new manufacturing system, the new site is well on its way to become a smart factory. We believe that the implementation of this system would further enhance the operational efficiency of this new facility as the overall manufacturing system becomes more proficient.

Figure 13: Electricity annual consumption forecast (Gigawatt hours)



Source: AEMO 2018 Electricity Statement of Opportunities Update

Growth in key end markets underpins BWC's top-line expansion

Growing applications of low-voltage cables and growth in infrastructure spends are set to drive demand for BWC's cables

BWC primarily sells low- voltage cables, whose demand is directly correlated to the expansion in the mining, railway, defence and construction and traffic management industry segments. We believe that as the demand for electricity continues to grow due to industrial/infrastructure expansion (Figure 13), coupled with increase in government spending on infrastructure and defence, demand for BWC's cables would rise in sync. Notably, in its 2019 budget, the Australian government allocated A$100bn for infrastructure spends to be incurred over the next 10 years, highlighting the extent of growth opportunity that exists for BWC.

Additionally, in recent years, the applications of low-voltage cables have grown across other niche areas, such as in heat pumps, electric vehicle charging stations and solar panels. In our view, as the number of applications for these cables expands, their demand would grow multiple times in tandem. Notably, the latest market report by ResearchandMarkets forecasts that the global wires and cables market would grow at a CAGR of 6.2% over 2018–2022, reaching a market size of US$173.5bn (from US$136.7bn in 2018). This makes BWC a worthy investment option.

EGY's renewed strategy for BWC is to develop cabling solutions targeting specific industries, such as rail and road infrastructure, power and transmission, mining, defence, and solar. In our opinion, this approach optimally positions the company to take advantage of growth in the following sectors:

Heavy government expenditure in the transport and defence sectors, as well as imminent recovery in mining investment, to fuel demand for BWC's cables

- **Rail infrastructure**: As part of its population planning, the Australian government is significantly investing in transport infrastructure to decongest the overpopulation in cities. A case in point is the latest budget announcement by the government that included A$2bn investment for the development of a fast-rail corridor from Geelong to Melbourne. As per Deloitte Access Economics, Australia is set to witness a horde of major rail and road projects coming underway till 2023, with the transport project activity peaking at US$19bn in 2021.

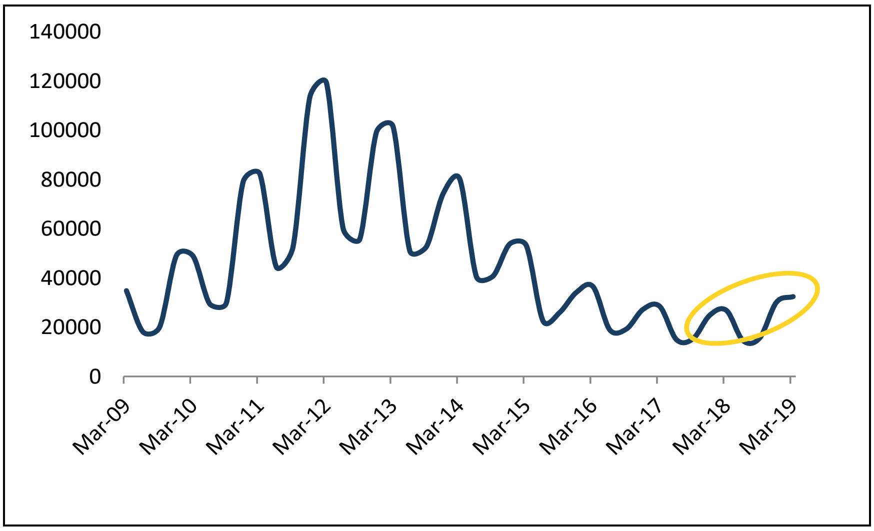
  For a major project (such as the US$11.5bn Sydney Metro City & Southwest project), the amount of LV cables required for track and signalling is equivalent to ~US$5-6bn. Additionally, for each station ~US$600k of LV cable is required, while each km of tunnel requires US$100-200k of LV. Notably, the Southwest project involves the construction of 6 new stations, as well as 15.5km of twin tunnels. We believe that as more of these projects come online, the LV cable market will witness substantial growth across the industry, including BWC.
- **Defence**: Since its inception in 1936, BWC has been catering to the defence sector through its specialised cable solutions for military ships and vehicles. Unsurprisingly, the company has gained expertise in serving this industry. In our view, this provides BWC a major advantage to capitalise on the opportunity presented by the federal government's plan to invest A$90bn in continuous shipbuilding. As part of its Naval Shipbuilding plan, the Australian government has signed various contracts to add 12 submarines, 9 frigates and 33 patrol boats to its fleet. The amount of LV cable required in a single submarine or frigate is ~US$1m, while a patrol boat requires ~US$300k of LV cable.
- **Road infrastructure**: In addition to rail infrastructure, the Australian government is spending heavily on building new roads as well as upgrading the existing ones. In the state of Victoria alone, two major road projects are underway – the A$15.8bn North East link and the A$6.7bn West gate tunnel project. Notably, for every km of tunnel build, ~US$50-100k of low smoke zero halogen and fire rated LV cables is required. Moreover, on the back of multiple road construction projects currently underway (such as the US$3.3bn Westconnex project) the demand for LV traffic cables is expected to grow by ~US$5-8m p.a.
- **Rolling stock**: In order to service the aforementioned rail projects, Australia will require >450 train sets. The construction of these train sets translates to a total contract value of ~US$15bn, distributed over a period of 8 years. With each train set requiring US$100-150k of cables, BWC's

addressable market opportunity (assuming the trains are built in Australia) is US$45-70m of cable requirement.

Deployment of smart grids presents a substantial opportunity for BWC's low-voltage cables

- **Power and transmission**: Driven by the increasing demand for electricity and grid reliability, the economy is transitioning towards smart grids. As per a report by Northeast Group, a US-based consultancy firm, Australia and New Zealand are expected to invest ~US$6.1bn in the development of smart grids over 2017–2027. As low- and medium-voltage cables form the core technology in distribution networks for smart grids, the cables market (including BWC) is expected to benefit substantially from this transition.
- **Renewable energy**: Recent years have witnessed a shift towards the adoption of renewable energy, driven in part by favourable government policies and consistently declining cost of production. Solar energy, in particular, has witnessed substantial growth. As per the Renewable Energy Index update released by Green Energy Markets (a research and advisory firm) for April 2019, the installed capacity for small-scale rooftop photovoltaic (PV) systems increased 48% YoY to 480MW in Q1 2019. This increase primarily reflected the success of the Solar Homes programme initiated by the government of Victoria, which offers solar rebates to residential properties, thereby stimulating demand for solar PV systems. We believe that the programme's target of installing solar PV systems in 700k households (30k already achieved), coupled with the anticipated launch of "FlareX" brand of solar cables, will greatly benefit BWC.

Figure 14: ABS mining investment forecast (in A$mn)



Source: ABS Private New Capital Expenditure and Expected Expenditure, March 2019

- **Mining**: Even though the mining sector has been experiencing a decline since its investment peak in 2012, the latest ABS Capital Expenditure survey data suggests that the mining investment cycle is in for a trend reversal. As per the capex long-term forecast data released by ABS in May 2019, the second estimate for mining investment stood at A$32.4bn for 2019–20, up 21% from A$26.8bn forecasted for 2018–2019 (Figure 14). We believe that this increase in mining investment will significantly contribute to demand for BWC's cables in the short–medium term.

Competitive landscape

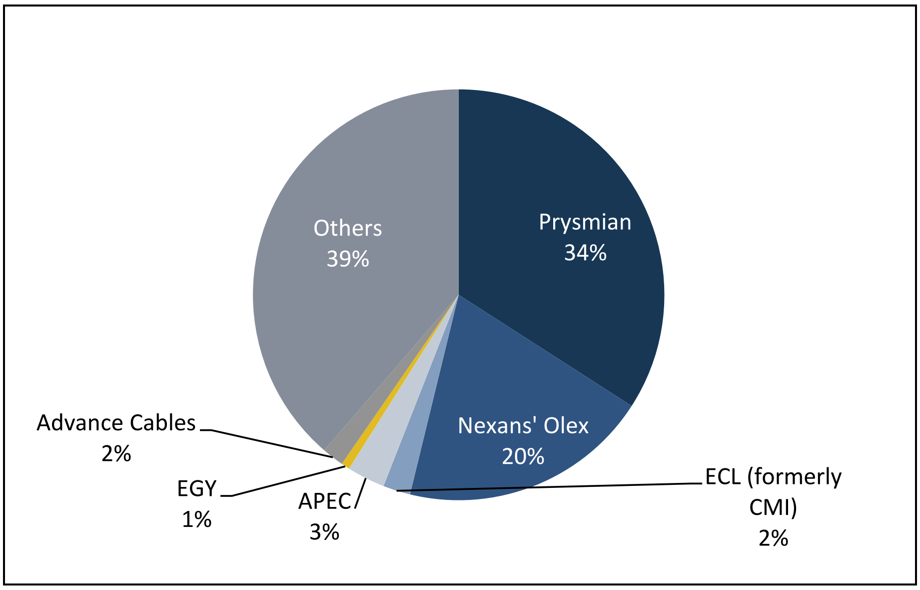
Australia's cable and wire market is highly competitive

The Australian wire and cable industry is highly competitive, with a large number of domestic players and prevalence of imports

As per the latest report by IBIS, the Australian cable and wire market, a US$2bn industry, is densely populated. The industry is characterised by a high degree of concentration of small private players and a couple of subsidiaries of large international players, such as Nexans' Olex and Prysmian. This is despite the consolidation phase that the industry underwent from 2012 to 2016.

Currently, 39% of the total market is held by a number of small players (Figure 15). In its original form, BWC held a 1% market share, but following the completion of the Advance Cables acquisition, BWC's market share will expand to 3%.

Figure 15: Breakdown of Australian electric cables and wires market



Source: Electric Cable and Wire Manufacturing in Australia, IBIS, December 2018

Cheap imports from China pose threat

Despite the large number of domestic manufacturers, the Australian end market still relies on imports to meet its wire and cable requirements. China, in particular, has historically dominated the cable imports segment, primarily on the back of its cost advantage. However, after the Infinity Recall[2], as well as the current mandate of the state and federal government to promote Australia-made goods, domestic players such as BWC are now at an advantage. A weakening Australian dollar further benefits the domestic suppliers of wires and cable, as it offsets the advantages of cheap imports.

[2] Launched in August 2014, Infinity Recall refers to a nationwide recall of faulty electrical cables supplied by Infinity Cable Co Pty Ltd., an importer of Chinese cables. Under the recall ordered by ACCC, 18 retailers and wholesalers that supplied the faulty Infinity TPS wires, which present the risk of electrocution or fire, recalled the wires supplied by them over 2010–2013. The recall is still underway, and ACCC continues to urge consumers to get their wiring checked if it was installed in the aforementioned period. (https://www.accc.gov.au/media-release/national-infinity-electrical-cable-safety-recall).

Key players in international space

Most wire and cable companies in Australia are private

Since most wire and cable companies in Australia are private, we have considered listed companies in developed economies whose product offerings match those of BWC closely. Additionally, only companies with a market capitalisation of up to US$1.5bn have been considered. We believe that the following listed companies, classified geographically, provide good insight into the growth potential of BWC.

Americas and Europe

- **Prysmian S.p.A.** (BIT:PRY): Prysmian, an Italy-based company, engages in manufacturing and distributing cables, primarily for the telecom and energy industries. The company also operates in Australia through Prysmian Australia Pty Ltd, and has two manufacturing plants located in Liverpool and Dee Why – producing power cables, and optical and copper cables, respectively.
- **Nexans S.A.** (ENXTPA:NEX): NEX provides cables and cabling solutions to customers in various industries, including energy infrastructure, telecom, data, transport and building. Like PRY, NEX has dedicated Australian operations (Olex) where it manufactures electrical cables through its Victoria-based facility.
- **Encore Wire Corp** (NasdaqGS:WIRE): Encore is a US-based manufacturer of copper and aluminium wires. It provides solutions for the residential, commercial and industrial building segments.
- **NKT A/S** (CPSE:NKT): NKT provides turnkey AC/DC cabling solutions to customers worldwide across a multitude of industries, including mining, power distribution and transmission, and telecom.

Asia Pacific

- **Fujikura Ltd.** (TSE:5803): Fujikura provides cabling solutions, primarily to power and telecommunications businesses. The company sells wires and cables to customers in Japan, as well as to international customers.
- **Hirakawa Hewtech Corp** (TSE:5821): Hirakawa engages in manufacturing and selling cables and assemblies to customers in Japan and overseas. The company also sells electronic and medical equipment.
- **Daewon Cable Co Ltd** (KOSE:A006340): A South Korea-based company, Daewon engages in manufacturing and selling cables and cabling solutions to both domestic and international clients. The company's solutions are aimed at serving the power and communication industries.
- **Gaon Cable Co Ltd** (KOSE:A000500): Gaon manufactures and sells industrial cables of high, medium and low voltage, primarily to the power and telecom sectors. It also provides oxygen-free copper and copper rods.

Advance Cables' asset acquisition to drive revenue momentum

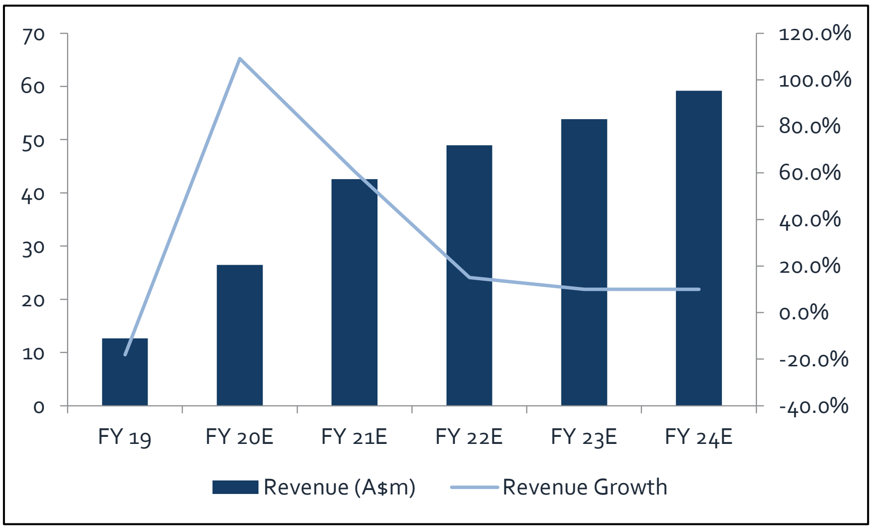
EGY top-line in transition mode

Advance Cables to support cross selling opportunity and 3x uplift in market share, resulting in exponential revenue growth

As the assets of Advance Cables get integrated into BWC, there will be a pronounced impact on the consolidated top line of EGY, from FY2021E onwards. In FY2018, Advance Cables achieved revenue of A$39m, that is >2x of BWC's revenue for the same year.

The broad-based product portfolio, increased market share, access to greater sales channels and a more diversified customer base coupled with enhanced manufacturing capability would enable EGY through BWC to accelerate revenue growth at a five-year CAGR of 36.1% till FY2024E (Figure 16). Importantly, this acquisition aided in the establishment of the new Rosedale facility enhancing 6x production capacity. This will result in revenue growth as enhanced capacity aids in executing widespread market opportunity from Australian government's investment in infrastructure upgrade over next 10 years.

Figure 16: Overall revenue growth projections through FY2024E



Source: Pitt Street Research

Further, the overall product mix is also expected to improve as BWC has developed new products for high margin segments (transport infrastructure, defence, specialised equipment), which augurs well for the revenue growth in terms of market share gains. With the government approval for several infrastructure, defence and energy projects, we expect BWC's growth to be primarily driven by end markets such as rail infrastructure, switchboards, mining. BWC's market share in these segments is projected to grow on the back of improved lead times and more competitive pricing (Figure 17).

Figure 17: Snapshot of revenue forecast by major end-markets

(A$m unless otherwise specified, Year end Jun)	FY 19	FY 20E	FY 21E	FY 22E
Total Revenue (incl. Advance Cables)	12.7	26.5	42.6	48.9
Growth		109%	61%	15%
BWC				
Rail Infrastructure-Track	1.9	2.4	2.9	3.5
Growth		25%	25%	20%
Road Infrastructure-Traffic Control	0.9	1.2	1.5	2.0
Growth		30%	30%	30%
Switchboards	1.6	2.0	2.6	3.0
Growth		30%	30%	15%
Mining	3.3	3.4	3.6	3.8
Growth		5%	5%	5%
Industry	0.8	0.9	1.0	1.1
Growth		10%	10%	10%
Others	4.1	4.7	5.4	6.3
Growth		14%	14%	17%

Source: Pitt Street Research

Synergies to drive margin expansion

The Rosedale facility will have a significantly reduced rental cost

The consolidated margin of EGY is expected to improve led by favourable product mix, better utilisation and operating leverage. The acquisition of Advance Cables assets would result in better production and inventory efficiencies owing to economies of scale. The superior plant and modern equipment will lead to substantial improvement in gross margin. The acquisition is also expected to achieve a significant reduction in the fixed and variable costs leading to a higher operating profitability. In addition, the Rosedale facility will have a significantly reduced rental cost (saving around A$1m). Once the synergies seep into the system, the gross margin will expand sharply by around 410bps during FY2019-23E — from 20.9% in FY2019 to 25.0% in FY2023E (Figure 18). Besides, the combined operations will start to remove the duplication of selling, general and administrative expenses and thereby, EGY is expected to achieve operating profit in FY2020E. Accordingly, the EBITDA margins are expected to inch up as synergies seep in — 11.1% in FY2020E to 13.1% in FY2023E.

Figure 18: Growth and profitability

Growth and Margins (%)	FY 17	FY 18	FY 19	FY 20E	FY 21E	FY 22E	FY 23E
Revenue	27.4%	18.6%	-18.1%	109.1%	60.7%	15.0%	10.0%
Gross margin	17.4%	18.3%	20.9%	23.0%	24.0%	24.5%	25.0%
EBITDA margin	-12.1%	-7.6%	-21.4%	11.1%	12.1%	12.6%	13.1%
EBIT margin	-14.3%	-10.0%	-25.0%	8.7%	9.7%	10.2%	10.7%
Adj. attributable profit margin	-22.5%	-20.1%	-28.3%	5.6%	6.7%	7.1%	7.5%

Source: Pitt Street Research

Recapitalisation to strengthen the balance sheet

Recapitalisation led to first positive equity balance since FY15

The implementation of the recapitalisation plan hasimproved the underlying balance sheet, with a posistive equity balance of A$16.74m equity as of 30 June 2019. The proposal primarily focused on the conversion of the company's consolidated debt into equity. While EGY had negative operating cash flow of A$0.8m in FY2018, the impact of the new acquisition is expected to be witnessed from H1 FY2020E onwards. The company is estimated to generate an operating cash flow of ~A$4.0m in FY2021E.

The consistent cash generation bolstered by the superior revenue prospects will aid EGY in having enough balance sheet strenght to scale up operations thorugh bolt-on acquisitons. In additon, ramp-up in profitability driven by massive cost savings is expected to enhance shareholder’s return, with both RoE and RoA expected to expand consistently. Accordinly, RoE is expected to jump significantly from 7.7% in FY2020EE to 13.7% in FY2023E. Likewise, RoA is expected to expand from 4.6% in FY2020E to 7.8% in FY2023E (Figure 19). It is worth noting that the smoothness and timeframe required by EGY to integrate Advance Cables will decide the extent of shareholder returns enhancement.

Figure 19: Balance sheet strength and return ratios

Balance Sheet Ratios (%)	FY 17	FY 18	FY 19	FY 20E	FY 21E	FY 22E	FY 23E
Total Cash / Total Assets	4.8%	1.3%	0.1%	6.5%	3.0%	4.3%	6.5%
Total Liabilities / Total Assets	127.5%	148.6%	32.8%	40.4%	45.9%	45.2%	43.5%
RoE	NM	NM	NM	7.7%	13.0%	13.6%	13.7%
RoA	NM	NM	NM	4.6%	7.0%	7.5%	7.8%
Operating Cash Flow / EBIT	NM	NM	NM	159.2%	40.0%	74.9%	80.5%

Source: Pitt Street Research

Valuation: Turnaround story not factored in the current share price

To derive EGY’s long-term value, we have deployed a weighted average valuation methodology, assigning equal weight to relative valuation based on comparable company analysis and a DCF calculation.

Peer-group-based valuation suggests a fair value of A$0.30 per share

Given EGY’s core activity of manufacturing specialist industrial cables, we have studied its peer group, which is engaged in a similar line of business. Besides, the acquisition of Advance Cables is expected to widen EGY’s cables portfolio and also give it a boost in revenue.

As BWC (wholly owned subsidiary of EGY) contributes ~100% of its total revenues to EGY, the latter has been benchmarked against the following global firms involved in the electrical cable and wire space, which primarily cater to industrial and residential needs: Prysmian (BIT:PRY), Nexans (ENXTPA:NEX), Belden Inc (NYSE:BDC), Encore Wire Corporation (NasdaqGS:WIRE), NKT A/S (CPSE:NKT), and Daewon Cable (KOSE:A006340). Some other global firms were not included due to lack of earnings forecast (Figure 20).

Figure 20: Peer group valuation

EV/Sales	Sector Average	Discount/ Premium	Effective Multiple	FY 2021E Sales (A$m)	Implied EV (A$m)
Base Case	0.7x	0.0%	0.64x	42.6	27.1
Bull Case	0.7x	10.0%	0.70x	42.6	29.9

Source: S&P Capital IQ, Pitt Street Research

We believe that EGY's current value at a slight discount to its peers is correct given the substantial equity erosion that has embedded into EGY's financials. However, as operations gets enhanced from Advance Cables and operating profitability is achieved in FY2020E, we believe EGY will be trading at par with peer multiples. The smooth integration will further enhance EGY's operating capabilities, attracting premium valuation. Consequently, we have applied a 10% premium in our bull case. Trading at a peer average EV/Sales multiple of 0.64x for FY2021E, EGY will have the implied EV of ~A$27m or an equity value of A$0.30 per share (Figure 21).

Figure 21: Relative Valuation Per Share

Equity value determination (A$m unless specified otherwise)	
EV / Sales Multiple	0.6
Sales 2021E	42.6
Implied EV	27.1
Net debt (cash)	1.4
Minority interest	(0.6)
Provisions	1.0
Equity value	**25.4**
FY 2021 Diluted Shares (m)	85.6
Implied price (AUD)	**0.30**
Current price (AUD)	0.29
Upside (%)	2.4%

Source: Pitt Street Research

DCF calculation suggests a substantially higher intrinsic value

The combined operations of BWC and Advance Cables will significantly improve production and inventory efficiencies

Our DCF model yields a 10.0% WACC for EGY (risk-free rate of 0.9%, a beta of 1.1, and an equity risk premium of 8.5%). Applying this discount rate to our free cash flow projections through FY2020E and using a terminal growth rate of 1%, EGY yields a value of A$0.39 per share (Figure 22).

While there remains an integration risk due to the acquisition of Advance Cables, we believe that the combined operations of BWC and Advance Cables will significantly improve production and inventory efficiencies. The broad-based product portfolio, cross-selling opportunities, cost savings, and selling synergies would provide a leeway for lower discount rates over the medium term. Further, as the product portfolio shifts towards high-margin segments, better utilisation levels at the new low-cost Rosedale site, and significant reduction in SG&A expenses, profitability is expected to improve substantially. This would further translate into a higher valuation.

Figure 22: DCF using various WACCs

Sensitivity Analysis										
WACC	10.02%									
Terminal Growth Rate	1.00%	Change in WACC								
Implied Price (AUD)	0.39	*9.3%*	*9.5%*	*9.8%*	*10.0%*	*10.3%*	*10.5%*	*10.8%*	*11.0%*
Change in Terminal Growth Rate	*0.25%*	0.41	0.40	0.38	0.37	0.36	0.34	0.33	0.32
	0.50%	0.42	0.41	0.39	0.38	0.36	0.35	0.34	0.32
	0.75%	0.43	0.42	0.40	0.38	0.37	0.36	0.34	0.33
	1.00%	0.44	0.42	0.41	**0.39**	0.38	0.36	0.35	0.34
	1.25%	0.45	0.43	0.42	0.40	0.38	0.37	0.35	0.34
	1.50%	0.46	0.44	0.43	0.41	0.39	0.38	0.36	0.35
	1.75%	0.48	0.45	0.44	0.42	0.40	0.38	0.37	0.35

Source: Pitt Street Research

Fair value of A$0.34–0.44 per share

Our base case value of A$0.34 per share has been derived using a weighted average valuation methodology, which assigns equal weight to our relative valuation and DCF calculation (Figure 23). Our optimistic or bull case calculation results in a valuation of A$0.44 and the mid-point of our valuation range comes out to be A$0.39.

Figure 23: Weighted average valuation: Base and bull case

Methodology	Weight (%)	Share price (AUD)
DCF	50.0%	0.39
Relative valuation	50.0%	0.30
Composite		**0.34**
Current Price		0.29
Upside/ Downside (%)		**18.6%**

Methodology	Weight (%)	Share price (AUD)
DCF	50.0%	0.55
Relative valuation	50.0%	0.33
Composite		**0.44**
Current Price		0.29
Upside/ Downside (%)		**51.3%**

Source: Pitt Street Research

Rich management experience

We believe EGY has an experienced management team capable of taking the company through to the next growth stage. The company's leadership team has strong background knowledge of various businesses and financial markets and they are experienced enough to take the company forward.

- **Alf Chown, Managing Director**, has been associated with Energy Technologies since July 1997. He also holds the position of Managing Director at Bambach Wires & Cables. Alf brings extensive manufacturing and business experience in areas such as factory builds, international sales, major projects, tenders and acquisitions, mergers and sales of businesses. He lived in Hong Kong for almost 25 years, where founded multiple companies including Dulhunty Engineering Ltd and Dulhunty Power Ltd.
- **Gregory R. Knoke, Chief Secretary and CFO**, has been associated with Energy Technologies since April 2003. He is also serving as the Director of Cogenic Pty Ltd and as CFO at Bambach Wire and Cables Pty Ltd, since 2012. Knoke served as Director of Energy Technologies from May 2000 to

April 2003. He is a chartered accountant and Associate Member of Chartered Accountants Australia and New Zealand since 1979, an affiliate member of Chartered Secretaries of Australia and member of Australia China Business Council. His extensive experience in financial industry makes him a perfect and valuable executive for the company.

Risks

We believe there are four main risks associated with EGY's investment thesis:

1) Post-merger integration risk: With EGY's plan to achieve operational efficiency through the Advance Cables acquisition, the company's profitability has become highly dependent on its ability to obtain synergies from the combined entity. However, we believe that certain obvious synergies, such as the expanded production capacity, help mitigate the risk of complexities in integration efforts.
2) Ability to procure raw materials: Copper, in particular, is a major raw material for manufacturing cables, which EGY sources from other countries (such as US). With major investment banks (such as Morgan Stanley and Goldman Sachs) maintaining bullish views on copper prices in the short–medium term, EGY would need additional funding to obtain the metal, which it might not be able to secure on time.
3) Currency risk: Appreciation in the AUD against the USD would negatively impact EGY's competitiveness as imports become cheaper. However, the current outlook on AUD/USD indicates a declining trend, translating to expensive imports, thereby driving demand for BWC cables.
4) Dependence on macro factors: EGY's current strategy is to leverage economic growth driven by government initiatives, such as increased fiscal spending on infrastructure. In our view, this makes EGY susceptible to changes in government policies.

Conclusion

EGY has established business operations, will be generating enhanced revenue from after a value-added acquisition, and has an experienced management team. In addition, as balance sheet becomes cash rich, after recapitalisation, it will support bolt-on acquisitions for inorganic growth. The initiation of operation from new location will provide the company with additional operating leverage. The lower rent tariff, high-margin new product portfolio, and better cost synergies will provide support to EGY in attaining operating profitability by FY2020E. Its newly acquired assets of Advance Cables, not only compliments EGY's existing customer base, but also provide cross sell opportunity. We believe that all the above features along with enhanced market opportunity from government's infrastructure spending push over next 10 years can contribute to a potential re-rating of the stock. Based on an equal weighted metric involving peer group valuation and a DCF calculation, we have set a valuation range of A$0.34–0.44.

Analyst qualifications

Stuart Roberts, lead analyst on this report, has been covering the Life Sciences sector as an analyst since 2002.

- Stuart obtained a Master of Applied Finance and Investment from the Securities Institute of Australia in 2002. Previously, from the Securities Institute of Australia, he obtained a Certificate of Financial Markets (1994) and a Graduate Diploma in Finance and Investment (1999).
- Stuart joined Southern Cross Equities as an equities analyst in April 2001. From February 2002 to July 2013, his research specialty at Southern Cross Equities and its acquirer, Bell Potter Securities, was Healthcare and Biotechnology. During this time, he covered a variety of established healthcare companies such as CSL, Cochlear and Resmed, as well as numerous emerging companies. Stuart was a Healthcare and Biotechnology analyst at Baillieu Holst from October 2013 to January 2015.
- After 15 months in 2015 and 2016 doing Investor Relations for two ASX-listed cancer drug developers, Stuart founded NDF Research in May 2016 to provide issuer-sponsored equity research on ASX-listed Life Science companies
- In July 2016, with Marc Kennis, Stuart co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Life Science companies.

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