

PRESSURE TECHNOLOGIES plc
www.pressuretechnologies.co.uk

Date: **27/10/11**

Ticker: **PRES**
Index: **AIM**
Sector: **Industrial Eng.**

Price: **114p**
Mkt Cap: **£13m**

52 Week High: **235p**
Low: **107.5p**

Business

Pressure Technologies plc designs, manufactures and offers testing and refurbishment services for a range of speciality high pressure, seamless steel gas cylinders.

| Year End | Revenue | Profit Before Tax | EPS | DPS | P/E | Yield |
|----------|---------|-------------------|------|-----|-------|-------|
| 9/2009 | 26.2m | 5.02m | 32p | 7p | 3.6x | 6.14% |
| 9/2010 | 21.7m | 3.39m | 22p | 7p | 5.2x | 6.14% |
| 9/2011e | 23.1m | 0.6m | 6.9p | 7p | 16.5x | 6.14% |
| 9/2012e | 27.7m | 1.6m | 14p | 7p | 8.1x | 6.14% |

The AIM listed, designer and manufacturer of speciality engineering solutions for high pressure systems issued a pre-close trading update last week for the year ending 1st October 2011.

Despite the somewhat 'mixed' news from the Group, recent updates from the giants of the offshore drilling space suggest huge promise for PRES into 2012 and beyond.

Results for 2011 below expectations but plenty of promise from the principal market

While turnover is expected to be in line with forecasts, profits for the financial year are now expected to be "substantially below" previous market expectations. Previous estimates were for adjusted pre-tax profits of £1.9m and adjusted eps of 13p.

Despite encouraging sales progress, gross profits have fallen due to changes to the sales mix at both Chesterfield Special Cylinders ("CSC") and the Engineered Products Division, as well as marginally lower sales in Chesterfield BioGas ("CBG"). Fixed costs were also higher than forecast due, principally, to the write off of acquisition costs (a one off) and a further investment in commercial and technical staff, budgeted for 2012, being brought forward to 2011 i.e. only a timing difference.

Balance Sheet remains in good shape

We weren't really surprised by the news as the nature of the Group's principal activities in CSC and the early stage nature of the Biogas activities always suggested that delays were likely. The PRES story has largely been about 2012 and beyond, and the diversification of the Group's activities, all

of which appears to be going to plan.

The balance sheet remains in great shape with year end net cash of £2.9m supporting the final dividend. This results in a full year dividend of 7.2p which equates to a yield of over 6% at the current share price.

The shares are now trading at less than the tangible net asset value (including tangibles, but ex Goodwill) of £13.2m at the interim stage.

DIVISIONAL BREAKDOWN

Chesterfield Special Cylinders: design and manufacture of high pressure, seamless steel gas cylinders for global energy and defence markets.

Management confirmed that the expected significant upturn in CSC's principal market, the supply of high pressure vessel systems ('APV') for deep water drilling rigs and drillships, appears to be underway; more on that below!

CSC has now secured orders to supply APVs to six drillships in 2012 against three for the whole of the 2011 financial year and the pipeline of live quotations remains strong.

With the lead-time for raw materials six to seven months the recovery in this market will be in the second half of the Group's 2012 financial year. Perhaps more worryingly competition in this key market has increased, notably from Korea, which has had an impact on margins, an area that management is addressing.

More encouragingly CSC has clawed back some of the work lost to low cost

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competitors in 2010 for more "difficult" to manufacture APVs.

The house broker Fairfax now estimates the Group will achieve better than expected full year 2011 cylinder sales of £11.3m, rising to £13.1m in 2012 producing respective gross profits of £4.0m and of £4.4m. They have cautiously assumed a lower gross margin of 33.6% in 2012 due to pressure to secure sales in a recovering market – we think it's likely to come in a little better!

Positive news from the offshore rig market

The news from the rig construction market is very positive with **Keppel Corp (SES:BN4)**, the world's largest oil-rig maker, having recently announced a 33% rise in third-quarter profit.

Keppel management commented that the offshore and marine business "sees good prospects for its deepwater solutions with the projected increase in deepwater capital expenditure for the next few years." Higher crude prices pushed oil companies' capex to an all time high of \$419bn in 2011, up 14% year on year. This also excludes the 'elephant in the room' that is Saudi Aramco.

Shares in Keppel Corp trade at approximately 10.5x 2012 consensus estimates, with a yield of 4.5%

National Oilwell Varco (NYSE:NOV), the leading provider of equipment and components used in oil and gas drilling and production, and the industry giant with a current market capitalisation of US\$39bn recently announced outstanding interim results for the 3rd quarter to 30th September 2011.

Third quarter revenues for NOV's Rig Technology segment were \$1.97bn, an increase of 4% from the second quarter of 2011 and an increase of 4% percent from the third quarter of 2010.

The Rig Technology segment booked a record \$3.94bn in new orders including their largest order ever, a \$1.5bn order for seven drillship packages. The backlog for capital equipment orders for the Company's Rig Technology segment at 30th September was up 33% from the 2nd quarter to a massive US\$10.27bn.

Shares in NOV now trade at 12.2x consensus estimates for 2012.

Greater focus on safety positive for PRES

With greater focus on safety in the oil and gas industry since the Gulf oil spill CSC's service for the in-situ testing of ultra-large cylinder installations is also attracting

interest and projects have been carried out in the UK, Singapore and Kazakhstan.

Engineered Products Division: formed in 2010 following purchase of AI-Met Limited ("AI-Met") and the Hydratron group of companies ("Hydratron").

Management has reported that **AI-Met** (manufacturer of precision engineered valve wear parts used in the oil and gas industries) had record annual sales in 2011.

They expect the **current record level of sales to be maintained into 2012** with further growth in this business expected in 2013. Industry forecasts and customer feedback indicate significant growth for wear parts into the subsea market from 2013 with double digit growth forecast for both 2013 and 2014.

The **Hydratron** business (design and manufacture of air operated high pressure hydraulic pumps, gas boosters, power packs, hydraulic control panels and test rigs, principally to oil and gas markets) has benefited from the increased focus on safety in the oil and gas industry. Business has been consistently good and the order book remains strong.

The house broker is of the opinion that, having missed expectation before, PRES stated expectations for Engineering product gross margins might be understated – it's called managing expectations!

The Group's stated focus remains to **double the size of the Engineered Products Division organically** with acquisitions offering a further boost. With AI-Met and Hydratron safely bedded in and the balance sheet in good shape we sense they will be eager to add to this Division in the not too distant future.

BioGas: provides turnkey solutions for the cleaning, storage and dispensing of biomethane, produced from waste water treatment and anaerobic digestion of organic waste.

Progress at Chesterfield BioGas ("CBG") has been slower than management expected, however we are of the opinion that in light of the involvement with the UK's utilities and planning authorities delays were inevitable and the huge long term potential remains.

Management commented that a number of large projects are in advanced stages of negotiation but, unless these are converted to orders by December 2011, the contracts are unlikely to be completed during the 2012 financial year. As a result management has lowered expectation of sales into the BtG market from four upgrader units to two

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upgrader units in 2012.

and Cameron International (2012 PER 13.7x).

The house broker is now forecasting CBG sales of £0.9m for 2011 compared with £1m previously rising to £2.0m in 2012 resulting in respective gross profits of £0.1m and of £0.5m.

Patient investors will, in the meantime, be rewarded with a very attractive dividend.

Outlook and forecasts

In the short term, growth in 2012 will come principally from the Engineered Products Division with growth from CSC expected to join the party in the second half of 2012 and into 2013. Major growth in the biogas business is now expected in 2013 rather than 2012.

The house broker now forecasts adjusted profit before tax of £1m for 2011, adjusted earnings per share of 6.9p and a dividend per share of. For 2012 estimates are now for adjusted pre-tax profit of £2.1m and adjusted earnings per share of 14p.

We appreciate that these represent material reductions, however, with the shares trading at a 2012 price earnings multiple of 8.14x, the balance sheet in good shape and key markets looking highly promising, the valuation looks attractive relative to giant peers like National Oilwell Varco

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