

## Swick Mining Services Ltd

### (SWK \$1.30) Buy

5 June 2008

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#### Western Australia

Sector: Contracting  
SWK.ASX

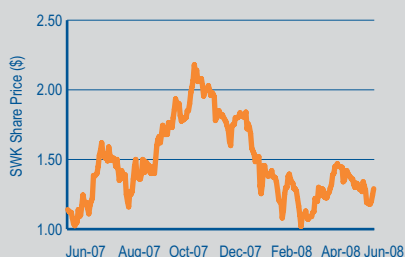
#### Reason for Research

Update

#### Key Metrics

12M price target	\$1.98
+/- up/downside	52%
Methodology	DCF
Market cap	\$202m
Shares in issue	153m
Free float (est.)	65%
12M avg daily volume	\$0.5m
12M high/low	\$2.25/\$1.00

#### Share Price Performance



Swick is currently experiencing exceptional growth driven by contract wins and tendering opportunities. Consequently Swick are aggressively growing the underground diamond rig fleet and plans are in place to grow the surface RC and underground longhole fleets as a result of successful innovation. We are forecasting a strong 3 year EPS CAGR of 63%, driven by the rollout of new rigs underpinned by a solid macro outlook. Swick's share price is trading at a 34% discount to our DCF valuation of \$1.98 per share which has decreased slightly from \$2 per share as a result of a slight downgrade to our forecasts for FY08. We expect management to drive further value through the business from 1) further expansion of the drill rig fleets beyond what we are forecasting and 2) innovated improvements driving expansion of other drilling divisions such as the surface diamond rig. We maintain our Buy recommendation.

**Revised forecasts.** We have decreased our NPAT forecast for FY08 to \$8.6m, down from \$9.7m, as a result of a delay in receiving innovative surface RC rigs and some slight slippage in the underground diamond build program. The surface RC rigs are all expected to be received within a month however will have little contribution to FY08. Our revised revenue and EBITDA forecasts for FY08 are relatively consistent with guidance of \$84m revenue and 26% EBITDA margin. We remain confident that Swick will meet or just fall shy of guidance as a result of improving productivity of the underground diamond rigs on the ground. Our forecasts for FY09 remain unchanged; although the current underground diamond build program is slightly behind schedule we anticipate this will pick up during FY09.

**Growth in other drilling divisions.** Close on the heels of the innovative underground diamond rig roll out, Swick is now rolling out innovative surface RC rigs and we anticipate that plans will be in place to roll out underground long hole rigs during FY09. The new surface RC rig is considered to be less costly for the customer, safer and easier to use than the industry standard. Initial results from an underground long hole rig incorporating a water hammer currently on trial is showing that the rig is capable of drilling to depths greater than industry standard with greater precision and penetration which would slash underground development costs for miners. We expect Swick to begin rolling out the underground long hole rigs during FY09.

**Macro remains strong.** Tendering opportunities remain robust and SWK expect to be on trial at a number of sites in FY09 with the underground diamond rig. In addition Swick plan to deploy 3 underground diamond rigs in Canada's Sudbury region, which hosts significant underground nickel mines, by October 2008 and if successful could open up significant contracts with the likes of Xstrata and Vale who operate in this region. Swick expects strong demand from the iron ore sector for Swick's surface RC rigs and we understand the potential market for the underground long hole rigs could be larger than the underground diamond market for Swick in Australia.

Key Financial Metrics	2006A	2007A	2008F	2009F	2010F
NPAT reported (A\$m)	2.0	5.4	8.6	19.0	27.5
NPAT Normalised (A\$m)	1.7	3.9	8.6	19.0	27.5
Fully Diluted Normalized EPS (A\$)	na	0.040	0.055	0.122	0.176
PER normalised (x)	na	32.7	23.5	10.6	7.4
EPS growth (%)	na	na	39%	121%	44%
EV/EBITDA (x)	na	19.2	9.0	4.6	3.3
Cashflow per share (A\$)	na	0.12	0.11	0.22	0.31
P/CFPS (x)	na	10.5	11.4	6.0	4.2
ROE (%)	94%	33%	18%	26%	28%
NBV/share (A\$)	na	0.26	0.42	0.55	0.73
P/NBV (x)	na	5.1	3.1	2.4	1.8
Net Debt/Equity (%)	33%	5%	net cash	18%	5%

Sector: Contracting  
Recommendation: Buy

Price (\$A): 1.30  
Target Price (\$A): 1.98

Market Cap (A\$m): 202.5  
Enterprise Value (A\$m): 195.2

SWICK MINING SERVICES LTD (SWK)	YEAR END 30 JUNE				
	06A	07A	08F	09F	10F
<b>Income Statement</b>					
Sales	19.4	38.0	83.9	159.0	225.4
Other	0.0	0.0	0.0	0.0	0.0
<b>Revenue</b>	<b>19.4</b>	<b>38.0</b>	<b>83.9</b>	<b>159.0</b>	<b>225.4</b>
COGS	-14.4	-25.1	-57.9	-105.8	-150.5
Other	-2.2	-2.7	-4.2	-11.0	-15.1
<b>EBITDA</b>	<b>2.8</b>	<b>10.1</b>	<b>21.8</b>	<b>42.2</b>	<b>59.8</b>
Depreciation & amortisation	-0.1	-3.6	-8.8	-14.0	-19.6
Other non cash	0.0	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>2.7</b>	<b>6.6</b>	<b>13.0</b>	<b>28.1</b>	<b>40.2</b>
Net Interest income/(expense)	-0.3	-0.8	-0.7	-1.0	-1.0
Associates	0.0	0.0	0.0	0.0	0.0
Other income/(expense)	0.0	0.0	0.0	0.0	0.0
Abnormal items (pretax)	0.0	2.1	0.0	0.0	0.0
<b>EBT</b>	<b>2.4</b>	<b>7.9</b>	<b>12.3</b>	<b>27.2</b>	<b>39.2</b>
Tax expense	-0.5	-2.5	-3.7	-8.2	-11.8
Minority interest	0.0	0.0	0.0	0.0	0.0
Preference Dividends	0.0	0.0	0.0	0.0	0.0
<b>Reported Earnings</b>	<b>2.0</b>	<b>5.4</b>	<b>8.6</b>	<b>19.0</b>	<b>27.5</b>
Dividends	0.0	0.0	0.0	0.0	0.0
Adjustments (one off)	0.0	0.0	0.0	0.0	0.0
<b>Retained earnings</b>	<b>2.0</b>	<b>5.4</b>	<b>8.6</b>	<b>19.0</b>	<b>27.5</b>
<b>Normalized Net Profit</b>	<b>1.7</b>	<b>3.9</b>	<b>8.6</b>	<b>19.0</b>	<b>27.5</b>
Fully Diluted Net Profit	1.7	3.9	8.6	19.0	27.5
<b>Cash flow (A\$m)</b>					
<b>Pretax Profit</b>	<b>2.4</b>	<b>7.9</b>	<b>12.3</b>	<b>27.2</b>	<b>39.2</b>
+ Depreciation	0.1	3.6	8.8	14.0	19.6
-/+ associates profit/loss	0.0	0.0	0.0	0.0	0.0
+ associates dividends	0.0	0.0	0.0	0.0	0.0
+ Foreign Exchange loss/(gain)	0.0	0.0	0.0	0.0	0.0
- Tax Paid	-0.5	-0.4	-3.7	-8.2	-11.8
+ inc (- dec) in provisions	0.0	0.3	0.0	0.0	0.0
- Profit/+ loss on disposal	0.0	-2.1	0.0	0.0	0.0
+/- Other	0.0	3.0	0.0	0.0	0.0
<b>Gross Cashflow</b>	<b>2.1</b>	<b>12.2</b>	<b>17.4</b>	<b>33.1</b>	<b>47.1</b>
- Capital expenditure	-0.1	-22.2	-36.5	-44.0	-33.8
+/- Changes in working capital	1.6	-7.2	-3.7	-4.9	-3.5
<b>Operating Free Cashflow</b>	<b>3.6</b>	<b>-17.2</b>	<b>-22.7</b>	<b>-15.8</b>	<b>9.9</b>
+/- Acq of subs/other investments	-0.2	0.0	-0.4	0.0	0.0
- Dividends	0.0	0.0	0.0	0.0	0.0
+ Proceeds from equity raised	0.0	22.5	25.2	0.0	0.0
+/- Proceeds from disp of subs/FA's	0.0	1.6	0.0	0.0	0.0
+/- Minority interests	0.0	0.0	0.0	0.0	0.0
+/- Other	-3.8	-7.7	0.0	0.0	0.0
Net cashflow	-0.4	-0.8	2.0	-15.8	9.9
Cash at beginning of period	-0.2	-0.6	-1.4	0.6	-15.2
Cash at end of period	-0.6	-1.4	0.6	-15.2	-5.4
<b>Balance Sheet (\$m)</b>					
Cash	0.0	12.4	21.9	11.1	21.0
Receivables	2.9	9.3	12.6	19.1	24.8
Inventories	0.9	3.3	5.0	6.4	9.0
Other	0.4	0.3	0.3	0.3	0.3
<b>Current Assets</b>	<b>4.2</b>	<b>25.3</b>	<b>39.8</b>	<b>36.9</b>	<b>55.1</b>
Receivables	2.7	0.0	0.0	0.0	0.0
Assets available for sale	1.7	0.0	0.0	0.0	0.0
Property/Plant/Equipment	0.8	29.5	57.2	87.2	101.3
Intangibles	0.0	0.2	0.6	0.6	0.6
Deferred tax assets	0.4	0.7	0.7	0.7	0.7
<b>Non Current Assets</b>	<b>5.6</b>	<b>30.4</b>	<b>58.5</b>	<b>88.5</b>	<b>102.6</b>
<b>Total Assets</b>	<b>9.8</b>	<b>55.8</b>	<b>98.4</b>	<b>125.3</b>	<b>157.7</b>
Payables	-5.7	-7.4	-8.7	-11.6	-16.6
Interest bearing liabilities	-0.7	-4.8	-4.8	-4.8	-4.8
Provisions	-0.3	-0.6	-0.6	-0.6	-0.6
Other	-0.7	-0.6	-0.6	-0.6	-0.6
<b>Current Liabilities</b>	<b>-7.4</b>	<b>-13.4</b>	<b>-14.7</b>	<b>-17.6</b>	<b>-22.5</b>
Interest bearing liabilities	0.0	-9.1	-16.6	-21.6	-21.6
Payables	0.0	0.0	0.0	0.0	0.0
Deferred Tax	-0.4	-2.4	-2.4	-2.4	-2.4
<b>Non Current Liabilities</b>	<b>-0.4</b>	<b>-11.5</b>	<b>-19.0</b>	<b>-24.0</b>	<b>-24.0</b>
<b>Total Liabilities</b>	<b>-7.7</b>	<b>-24.8</b>	<b>-33.6</b>	<b>-41.6</b>	<b>-46.5</b>
<b>Net Assets</b>	<b>2.1</b>	<b>31.0</b>	<b>64.7</b>	<b>83.8</b>	<b>111.2</b>
Contributed equity	0.0	25.4	50.5	50.5	50.5
Reserves	0.9	0.0	0.0	0.0	0.0
Retained profits	1.2	5.6	14.2	33.2	60.6
Minority Interests	0.0	0.0	0.0	0.0	0.0
<b>Total equity</b>	<b>2.1</b>	<b>31.0</b>	<b>64.7</b>	<b>83.7</b>	<b>111.2</b>

PERFORMANCE RATIOS	06A	07A	08F	09F	10F
<b>Growth &amp; Margins</b>					
Revenue Growth	88%	96%	121%	89%	42%
EBITDA Growth	196%	261%	115%	94%	42%
EBIT Growth	299%	143%	97%	116%	43%
Normalized Net Profit Growth	327%	133%	119%	121%	44%
EBITDA margin	14.5%	26.7%	25.9%	26.5%	26.5%
EBIT margin	14.0%	17.3%	15.5%	17.7%	17.9%
Normalized net profit margin	8.7%	10.3%	10.3%	12.0%	12.2%
Effective tax rate	19%	31%	30%	30%	30%
<b>Liquidity</b>					
Capex/depreciation (x)	1.1	6.2	4.2	3.1	1.7
Current ratio (x)	0.6	1.9	2.7	2.1	2.4
Quick ratio (x)	0.5	2.9	4.0	2.6	2.8
Receivable days	43	59	48	36	36
Inventory days	11	31	26	20	19
Payable days	92	95	51	35	34
<b>Risk Measures</b>					
Dividend Cover (x)	na	na	na	na	na
Payout ratio (%)	0%	0%	0%	0%	0%
Net interest cover (x)	9.0	8.2	18.6	29.6	39.1
Net debt/equity (%)	33%	5%	net cash	18%	5%
<b>Returns</b>					
Return on average capital employed (%)	108%	20%	15%	21%	24%
Return on invested capital (%)	53%	28%	17%	22%	25%
WACC (%)	na	12%	12%	12%	12%
Return on assets (%)	28%	12%	13%	22%	39%
Return on average equity (%)	94%	33%	18%	26%	28%
Company cost of equity (%)	na	15%	15%	15%	15%
<b>SHARE DATA/VALUATION</b>					
<b>Share Data</b>					
Issued shares (m)	na	120	153	153	153
Weighted ave shares (m)	na	99	153	153	153
Fully diluted shares (m)	na	99	156	156	156
Basic EPS (c)	na	5.5	5.6	12.5	18.0
YoY change (%)	na	na	3%	121%	44%
Fully diluted EPS (c)	na	5.5	5.7	12.3	17.8
YoY change (%)	na	na	3%	118%	44%
Fully diluted normalised EPS (c)	na	4.0	5.5	12.2	17.6
YoY change (%)	na	na	39%	121%	44%
Dividend/share	na	0.0	0.0	0.0	0.0
Franking (%)	na	na	na	na	na
Gross cashflow/share (c)	na	12.4	11.4	21.7	30.8
NBV/share (c)	na	25.7	42.4	54.9	72.9
NTA/Share (c)	na	25.7	42.4	54.9	72.9
<b>Valuation</b>					
PER (Basic) (x)	na	23.7	23.0	10.4	7.2
PER (Fully diluted) (x)	na	23.7	23.0	10.5	7.3
PER (Fully diluted, normalized) (x)	na	32.7	23.5	10.6	7.4
P/CFPS (x)	na	10.5	11.4	6.0	4.2
Price/NBV (x)	na	5.1	3.1	2.4	1.8
Price/NTA (x)	na	5.1	3.1	2.4	1.8
Dividend Yield (%)	na	0.0%	0.0%	0.0%	0.0%
Fully dil. normal d 3 yr EPS Cagr (%)	na	na	63%	56%	28%
PEG ratio (x)	na	na	0.4	0.2	0.3
EV	na	129.9	204.0	204.0	204.0
EV/EBITDA (x)	na	19.2	9.0	4.6	3.3
EV/EBIT (x)	na	29.6	15.0	6.9	4.9
EV/Revenue (x)	na	5.1	2.3	1.2	0.9
NPV (A\$/sh)			1.98		
WACC (%)			12.2%		
<b>OTHER INFORMATION</b>					
Major shareholders:					
	Swick family				34.5%
	Entrust				9.2%
	Estimated free float				65%
	12-mth High/Low (A\$/sh)				2.25 / 1.00
	Average daily volume (A\$m)				1.0
	ASX Code				SWK
	Next result				FY08 (Aug 08)
<b>COMPANY DESCRIPTION</b>					
Swick was listed on the ASX in November 2006. Swick provides surface and underground drilling services to mining companies in Australia across a range of commodities, mainly nickel, copper, manganese, bauxite, and gold. Swick currently has 5 types of drill rigs: underground diamond, underground long-hole, surface RC, surface air-vac, and surface diamond.					

## Valuation

### DCF Valuation: \$1.98

We prefer to use DCF for our valuation of SWK as it more appropriately captures longer term value not evident in FY08 and FY09 forecasts.

Our DCF valuation of \$1.98 assumes:

- the drill rig fleet expands from 53 at mid 2008 to 85 by mid 2009 and to 143 by mid 2012.
- WACC of 12.2%.
- terminal growth of 3%.

We understand Swick has capacity to expand the drilling rig fleets at a faster rate than we are forecasting, which if eventuated would provide upside to our DCF valuation.

### PER Comparison

We provide the table below which presents comparable P/E ratios and the price earnings growth ratio for ASX listed drilling companies.

Ticker	Name	Price (A\$/sh)	Rec	Mkt Cap (A\$m)	P/E 08	P/E 09	2008 EPS growth	2009 EPS growth	PEG 08
ASL	Ausdrill	2.60	Buy	410	12.0x	10.4x	14.0%	15.3%	1.0
BLY	Boart Longyear	2.20	na	3267	14.9x	13.1x	13.8%	13.5%	1.3
BDL	Brandrill	0.25	Buy	100	7.9x	6.6x	50.5%	20.4%	0.3
<b>Average excl. Swick</b>					<b>11.6x</b>	<b>10.0x</b>			
SWK	Swick	1.30	Buy	203	23.5x	10.6x	39.0%	120.9%	0.4

The only listed competitor is the much larger Boart Longyear, trading at 13x 2009.

Listed surface drillers include ASL and BDL, who are not competitors of SWK and are subject to different business drivers. That said, comparison by the market is inevitable.

The recent takeover bid for ASL was priced at 10.4x FY09, a similar multiple that SWK is currently trading on. In our view SWK has a stronger growth profile than ASL and all things equal should demand a higher multiple.

SWK currently trades at 10.6x forecast 2009 EPS of 12.2c, a cheap multiple in our view given the low PEG ratio of 0.4, which is a result of the strong forecast 3 year EPS CAGR of 63%.

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