Matrix
BUY

24 May 2010

Current Price:	**$2.69**
Target Price:	**$3.00**
Ticker:	MCE.ASX
Sector:	Engineering
Shares on Issue (m):	70.0
Market Cap ($m):	188.2
Net Debt ($m):	-20.9
Enterprise Value ($m):	167.3

52 wk High/Low:	2.97	1.36
12m Av Daily Vol (m):		0.16

Key Metrics

	10F	11F
EV/EBITDA (x)	6.51	4.24
P/E (x)	10.96	8.94

Ratios

	09A	10F	11F
ND / Equity	20.1%	26.3%	28.9%
EBITDA Mgn	9.2%	25.0%	21.7%
RoA	8.7%	23.7%	25.3%
RoE	15.0%	25.7%	27.7%

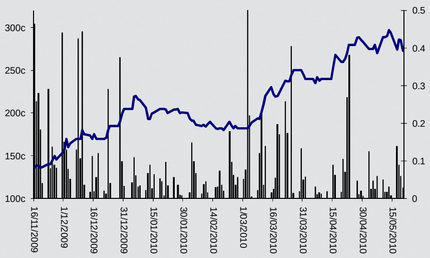
Financials:

	09A	10F	11F
Revenue ($m)	54.6	99.8	181.9
EBITDA ($m)	5.3	25.7	39.4
NPAT ($m)	3.1	15.8	22.0
Norm NPAT ($m)	3.1	15.3	22.0
Net Assets ($m)	20.6	61.5	79.3
Op CF ($m)	8.9	13.6	23.5

Per Share Data:

	09A	10F	11F
EPS Diluted (cps)		24.5	30.1
DPS (cps)		4.0	6.0
Div Yield		1.5%	2.2%
NTAPS (cps)	26.5	86.4	98.2
CFPS (cps)	18.1	21.7	32.3

Share Price Graph



Analyst:
Ian Christie, CFA

Malaga ramps up; focus now Henderson

Matrix (MCE) has achieved a lot in the short while since listing in November 2009:

- After delivering excellent 1H10 results, the Company is on its way to significantly beat prospectus forecast earnings for FY10
- Debt and equity financing has been obtained to fully fund the $55m Stage 1 development at Henderson
- The Company has confirmed a bulky $200m order book and identified at least another $200m in potential opportunities

The coming financial year will be one of transition. By June 2011, MCE should be operating out of a state of the art production facility ideally located in the Marine Complex at Henderson. During the year, the Company will need to complete buildings worth $29m and fit them out with another $26m worth of equipment, effectively tripling current production capacity.

The coming period will see MCE looking to derisk the bold expansion programme by consecutively ticking the following boxes:

- Maintaining the increased production rates at Malaga and delivering a strong 2H10 (3 month timeframe)
- Completing the development and fitout at Henderson (6 months)
- Ramping up production at Henderson in line with expectations and demonstrating longer-term maintainable margins (6 – 18 months)

It doesn't make forecasting FY11 easy. However, we are greatly encouraged by the recent ramp up in production which will see the Malaga operations enter FY11 at a run-rate that comfortably underpins our FY11 revenue forecast. The table below shows the changes to our forecasts, while detail on page 3 provides an indication of NPAT sensitivity to margin and production assumptions.

	FY09A	FY10F			FY11F		
	Actual	Old	New	Change	Old	New	Change
Revenue ($m)	54.3	95	99	4.1%	169	182	7.5%
EBITDA margin	9.2%	25.0%	25.0%	0.0%	20.0%	21.7%	8.4%
NPAT ($m)	3.1	14.2	15.3	7.6%	18.5	22.0	18.7%

Post the capital raising and adjustments to our longer term forecasts, we have increased our target price to $3.00 per share (from $2.50). This is 10.0x our FY11 EPS forecast, but below our DCF valuation of $3.43.

Further out, time and strategy execution is needed to tighten up our forecasts. MCE has the flexibility to change the product mix based on demand, and should the Company generate orders that support production at maximum capacity there is considerable potential uplift to our FY12 numbers.

If this potential is met, it also provides signficant upside to our current valuation and TP.

BUY

Ticking the boxes

MCE has achieved a lot since listing .....

At the time of listing in November 2009 we indicated we would be looking for Matrix (MCE) to tick a number of boxes. So far, so good:

Table 1: Boxes ticked

Event		Comment
Delivering 1H10 earnings consistent with prospectus forecasts	✓	While revenue was lower than expected, the normalised 1H10 NPAT of $6.9m was >90% of the full FY10 prospectus forecast of $7.6m. We now expect FY10 revenue of $99.8m and normalised NPAT of $15.3m, well ahead of forecast.
Financing the Henderson development ($55m total - $29m buildings, $26m fitout)	✓	Debt financing facilities of $28.8m were arranged with NAB in December 2009. Equity of $15.0m was raised at the IPO in Nov. 2009 and $13.5m was raised via a Placement in Apr. 2010.
Providing evidence of growth in the order book	✓	The order book is currently around $220m, with at least another $200m of opportunities identified by MCE.

..... and will be looking to tick more boxes over the coming period

With the development at Henderson in full swing, there are more boxes that need to be ticked over the next 18 months:

Table 2: Boxes being / to be ticked

Event		Comment
A strong 2H10 and evidence of the increased production at Malaga		We understand that production at Malaga has ramped up over the last three months and expect this will drive stronger 2H10 revenues. We forecast a revenue split of 44:56 between the two halves. Furthermore, we expect a much stronger monthly production rate from Malaga as we head into FY11.
Confirming the potential for, and extent of, margin expansion with increasing scale		1H10 EBITDA margins improved significantly to ~25% as a result of lower input costs and improved efficiencies at the Malaga operations. We expect further efficiency gains from increased scale and design advantages as production from Henderson ramps up. These gains may be offset by movements in the prices of inputs and the exchange rate.
Progressing development at Henderson and expanding capacity as expected		This is ongoing. MCE expects first production from Henderson in 1Q11, ramping up to nameplate capacity (double current Malaga capacity) by 4Q11.
Expansion of the product range		MCE is currently feeding strong demand for riser bouyancy modules. In order to continue growing the order book and to produce at capacity from new facilities, flexibility in product mix will need to be demonstrated.
Managing the transition and expanded production		The senior team will need to demonstrate their ability to manage significant change – which is likely to see revenue increase threefold in only two years.

FY11 Outlook

FY11 will be a transition year as MCE begins production from its state of the art Henderson facility

The coming financial year will be one of transition. By June 2011, MCE should be operating out of a state of the art production facility ideally located in the Marine Complex at Henderson. During the year, the Company will need to complete buildings worth $29m and fit them out with another $26m worth of equipment in order to be able to produce double the current Malaga capacity from this site.

This is no small order and until it is complete there will always be a question mark over timing. Apart from production, further variables include margins and the exchange rate. For FY11, we have assumed:

× Production primarily from the Malaga operations, with only a relatively small contribution from Henderson. This will still be nearly double our expected FY10 production due to the strong ramp up in capacity towards the end of FY10.

× An EBITDA margin of 21.6%. This is lower than 1H10, but until we have more results to refer to we have been conservative. We also note that the fall in input costs seen in 1H10 could reverse, and that there may be one off costs related to the move to Henderson.

× An exchange rate of US$0.82 (with hedging locking in this rate for most of the financial year).

Time and strategy execution is needed to tighten up our forecasts

As the results are so sensitive to these variables, we show NPAT under different assumptions in the table below. This provides an NPAT range between $15.2m (20.8cps) and $29.5m (40.5cps).

FY11 NPAT sensitivity ($m)		FY11 Production (Multiple of FY10E)		
		1.6x	1.8x	2.1x
EBITDA Margin*	19.1%	15.2	18.8	22.1
	21.7%	18.0	22.0	25.9
	24.2%	20.8	25.1	29.5

** Margin calculations are also influenced by our currency assumption for FY11 (US$0.82). If we assumed a rate of US$0.80, the margins would be 20.0%, 22.5% and 25.0%.*

FY12 and beyond

If MCE can generate orders to keep Henderson and Malaga facilities at full capacity .....

Further out becomes harder to predict. If both facilities were to produce riser bouyancy modules at maximum capacity, the current $200m order book would be met in less than a year. As a result, the production mix is very likely to change (bouyancy products for production as well as exploration, insulation products for LNG plants, as well as a number of other subsea products). MCE has the flexibility to meet different market requirements.

At this stage we simply assume a further ramp up in the production of riser bouyancy modules to ~2.5x FY10E production and a similar margin to FY11F (although negatively impacted by a slightly higher assumed exchange rate of US$0.85). Flexing our production and margin forecasts in a similar manner to that shown above provides an NPAT range of $19.1m (26.2cps) to $35.2m (48.3cps).

There is upside to these numbers if MCE can generate orders that support production at maximum capacity. Once Henderson is up and running, MCE will have the ability to begin aggressively marketing their high quality products to the likes of Transocean and Ensco.

..... the upside is large

This potential, if met, provides major upside to our current valuation and target price.

ARGONAUT

Matrix Composites & Engineering

Equities Research

Ian Christie, CFA

Recommendation	BUY
Current Price ($)	2.69
All Ords (XAO)	4,386.4

Sector	Engineering
Market Cap ($m)	188.2
Date	24 May 2010

Profit and Loss ($m)	2009A	1H10A*	2010F*	2011F	2012F
Revenue	54.6	44.3	99.8	181.9	231.4
EBITDA	5.3	12.0	25.7	39.4	47.6
Depreciation	-1.7	-1.6	-3.1	-5.8	-6.8
EBIT	3.6	10.3	22.6	33.6	40.7
Net Interest	-0.2	-0.1	-0.4	-2.3	-2.7
PBT	3.5	10.2	22.2	31.4	38.1
Rep. NPAT	3.1	7.4	15.8	22.0	26.6
Norm. NPAT	3.1	6.9	15.3	22.0	26.6

**Normalised NPAT adjusted for forex gain on derivatives*

Cash Flow ($m)	2009A	1H10A	2010F	2011F	2012F
Receipts	64.0	41.7	91.9	161.8	221.2
Payments	-52.2	-33.7	-71.6	-126.6	-173.6
Other	-3.0	-0.6	-6.7	-11.7	-14.1
Cash from Operations	8.9	7.4	13.6	23.5	33.5
Property, Plant & Equip	-10.3	-8.8	-50.7	-26.1	-20.0
Payment for Subsidiary	0.0	0.0	0.0	0.0	0.0
Other	-0.0	-0.0	0.0	0.0	0.0
Cash From Investing	-10.3	-8.8	-50.7	-26.1	-20.0
Issue of Shares	0.0	13.9	27.1	0.0	0.0
Net Borrowing	1.8	0.8	21.8	8.0	0.0
Dividends	-0.5	-1.0	-1.7	-4.2	-5.6
Cash From Financing	1.3	13.8	47.1	3.8	-5.6
Net Cash Flow	-0.1	12.3	9.9	1.2	7.9
Ending Cash	1.2	13.6	11.2	12.4	20.3

Balance Sheet ($m)	2009A	1H10A	2010F	2011F	2012F
Cash	1.5	13.6	11.2	12.4	20.3
Receivables	9.4	24.2	17.3	37.4	47.5
Inventory	-3.6	-14.9	-5.1	-7.8	-10.1
Other	6.1	5.9	6.1	6.1	6.1
Current Assets	13.4	28.9	29.6	48.1	63.9
Property, Plant & Equip	19.2	26.4	66.9	87.2	100.3
Intangibles	7.6	7.6	7.6	7.6	7.6
Other Non-current Assets	2.6	3.8	2.6	2.6	2.6
Non-Current Assets	29.4	37.8	77.0	97.3	110.5
Total Assets	42.8	66.6	106.6	145.4	174.4
Payables	13.1	13.2	14.2	27.3	35.2
Borrowings	5.6	6.2	27.3	35.3	35.3
Provisions	1.0	1.1	1.0	1.0	1.0
Other	2.5	5.0	2.5	2.5	2.5
Total Liabilities	22.2	25.5	45.0	66.2	74.1
Net Assets	20.6	41.1	61.5	79.3	100.3
Ordinary Equity	13.1	27.4	40.2	40.2	40.2
Reserves	4.8	4.6	4.8	4.8	4.8
Retained Earnings	2.7	9.2	16.6	34.3	55.4
Total Equity	20.6	41.2	61.5	79.3	100.3

Summary	
Target Price (A$ per share, diluted)	3.00
Forecast 2011 Yield (%)	2.2%
Forecast 2012 Yield (%)	3.0%
Forecast 2011 P/E (x)	8.9
Forecast 2012 P/E (x)	7.4

Valuation Method	Calculations	Results
DCF Valuation	Discount Rate / WACC (%)	13.5%
	PV Free Cash Flow ($m)	228.1
	Less Net Debt / Plus Cash ($m)	20.9
	Unpaid Capital ($m)	1.5
	Equity Value ($m)	250.5
	Equity Value (A$ps)	3.43

FY11 Earnings	Multiple	EV	Equity Val per Share
EV/EBITDA			
EV/EBIT			
P/E (x)	10.0	219,559	3.01
Multiple Valuation (A$ps)			3.01

Target Price ($ per share)	3.00

Financial Ratios	2009A	2010F	2011F	2012F
Balance Sheet Ratios				
Net Debt / Equity (%)	20.1%	26.3%	28.9%	15.0%
Current Ratio (x)	0.9	1.3	1.2	1.4
Net Interest Cover (x)	16.9	59.1	14.8	15.2
Profitability Ratios				
EBITDA Margin (%)	9.2%	25.0%	21.7%	20.6%
Net Profit Margin (%)	5.7%	16.0%	12.1%	11.5%
Return on Assets (%)	8.7%	23.7%	25.3%	26.4%
Return on Equity (%)	15.0%	25.7%	27.7%	26.6%
Cash Flow Ratios				
Free Cash Flow Yield		-19.7%	-1.4%	7.2%

Per Share Data	2009A	2010F	2011F	2012F
Basic EPS (cps)		25.8	31.4	38.1
Diluted EPS (cps)		24.5	30.1	36.5
Diluted P/E (x)		11.0	8.9	7.4
Div. per share (cps)		4.0	6.0	8.0
Dividend Yield (%)		1.5%	2.2%	3.0%
NTA per share (cps)	26.5	86.4	98.2	127.1
CF per share (cps)	18.1	21.7	32.3	45.9

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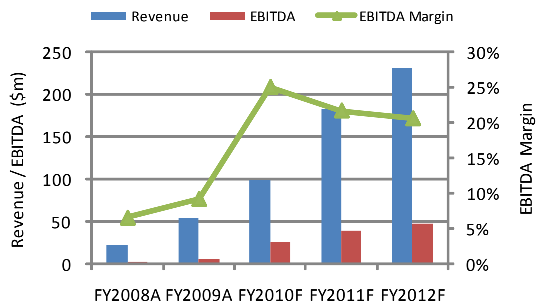
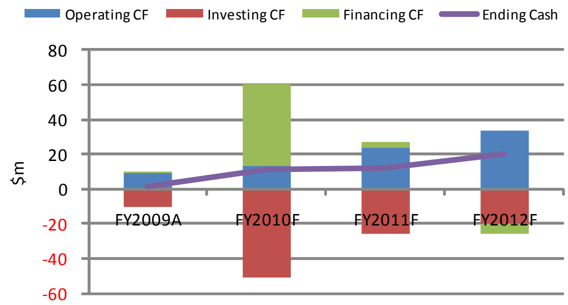


Cash Flow



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Important Disclosures

- Argonaut acted as corporate advisor and broker to the Initial Public Offer in November 2009 and manager to the Placement in April 2010. Argonaut received fees commensurate with these services.
- Argonaut holds and/or controls 337,000 shares in Matrix.

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