

Matrix Composites & Engineering (MCE)

Initiation of coverage

22 June 2010

Opinion Data

Recommendation	Buy
Risk Rating	High
Current share price	\$2.55
12 month target price	\$4.00
DCF valuation (base case)	\$4.00
Market capitalisation	\$178m

Matrix Composites & Engineering (MCE) is a manufacturer of deep-sea oil exploration riser buoyancy systems and other associated offshore oil buoyancy products.

We expect MCE to double revenue in FY'10F and double it again in FY'11F.

Positives:

- MCE has significantly increased production of riser buoyancy modules at its Malaga factory and is building an additional larger facility at Henderson (near Perth) close to the port;
- Raw material savings and greater scale has lifted margins;
- Deep-sea oil exploration has expanded rapidly, particularly off the coast of Brazil; and
- A ~\$210m order book supports production for the next 12+ months.

Risks:

- A possible slowdown in deep sea oil drilling post the BP incident in the Gulf of Mexico;
- MCE intends to break into the production buoyancy market. It does not have an established track record yet;
- The current surge of orders for riser buoyancy may not be reflective of future demand; and
- Deep-sea oil exploration is dependant on a +\$70 per barrel oil price. A sustained fall in the oil price could see demand for product plummet.

Investment View:

The order book gives confidence of strong revenue growth in the 2H'10 and FY'11. The large increase in production is the key profit driver.

MCE would be a takeover target for big oil service providers, though the Board own ~50%.

We estimate MCE is trading at 5.9x's FY'11F earnings and have a Buy recommendation.

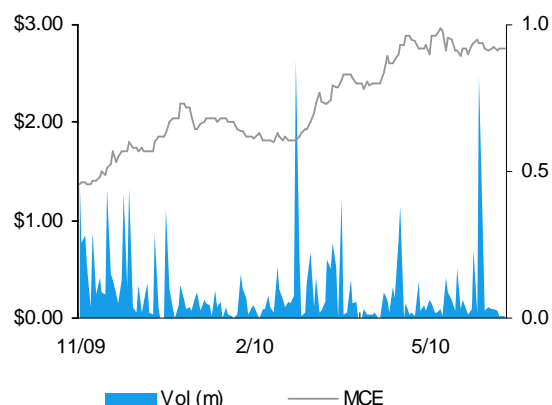
Earnings Forecasts

Y/end June (A\$m)	2009A	2010F	2011F	2012F
Revenue	54.7	108.8	225.7	305.0
EBITDA	5.4	29.7	53.9	71.0
EBIT	3.7	25.2	47.5	62.9
NPAT (Adj)	3.1	16.7	31.4	42.4
NPAT (reported)	3.1	15.3	31.4	42.4
EPS Adj (c)	6.0	26.8	43.0	58.1
EPS Growth	109%	350%	60%	35%
DPS (c)	0.0	6.0	14.8	30.3
Dividend Yield (%)	0.0%	2.4%	5.8%	11.9%
PE Underlying (x)	42.8	9.5	5.9	4.4
EV / EBITDA (x)	33.7	6.8	3.9	2.7
EV / EBIT (x)	49.7	8.0	4.5	3.1
EBIT Margin (%)	6.8%	23.3%	21.1%	20.6%
Gearing (%)	20%	39%	42%	16%
Interest Cover (x)	11.3	18.2	17.5	26.1

Base case revenue and EBIT growth

\$m	FY'09	FY'10	FY'11	FY'12	FY'13
Revenue	55	109	226	305	315
Growth %	138%	99%	107%	35%	3%
EBIT	3.7	25.2	47.5	62.9	59.5
EBIT Margin %	6.7%	23.2%	21.0%	20.6%	18.9%

MCE Share Price / Volume



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REPORT VALUE ADD

WHY WE COVER MCE

Deep-sea, a buoyant sector

The deep-sea oil & gas industry has been estimated to be growing much faster than other parts of the oil & gas industry. We are a believer that oil will be harder to find in the future and expect this industry to expand, providing the oil price does not fall.

Management

Aaron Begley (MD); has overseen the development of MCE's products and is a key man. With large production increases and offshore customers, management is likely to be stretched in our opinion. Paul Wright, the CFO, is retiring shortly.

MCE has a earnings upside

We include base case and best case forecasts for MCE. The numbers quoted in this report are base case, to provide a margin of safety. Best case assumes that production ramps up as anticipated, and that all product produced is capable of being sold.

Coverage is thin

MCE has thin research coverage and is unknown to many investors.

WHAT AUSTOCK RESEARCH OFFERS

Experienced in understanding batch manufacturing operations

We visited the production facility and Engineering workshop at Malaga. The Advanced Materials division is a batch manufacturing operation, similar in operation to the business that this analyst used to manage / part own, prior to becoming a research analyst (though different products).

Industry feedback is that MCE's buoyancy riser products are well regarded.

BUSINESS OVERVIEW

ADVANCED MATERIALS

82% FY'10F revenue

The Advanced Materials division designs, tests and manufactures a range of buoyancy products to the offshore oil & gas industry. The principal product is the riser buoyancy, used in deep-sea oil exploration drilling.

To date, demand has ensured that MCE has concentrated its efforts on manufacturing the riser buoyancy product, with ancillary products manufactured away from its main site.

Layman's description of riser buoyancy and purpose

A riser (a series of pipes), when joined together create the drill string, that span from the drilling vessel to the blow out preventer on the seabed. Due to the extreme weight of the riser and drill rods in deep-sea exploration (up to 3000m, though 2000m is more common), buoyancy is attached to the riser to give the unit uplift.

Different depths require different buoyancy characteristics and MCE customise the shape of the buoyancy to best fit each customers riser design (designs are not standard).

A photo of a riser with buoyancy modules, attached being loaded onto a ship.



MCE use a range of materials to produce riser buoyancy units. The inner core is called Syntactic foam, made up principally from carbon fibre and epoxy resins. The outer skin is made from a fibre glass / Kevlar composite.

The riser buoyancy is manufactured in moulds that are produced by MCE's Heavy Engineering division to meet each customer's specification.

MCE believes it has advantages over peers in relation to key features

The key features required of riser buoyancy modules are:

- Resistance to water absorption;
- The ability to resist compression whilst at depth;
- Thermal insulation to prevent plugging of material when returning to the surface;
- Durability (to avoid damage when handled); and
- The greater the buoyancy, the better.

MCE believe they are best of breed on most of the above points.

MCE operates in an industry with not a lot of participants, but scope exists to expand past its current key customers

MCE's customers are split between oil & gas equipment/service providers and deep sea drilling companies. Approximately 95% of sales are exported.

It is via the equipment providers that MCE sell to the drill rig/vessel builders for new build rigs. This is how MCE's buoyancy modules can make its way onto a new Petrobras rig for example. Equipment and service providers that are customers of MCE are:

- National Oilwell Varco
- GE Vetco; and
- Aker Solutions.

MCE sell direct to some of the larger deep-sea drillers, including:

- Diamond Offshore (31 floating rigs); and
- Pride (18 floating rigs).

Customer risk applies, as MCE has few customers, with each one representing a high proportion of sales.

According to a Diamond Offshore presentation, the other deep sea drilling companies that MCE do not sell to (including their number of floating rigs – excluding jack-up drill rigs) are:

- Transocean (76 rigs, but also BP's drilling contractor in the Gulf of Mexico oil spill);
- Noble (17 rigs);
- SeaDrill (14 rigs);
- Fred Olson (8 rigs);
- Ensco (8 rigs);
- Maersk (6 rigs); and
- Atwood Oceanics (6 rigs).

Competition is limited and all the peers have had strong growth

We estimate MCE has ~24% of the riser buoyancy modules market. Competitors are:

- Trelleborg AB – listed in Sweden. A diversified company with riser buoyancy operations in the UK and USA. Trelleborg has ~35% of the riser buoyancy market and is the market leader;
- Cuming Corp (US) – may be acquired by Deep Down Inc for \$50m in Jun'10, though doubts exist about this deal. For CY'09, Cuming Corp had revenue of \$73m and gross profit of \$15m. It holds ~23% market share; and
- Balmoral Offshore Engineering (Aberdeen) – privately owned, ~18% market share.

HEAVY ENGINEERING

18% FY'10F revenue

The Heavy Engineering division consists of an Engineering workshop that designs, manufactures and supplies products and services to the offshore oil & gas (61% of FY'09 revenue), and mining & mineral processing industries (39% of revenue, predominantly iron ore mining).

Key products are manufactured under licence, such as car dumpers for the iron ore industry.

Heavy Engineering provides a key advantage, with other competitors outsourcing Engineering

A lot of the work performed by this division is now associated with the Materials division. Heavy Engineering manufactures the custom built moulds used in the materials division. While this could be outsourced, it means that MCE can control the quality and timeliness of construction of the moulds.

The division is also involved in the construction of some of the machinery used within the Materials division, particularly for the Henderson expansion. Again this could be outsourced, but it also reduces the risk of untimely delivery of equipment.

In terms of revenue and profitability, we expect this division to be relatively flat going forward, though it has strategic importance.

BARRIERS TO ENTRY

Composites production has the following barriers: high capex, good customer relationships is critical, knowledge of the production process and raw materials, and reputation within the industry (track record).

In-house testing facilities

MCE has an in-house a hydrostatic testing facility at the Malaga site (up to 3000msw). An additional hydrostatic testing facility is being built for the Henderson site, capable of testing up to 5000msw. MCE test 1 in 20 of each of the riser buoyancies manufactured.

Regular audits by customers

Apart from possessing ISO9001, MCE is intent on gaining accreditation to APIQ1 – the industries highest accreditation standard – important we feel given the Gulf of Mexico incident. Our impression is that competitors are not yet accredited to APIQ1. MCE plan to gain this accreditation by Dec'10.

The buoyancy industry is such that customers regularly audit supplier premises to ensure they comply with their standards. Some earlier issues identified by auditors have assisted MCE in focusing on getting quality right.

Henderson operations give a competitive advantage

The factory at Henderson offers a potential advantage over competitors. Risers are difficult to transport due to their length. At the Henderson site, the buoyancy could be fitted onto the riser and shipped directly to the drilling vessel, as the factory is located next to the port. Currently, buoyancy modules are shipped to a location (generally Houston), fitted to the riser and then shipped to the drilling vessel.

ORDER BOOK

The order book = ~15 months of production

The order book stands at ~\$210m, with a further ~\$230m of work tendered on. Based on our forecast growth in revenue, this represents ~12 months of work.

Riser buoyancies have a lead time due to construction of moulds and sometimes marry up with construction of a drilling vessel. Nonetheless, it is unusual for a manufacturing company to have an order book extending up to 12 months. We believe the long lead times for new orders constrains MCE's ability to grow its order book until production capacity further increases.

Growth locked in due to the order book

The order book gives confidence that the increased production constructed at Malaga will be fully utilised in FY'11, and supports ramp up at Henderson.

An order of 3km's of buoyancy (i.e. 1 new large vessel) is ~\$17m

Orders are often lumpy. For example an order to supply a new drilling vessel drilling with riser buoyancy of up to 3km would require up to 1200 buoyancy modules (**each 1km of a drilling string requires ~333 buoyancy modules**).

FOUR MAIN DRIVERS

1. DEEPWATER OIL EXPLORATION A GROWTH INDUSTRY

Shift to deepwater production

Oil & gas production from deepwater wells has grown by a CAGR of 20% since 1992, vs. shallow water by 4% and onshore by < 1%. The long term fundamentals are positive with the structural shift towards deepwater oil & gas expected to continue.

Deepwater is in 'early' industry evolution

Deepwater exploration is expected to outperform other drilling sectors (shallow and mid-water) due to the successes achieved today, such as the Tupi field off the coast of Brazil in 2007 (the largest field discovery in a decade).

90 new deepwater discoveries were announced in 2008-09 and Chevron forecasts deepwater wells will account for 25% of offshore oil production by 2015 vs. 9% today.

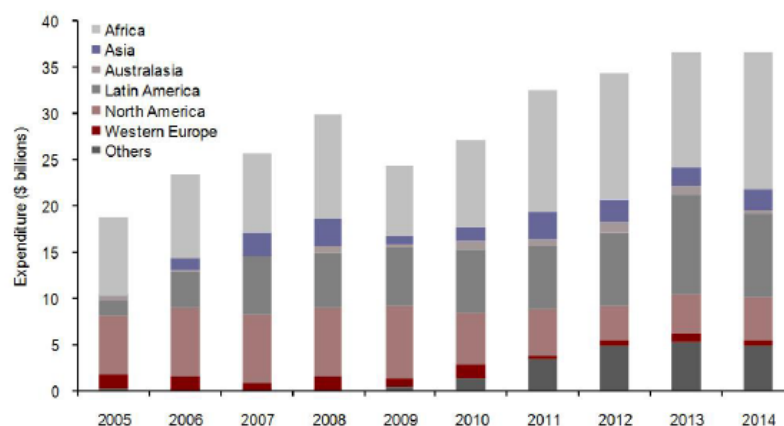
Long-term drivers intact, but under pressure

"The lack of new opportunities onshore or in shallow waters, together with the need to offset decline from existing reservoirs, is driving deepwater investment at a much higher rate than in previous years. In addition, technological advances have improved the economic viability of developments much further offshore." Douglas-Westwood

The Gulf of Mexico disaster could slow this growth as big oil reconsider capex and review procedures etc to ensure that another costly disaster is avoided. Longer term we are of the view there are few alternatives to source large quantities of oil and any slow down may see a ramp up in activity at a later date.

Forecast global deepwater expenditure

Douglas-Westwood forecasts that the global deepwater sector will spend \$167bn between 2010-2014 (~33bn pa). This is an increase of 37% over the preceding 5 years



Source: 'The World Deepwater Report 2010-2014', Douglas-Westwood

New offshore drill rig construction remains strong. Globally, the deepwater rig fleet is expected to grow by 32% between 2009 - 2013.

Drilling contractors adding rigs

Contractor	Deepwater rig additions
Transocean	5 currently under construction
Pride International	4 new builds 2010-12
Noble Corporation	4 new builds by 2011
Ensco International	4 currently under construction
SeaDrill	3 new builds 2010-11
Atwood Oceanics	2 currently under construction

Source: Company reports

Petrobras fuelling growth, with 28 rigs ordered

In addition to above, **Petrobras** (Brazil's state controlled oil and gas multi-national) **has ordered the construction of 28 new deep-sea drilling rigs over the next 8 years.** MCE could be an indirect supplier of buoyancy modules.

2. PRODUCTION EXPANSION

Two pronged production expansion plans

MCE is in the process of constructing a new manufacturing facility in the Australian Marine Complex in Henderson, WA. First production at the Henderson facility is expected in Q2 FY'11. Given this sites direct access to the port, we believe it offers logistical advantages.

**3D birds eye view
of the Henderson
expansion**



Stage 1 of the Henderson development will house the advanced materials manufacturing plant and testing facilities and is expected to cost ~\$60m. Stage 2 is planned for completion in 2013 (no guidance on costs) and will house the new head office and potentially an engineering workshop, and extension of composites operations.

**Malaga also has
increased
production in
FY'10**

The Malaga plant is expected to continue to run as is, resulting in minimal business interruption from the Henderson expansion. Malaga has also undergone expansion, with March revenue some 40% above the average monthly revenue monthly achieved in the 1H'10. We estimate that production at the end of FY'10 at Malaga will be more than double production from 12 months ago.

The tables below compare the assumptions we have used in our base case and our best case (factoring in full ramp and all product sold). The product mix will change to include offshore oil production related products. Production buoyancy uses similar technology and we expect that margins and revenues generated will be similar to riser buoyancy.

Best case revenue and EBIT forecasts

\$m	FY'09	FY'10	FY'11	FY'12	FY'13
Revenue	55	111	278	418	423
Grow th %	138%	103%	150%	50%	1%
EBIT	3.7	25.9	61.6	91.2	84.4
EBIT Margin %	6.7%	23.3%	22.2%	21.8%	20.0%

Source: Austock forecasts

Base case revenue and EBIT forecasts

\$m	FY'09	FY'10	FY'11	FY'12	FY'13
Revenue	55	109	226	305	315
Grow th %	138%	99%	107%	35%	3%
EBIT	3.7	25.2	47.5	62.9	59.5
EBIT Margin %	6.7%	23.2%	21.0%	20.6%	18.9%

Source: Austock forecasts

MCE has been successful at lowering the cost of its raw materials in FY'10, by renegotiating pricing with suppliers. It is likely that as MCE further ramps up production and becomes a larger consumer, it can secure further purchasing benefits.

In our opinion, raw material savings will be a driver to profits in the 2H'10 and 1H'11. In the 1H'09, cost of sales were 61% of revenue. This fell to 47.5% in the 1H'10 and we would expect further falls in the 2H'10, though not factored into our forecast.

As with any business, an increase in scale leads to overheads being spread over a greater base. We would expect this to be a small driver for MCE going forward.

The centralisation of most of MCE's production to one site will reduce transport and logistic costs etc, as these will now be mostly performed in the 1 location. This is likely to result in \$0.1m pa in cost savings.

3. OIL PRODUCTION RELATED PRODUCTS

A significant part of the Henderson expansion is to better service the oil production buoyancy market, also called Surf – Subsea construction umbilical risers and flow-lines (flexible as they connect to floating rigs). This essentially refers to: subsea pipelines (well head to rig), bend restrictors and clamping systems.

MCE has a range of products that service offshore oil production. Due to the demand of the riser buoyancy product, this product range has been in limbo. We include \$20m in capex in our modelling to cover the cost of equipment and development costs for this product range.

A key factor in establishing MCE in the deep-sea production market is track record. Potentially MCE is able to leverage their riser buoyancy track record, but this still represents a risk, as Trelleborg is the established incumbent in this market.

Subsea pipeline, coated with Matrix produced buoyancy



MCE has already developed these products, but has not had the production capacity in the past to properly service this market. Customers are also different, being mainly the EPCM oil & gas contractors. Ramp up risk exists with entering this market in a more substantial way, but it also reduces MCE's reliance on one product.

The Pluto 2 and Inpex projects are on the horizon and both require production buoyancy equipment, with MCE having proximity advantages over competitors.

4. SHORTER PRODUCT LIFECYCLE DUE TO REGULATION

Product turnover could increase due to the Gulf of Mexico incident

One likely outcome from the Gulf of Mexico oil spill is that drilling and oil companies could replace buoyancy related equipment more frequently. Currently, buoyancy risers have a 5-10 year shelf life, depending on how well they are maintained.

It is possible that buoyancy risers will be replaced more often: by choice, due to increased regulation or upon minor damage.

The best buoyancy risers stand to benefit

If MCE is right in their claim that they have one of the better buoyancy risers in the market due to their superior protective coating and greater buoyancy, the cost of a drilling contractor ensuring that they have the best product is immaterial compared to the cost of an accident. We would not expect this to be an immediate driver. Feedback from industry supported this claim.

FOUR MAIN RISKS

1. NOT SELLING TO CAPACITY / MARGIN DECLINE

Rising production from other competitors could see competition increase

MCE is rapidly ramping up production capacity, along with its competitors. While demand for buoyancy risers is currently strong and a large number of new deep-sea drilling rigs are on order, **it is likely that at some point in the future this market could move into over supply.** An oversupplied market leads to price reduction and production cuts.

The near term demand for riser buoyancy is strong, however we see reduced demand as the key risk to our forecasts. We factor in lower sales and lower margins in later years to factor in this risk in our forecasts, but note that a sharper fall off in demand than we forecast is a possibility. The order book gives certainty for the next 12 months.

2. SUSTAINED OIL PRICE FALL

Not being forecast, but a possibility with European concerns

Deep sea oil production is at the margin and is not viable should the oil price fall. History demonstrates that if the oil price falls, big oil continues to spend through the cycle – to a point. Should the oil price remain low for a sustained period, demand for new deep-sea drilling rigs and riser buoyancy could plummet.

According to Worley Parsons, the price point at which deep-sea oil production is not economic is ~US\$70 per barrel of crude oil. Current pricing is US\$74.50/barrel. Due to higher insurance and safety costs, the inflection point price could rise.

3. CUSTOMER / PRODUCT RISK

The number of customers using MCE product is small. Should a customer become dissatisfied with MCE's product, the consequences could be material.

Conversely, with a high reliance on 1 product, should product development fall behind competitors in terms of quality or be linked to a negative one off event, MCE's sales could be significantly impacted. It is also likely overtime that additional competitors will enter the market.

4. DEEP-SEA DRILLING DELAYS

Problems from the BP incident could escalate

Deep-sea is defined as a minimum of 3000ft (940m).

The moratorium on drilling in the Gulf of Mexico could last > 6 months and could see rigs deployed in other regions, potentially reducing demand for new rigs.

Big oil companies will be reviewing practices in deep-sea drilling, as the cost of getting it wrong is enormous. This uncertainty is likely to result in delays in the growth of the deep-sea sector in our view.

In terms of deep-sea activity, the Gulf of Mexico is not huge (more active in shallow water), however the scale and cost of the problem is likely to cause a slow down in the ordering of new rigs in deep-sea exploration until certainty on regulation is delivered. Greater regulation may be a long term driver for MCE.

Deep water activity statistics

The large number of new drill rigs on order has led to a spike in the order books of riser buoyancy.

Predicting when the buoyancy modules are completed to support the pent up demand for new rigs could represent a point in time that demand for riser buoyancy falls, assuming a slowdown in demand for new deep-sea drilling rigs. Conversion of the further \$200m of product being bid on is also a factor.

No. Deep water rigs worldwide	99
No. Deep water rigs under construction	61
Deepwater prospects with drilling activity by region	
Gulf of Mexico	3
West Africa	18
North Sea	8
Brazil	38
Asia	13
Australia	6
Total	86

Source: World Oil Magazine, Jun'10

Deep sea exploration off the coast of Brazil is the main game

Post the discovery of up to 8bn barrels (the largest oil discovery in a decade) in the Tupi field in ~2000m of water off the coast of Brazil, deep sea drilling for oil has concentrated in this area. Petrobras is the operator and appears determined to continue development of these fields.

The table above indicates the importance of Brazil, where ~44% of the worlds deep-sea rigs are operating. We are unsure as to whether the BP incident will drive legislation changes in Brazil.

INVESTMENT THESIS

Liquidity an issue ~47% of the register is owned by the Begley family. Since listing, those that took up stock have tended to hang on to it. The average daily turnover is \$0.3m. Acquiring or exiting a stake requires patience. Max Begley is expected to sell shares after the FY'10 result.

Appealing characteristics that are not often found MCE has several factors that appeal to us:

- It does not have a lot of research coverage. Many institutional investors have not looked at (or heard of) MCE;
- The growth in production capacity is impressive. We are forecasting that FY'12 revenue will be 280% above FY'10; and
- MCE is exposed to a segment of the energy industry that is experiencing strong long term growth.

Best case valuation \$6.29/share Our best case scenario factors in revenue of what we believe is MCE's best case production capacity. See the table on the right below. Factored in are lower sell prices in future years and margin contraction.

This scenario results in a DCF valuation of \$6.29/share.

Base case valuation \$4.00/share Our base case valuation factors in lower production than what MCE is capable of producing. The rationale for using a base case is to factor in a margin of safety given that:

- MCE is newly listed and does not have a public track record;
- Sales are reliant upon entry into the oil production buoyancy market; and
- The increase in production capacity being constructed is large and there is no guarantee that MCE can sustain sales at these levels in the long term.

Our base case results in a DCF valuation of \$4.00/share, equal to our price target.

The tables below reflect the different profit outcomes under the best and base case scenarios.

Best Case financials

Y/end June (A\$m)	2009A	2010F	2011F	2012F
Revenue	54.7	111.2	277.9	418.1
EBITDA	5.4	30.4	68.0	99.2
EBIT	3.7	25.9	61.6	91.2
NPAT (Adj)	3.1	17.2	41.2	62.2
NPAT (reported)	3.1	15.8	41.2	62.2
EPS Adj (c)	6.0	27.6	56.5	85.2
EPS Growth	109%	363%	105%	51%
DPS (c)	0.0	6.0	19.4	44.4
Dividend Yield (%)	0.0%	2.4%	7.6%	17.4%
PE Underlying (x)	42.8	9.2	4.5	3.0
EV / EBITDA (x)	33.7	6.6	3.1	2.0
EV / EBIT (x)	49.7	7.8	3.4	2.1
EBIT Margin (%)	6.8%	23.4%	22.2%	21.8%

Source: Austock forecasts

Base case financials

Y/end June (A\$m)	2009A	2010F	2011F	2012F
Revenue	54.7	108.8	225.7	305.0
EBITDA	5.4	29.7	53.9	71.0
EBIT	3.7	25.2	47.5	62.9
NPAT (Adj)	3.1	16.7	31.4	42.4
NPAT (reported)	3.1	15.3	31.4	42.4
EPS Adj (c)	6.0	26.8	43.0	58.1
EPS Growth	109%	350%	60%	35%
DPS (c)	0.0	6.0	14.8	30.3
Dividend Yield (%)	0.0%	2.4%	5.8%	11.9%
PE Underlying (x)	42.8	9.5	5.9	4.4
EV / EBITDA (x)	33.7	6.8	3.9	2.7
EV / EBIT (x)	49.7	8.0	4.5	3.1
EBIT Margin (%)	6.8%	23.3%	21.1%	20.6%

Source: Austock forecasts

Low forward multiples on our base case Assuming MCE deliver on growth as to our base case forecasts, MCE is on low FY'12F multiples:

- EV/EBITDA – 2.7x's; and
- P/E – 4.4x's.

Initiate with a Buy recommendation and \$4.00/share target

Like its competitor Cuming Corp, we believe that MCE would be an attractive takeover target. However, given the Begley family holding, it would need to be on friendly terms.

The likely rapid growth in sales is eye catching, with relative certainty on FY'10 and FY'11 sales growth capable of being forecast due to the order book.

We commence coverage with a Buy recommendation. The No. 1 risk is whether MCE can sustainably sell greater volumes.

FINANCIALS

BALANCE SHEET

MCE has conducted 2 equity raisings in quick succession (\$15m at the Nov'09 IPO and a further \$13.5m in April). The purpose of the raisings was to assist with the funding of the Henderson expansion.

We would not rule out MCE needing additional capital should it gain the chance to buy the Henderson land outright. This would create more liquidity and whilst it would likely to be dilutive, owning land near a port (high capital appreciation) and increased liquidity would be positive in our view

ND/E gearing initially on the high side

We forecast gearing to be at the high end for a small cap whilst MCE is constructing the Henderson facility (42% in FY'11). This falls in FY'12, as cashflow is forecast to be solid.

Interest cover is healthy due to the high margins currently earned.

MCE Balance Sheet

(\$m)	2008A	2009A	2010F	2011F	2012F	Comments
Cash	1	1	1	1	1	
Current Assets	10	13	34	61	74	Increasing due to Henderson expansion
Total Assets	30	43	116	177	201	Greater working capital in use a driver
Borrowings	4	6	25	35	18	Increases before falling due to cashflow
Total Liabilities	14	22	56	96	99	
Total Equity	16	21	60	81	102	
Gearing	14%	20%	39%	42%	16%	Upper end of where we would like it in FY'11
Interest Cover	5.4	11.3	18.2	17.5	26.1	High interest cover reduces high gearing concerns

Source: Company financials & Austock Securities estimates

PROFIT & LOSS

Conservative margins forecast going forward

With logistics cost out, greater scale and raw material price reductions, it could be argued that MCE is likely to expand its margins. We have erred on the conservative side and have margins falling in future years, as additional production increases could weigh on end product pricing.

MCE had 1H'10 EBIT margins of 24%. We factor in EBIT margins progressively falling to 16.1% by FY'14. We lower the sale price per module from an average of US\$14k to US\$12k by FY'14.

Revenue growth over FY'08A to FY'10F has averaged 106% pa. We are forecasting 107%, 35% and 3% in FY'11, FY'12 and FY'13 respectively.

MCE Profit and Loss

(\$m)	2008A	2009A	2010F	2011F	2012F	Comments
Advanced Materials	22.0	34.2	89.4	204.4	282.6	Growth driven by production increases
Heavy Engineering	0.0	20.1	19.0	20.9	22.0	Remaining relatively flat
Operating Revenue	22.0	54.3	108.5	225.3	304.6	
Advanced Materials	1.4	3.7	23.3	46.2	61.6	Steady margin decline factored in
Heavy Engineering	0.0	0.0	1.9	1.3	1.3	
Total EBIT	1.4	3.7	25.2	47.5	62.9	
EBIT Margin	6.2%	6.8%	23.3%	21.1%	20.6%	FX assumptions are also a positive factor in FY'12
Net Interest	(0.2)	(0.2)	(1.3)	(2.7)	(2.3)	
Tax	(0.5)	(0.4)	(7.2)	(13.4)	(18.2)	R&D deductions could see a lower tax rate - 30% used
Underlying NPAT	0.7	3.1	16.7	31.4	42.4	
Abnormals	0.0	0.0	(1.4)	0.0	0.0	FX losses forecast
Reported NPAT	0.7	3.1	15.3	31.4	42.4	\$7.8m reported in the 1H'10
Underlying EPS (cps)	2.8	6.3	28.2	44.8	60.6	Raisings included, EPS dilutive

Source: Company financials & Austock Securities estimates

CASH FLOW

Capex is expected to be high in FY'10 and FY'11. Part of this is the cost of expanding the Malaga production site, though the bulk of it is spending on Henderson. We factor in \$30m for buildings and \$30m for plant at Henderson.

This impacts free cashflow, which we see as being highly negative in FY'10. Operating cashflow is expected to significantly increase as production volumes increase and MCE should produce solid free cashflow from FY'12, when large capex programs have completed.

MCE Cashflow

(\$m)	2008A	2009A	2010F	2011F	2012F	Comments
EBITDA	2	5	30	54	71	1H'10 was \$12m
Operating Cashflow	4	9	15	41	57	Increase is due to higher production
Maintenance Cap-ex	-4	-3	-7	-8	-9	Running ahead of forecast depreciation
Expansion Cap-Ex	0	-7	-50	-33	-10	Capex above company guidance factored in
Free Cash Flow	0	-1	-44	0	38	
Financing Cashflow	1	1	24	-10	-21	Dividends included here
Net change in cash/debt	1	0	-20	-10	17	

Source: Company financials & Austock Securities estimates

DIRECTORS

<i>Chairman</i>	Nigel Johnson. Previously CFO for Straits Resources and currently non-executive director of Catalpa Resources.	<i>Shareholding: 0.2m shares</i> <i>Elected 2008</i>
<i>CEO</i>	Aaron Begley. Managing Director of Advanced Materials division since 1999. Architect and key man in development of the Materials product line and business.	<i>Shareholding: 3.5m shares</i> <i>Elected 1999</i>
<i>Executive Director</i>	Paul Wright. Joined MCE in 1996, previously MD of Centurion Industries (now part of RCR Tomlinson). Also CFO of MCE.	<i>Shareholding: 1.8m shares</i> <i>Elected 2007</i>
<i>Non-Executive Director</i>	Maxwell Begley. Begley Engineering founder and Director since 1990. Over 50 years in the oil & gas and resources sectors, established the heavy engineering business in 1982.	<i>Shareholding: 29.2m shares</i> <i>Elected 1990</i>
<i>Non-Executive Director</i>	Craig Duncan. Currently drilling and well construction manager with PTTEP. Previously with Apache Energy for 12 years.	<i>Shareholding: 0.6m shares</i> <i>Elected 2007</i>

Matrix C & E

NFPOS
70 m
Price \$ 2.55
Market Cap \$178 m
Date:
22-Jun-10
Model Updated:
22-Jun-10

PROFIT & LOSS (\$m)

y/end June	2008A	2009A	2010F	2011F	2012F
Revenue	22.0	54.3	108.5	225.3	304.6
EBITDA	2.2	5.4	29.7	53.9	71.0
Depreciation	-0.9	-1.7	-4.5	-6.5	-8.1
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	1.4	3.7	25.2	47.5	62.9
Net Interest	-0.2	-0.2	-1.3	-2.7	-2.3
Income tax expense	-0.5	-0.4	-7.2	-13.4	-18.2
NPAT Underlying	0.7	3.1	16.7	31.4	42.4
Abnormal Items	0.0	0.0	-1.4	0.0	0.0
NPAT Reported.	0.7	3.1	15.3	31.4	42.4

BALANCE SHEET (\$m)

y/end June	2008A	2009A	2010F	2011F	2012F
Cash	1	1	1	1	1
PP&E	11	19	72	106	117
Debtors & Inventory	16	9	20	45	58
Intangibles	8	8	8	8	8
Other assets	-7	5	16	17	18
Total Assets	30	43	116	177	201
Borrowings	4	6	25	35	18
Trade Creditors	8	13	27	56	76
Other Liabilities	2	3	4	5	5
Total Liabilities	14	22	56	96	99
NET ASSETS	16	21	60	81	102
OBI and Pref Shares	0	0	0	0	0
Shareholder Equity	16	21	60	81	102

CASHFLOW STATEMENT (\$m)

y/end June	2008A	2009A	2010F	2011F	2012F
Operating EBITDA	2	5	30	54	71
Interest & Tax Paid	(0)	(1)	(8)	(16)	(21)
Working Cap.	2	4	(7)	3	6
Operating CF	4	9	15	41	57
Maintenance Capex	(4)	(3)	(7)	(8)	(9)
Expansion Capex	0	(7)	(52)	(33)	(10)
Free Cashflow (FCF)	0	(1)	(44)	0	38
Ord & Pref Dividends	(1)	(0)	(4)	(10)	(21)
Net Other	2	2	28	0	0
Net Cashflow	1	(0)	(20)	(10)	17

DIRECTORS

	Shares (m)		Shares (m)
Aaron Begley	3.5	Maxwell Begley	29.2
Nigel Johnson	0.2	Craig Duncan	0.6
Paul Wright	1.8		
		Total	35.2

DIVISIONAL SUMMARY (\$m)

y/end June	2008A	2009A	2010F	2011F	2012F
Revenue					
Advanced Materials	22.0	34.2	89.4	204.4	282.6
Heavy Engineering	0.0	20.1	19.0	20.9	22.0
Total Revenue	22.0	54.3	108.5	225.3	304.6
EBIT					
Advanced Materials	1.4	3.7	23.3	46.2	61.6
Heavy Engineering	0.0	0.0	1.9	1.3	1.3
Total EBIT	1.4	3.7	25.2	47.5	62.9
EBIT Margin					
Advanced Materials	6.2%	10.7%	26.1%	22.6%	21.8%
Heavy Engineering	na	na	10.0%	6.0%	6.0%
Total Margin	6.2%	6.8%	23.3%	21.1%	20.6%

KEY RATIOS

y/end June	2008A	2009A	2010F	2011F	2012F
EBIT Margin (%)	6.2%	6.8%	23.3%	21.1%	20.6%
NPAT Margin (%)	3.2%	5.7%	14.1%	13.9%	13.9%
ROE (%) y/e	4.5%	15.0%	27.8%	38.7%	41.4%
ROA (%) y/e	4.8%	8.9%	22.0%	27.0%	31.5%
ROIC (%) Av.	12.2%	15.8%	44.4%	46.5%	52.5%
NTA per share (\$)	0.11	0.18	0.75	1.04	1.34
Eff Tax Rate (%)	39.6%	10.6%	30.0%	30.0%	30.0%
Interest Cover (x)	5.4	11.3	18.2	17.5	26.1
Net Gearing (%)	14.2%	20.1%	39.4%	41.6%	16.4%

VALUATION PARAMETERS

y/end June	2008A	2009A	2010F	2011F	2012F
Adj EPS (cps)	2.8	6.0	26.8	43.0	58.1
PE (x) cps	89.5	42.8	9.5	5.9	4.4
Enterprise Value (\$m)	180.6	182.5	202.1	212.2	195.2
EV / EBITDA (x)	80.6	33.7	6.8	3.9	2.7
EV / EBIT (x)	133.4	49.7	8.0	4.5	3.1
Price / NTA	24.2	14.5	3.4	2.4	1.9
DPS (cps)	0.0	0.0	6.0	14.8	30.3
Dividend Yield (%)	0.0%	0.0%	2.4%	5.8%	11.9%
Franking (%)	0%	0%	100%	100%	100%
Free Cash / Share (c)	1.5	-2.8	-70.1	0.4	52.3
Price / FCF PS (x)	165.9	-90.8	-3.6	604.0	4.9

DCF VALUATION & SENSITIVITY

PV of Cashflows 2010 to 2014	40	Risk Free Rate	6.0%
PV of Cashflows 2015 to 2019	87	Equity Risk Premium	6.0%
PV of Term Year Cashflow	169	Equity Beta	1.4
Other	0	Cost of Equity	14.4%
Less Net Debt	4	WACC	13.4%
PV of Equity	292	Terminal WACC	12.4%
PV of Equity per share	\$ 4.00	Terminal Growth th	3.5%

TV WACC

	13.4%	12.4%	11.4%	10.4%
2.5%	\$ 3.33	\$ 3.74	\$ 4.25	\$ 4.89
3.0%	\$ 3.42	\$ 3.87	\$ 4.42	\$ 5.12
3.5%	\$ 3.52	\$ 4.00	\$ 4.60	\$ 5.37
4.0%	\$ 3.64	\$ 4.15	\$ 4.81	\$ 5.66
5.0%	\$ 3.91	\$ 4.52	\$ 5.32	\$ 6.42

MAJOR SHAREHOLDERS

	%	%	
Acorn Capital	5.9%	Perrenial	4.6%
Max Begley	41.8%		
Aaron Begley	5.0%	Substantials	57.3%

GROWTH PROFILE (YoY)

y/end June	2008A	2009A	2010F	2011F	2012F
Sales (\$m)	91%	138%	99%	108%	35%
EBITDA (\$m)	29%	142%	450%	81%	32%
EBIT (\$m)	-8%	171%	587%	88%	32%
NPAT (\$m)	-26%	338%	441%	87%	35%
EPS (cps)	-98%	109%	350%	60%	35%
DPS (cps)	0%	0%	0%	147%	105%

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Austock Securities Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
> 20%	20% - 5%	< 5%

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