Titan Energy Services 01/07/2014 **FAT-AUS-679**

TTN AUD $2.03 Spec. **HIGH** **B**

Setting up camp

With many mining companies pulling back on production and budgets, the services end of the resources sector has generally not been the place to be in recent years. Conversely, the energy sector however has fared somewhat better, with robust oil and gas prices setting the stall for further increases in activity in our view, upping the demand profile for service companies in the space.

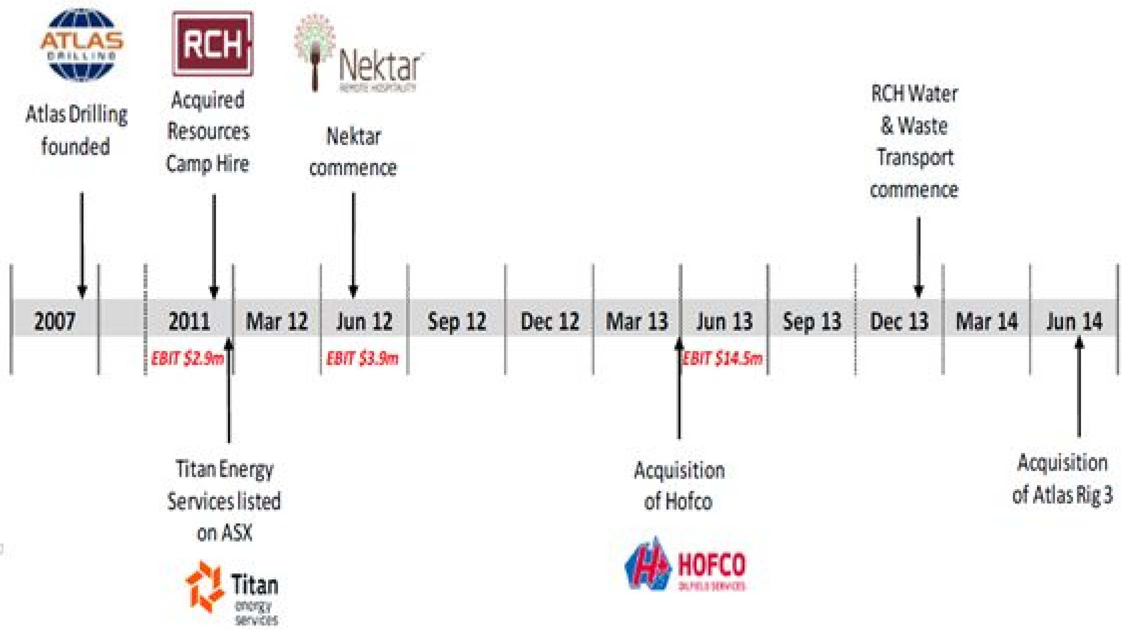
One company we believe offers an excellent exposure to increasing activity in the oil and gas sector is Titan Energy Services (ASX, TTN). The company provides drilling, camp hire accommodation, as well as hospitality services to oil and gas clients. From a valuation perspective the shares are moderately priced in our view, with a forward earnings multiple of 7.6 times earnings and a 3.7% dividend yield. A modest level of debt also provides comfort from a risk perspective.

The shares enjoyed a stellar run last year, but have pulled back in recent months as full year earnings forecasts have moderated slightly, providing a reasonable entry point opportunity for Members in our opinion.

Accordingly, we recommend Titan Energy Services as a buy for Members with a higher appetite for risk. The company has a small market cap of just under $100 million and patience should be exercised when buying.

Background

Titan provides diversified energy and infrastructure services to the oil and gas, mining, pipeline, rail, road and infrastructure sectors. The company is fronted by a well-heeled management team, reinforcing the company's reputation and ability to understand and meet the needs of energy sector clients. This expertise has also facilitated the company's growth through acquisition and a listing on the ASX in late 2011. The company has operated through four principal business units, and started up a fifth in November last year.



Source Company Presentation

The company's main operating businesses are Atlas Drilling, Hofco Oilfield Services RCH, and Nektar. Each provide a distinct set of services ranging from traditional drilling services and equipment hire, to camp and catering facilities. A waste and water unit was set up last November.

The Titan Energy Services Group				
ATLAS DRILLING	Camps RCH	Nektar	HOFCO OILFIELD SERVICES	Water & Waste RCH
▪ 2 rigs under contract ▪ Rig 3 recently acquired ▪ Strong utilisation ▪ 'Blue chip' customers	▪ 1,138 rooms - May 2014 ▪ Servicing CSG construction and production projects ▪ Experiencing good growth	▪ Organic start-up business ▪ Commenced in April 2012 ▪ 8 contracts secured ▪ Experiencing solid growth	▪ Rental provider of drilling equipment to the oil and gas sector ▪ Growth potential under Titan ownership	▪ Organic start-up through client demand ▪ Commenced in Nov 13 ▪ Water and waste cartage ▪ 6 x Trailers

Source Company Presentation

Atlas Drilling was formed in 2007 and represented the birth of Titan Energy Services. The unit supplies machines, personnel and engineering services to the coal seam methane gas industry. The company now owns and operates four drilling rigs with activities in Australia, Thailand, Nigeria and New Zealand.

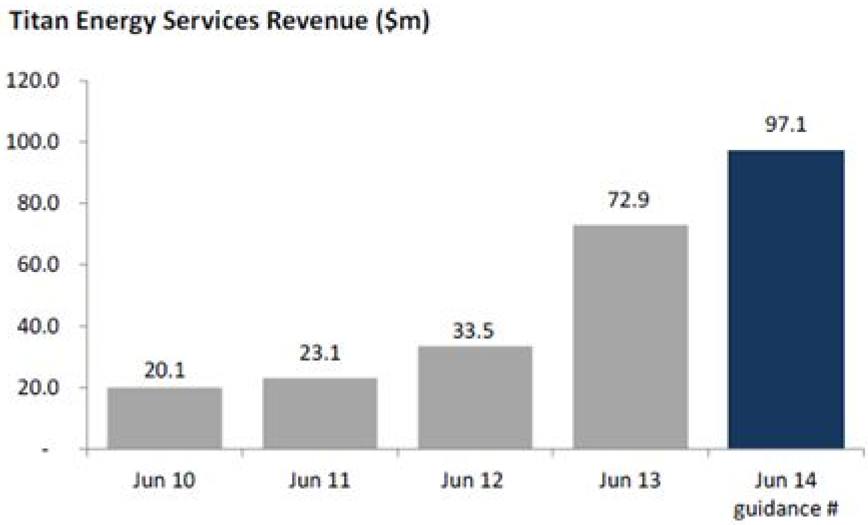
Hofco Oilfield Services meanwhile was acquired in March 2013, and provides a wide range of tools for rent, including pipes, down-hole equipment, and drill collars.

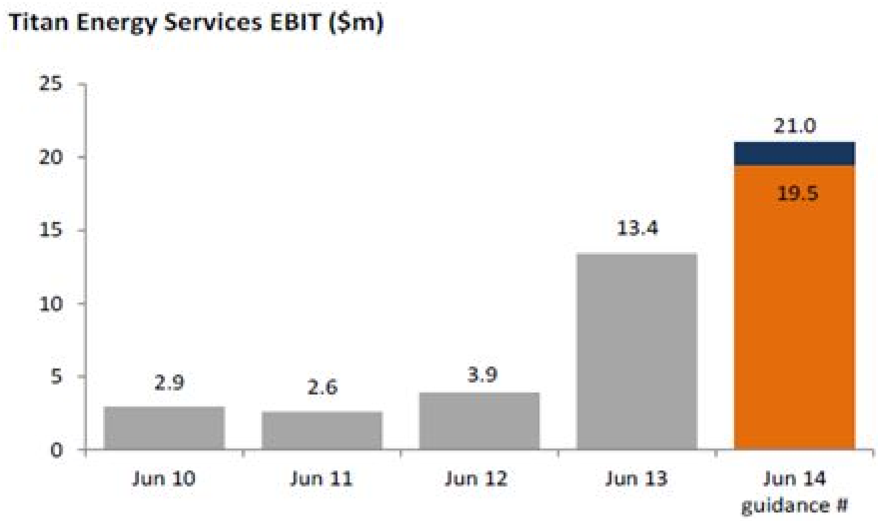
The company's portable camps business, RCH (resource camp hire) operates high quality dwellings which can be containerized, and are tailored to accommodate from 8 to 100 people. The business, which was acquired in September 2011, prides itself on being able to set up these portable camps within a few days' notice,

Titan also has the food needs of clients covered through Nektar Remote Hospitality which was started up in April 2012. The division provides remote catering along with camp management.

Financial Results

The strength of Titan Energy Services' underling business and success of acquisitions made, are underlined by a strong record of revenue and earnings growth in the past four years, as the bar charts below bear evidence. In the first half of the current financial year the company delivered a 53% year on year increase in revenue to $45.2 million, and an 86% increase in EBIT (earnings before interest and tax) to $8 million. Net profit after tax came in at $5.0 million.





Source Company Presentation

And a trading update in May revealed that the group is continuing to forge ahead. <u>Management expects the group to chalk up EBIT of between $19.5 million and $21 million for the 12 months</u>

to 30 June 2014. This would equate to growth of 34-45% on the 2013 earnings result, and a quadrupling of profits since the company's maiden profit as a listed company.

The robust forecast though was however slightly below the lofty expectations set by management at the half year. Earlier they had indicated that EBIT was to be in the region of $21 to $23 million.

Profits it seems have been impacted by the 'early termination of camp contracts and the suspension of Megasco's Rosella Exploration drilling program; This clearly unnerved investors who have been used to a one way flow of firm news, with the shares pulling back from around $2.25 to below (and currently around) the $2 mark..

We however are impressed by the overall robust levels of activity at Titan and believe the recent 'downgrade' will prove fleeting with the overall demand outlook in the energy sector very robust.

And the company is making sure it is ready to accommodate this demand. Recently the company purchased a third rig for $5.2 million (cash $2 million, scrip $3.2 million) for the Atlas Drilling business. Management also reports that the pipeline for new business is strong.

Two of the company's rigs are contracted through to June and August 2014 with APLNG, whilst the third will likely be available after completing a well for Origin Energy, with the Metgascos Rosella exploration not proceeding. The rig however has been earmarked to commence drilling in the Northern Territory in July. The company is currently marketing the fourth rig to prospective clients.

In the company's low capital intensive RCH business, room numbers have been expanded to 1,138; and although average room rates have marginally eased, particularly to win larger volume deals, the company is looking to benefit by pushing for preferred supplier status with coal seam gas (CSG) majors. Near term management continue to see significant opportunity in the CSG space in Queensland. The company is also looking to expand interstate, and has submitted tenders in Western Australia, South Australia and the Northern Territory.

The company's Nektar business also continues to grow, and recently secured a 200 room permanent camp at Reedy Creek (also APLNG). An increasing mix away from higher margin temporary camps has however dampened earnings slightly, whilst increasing stability thereof.

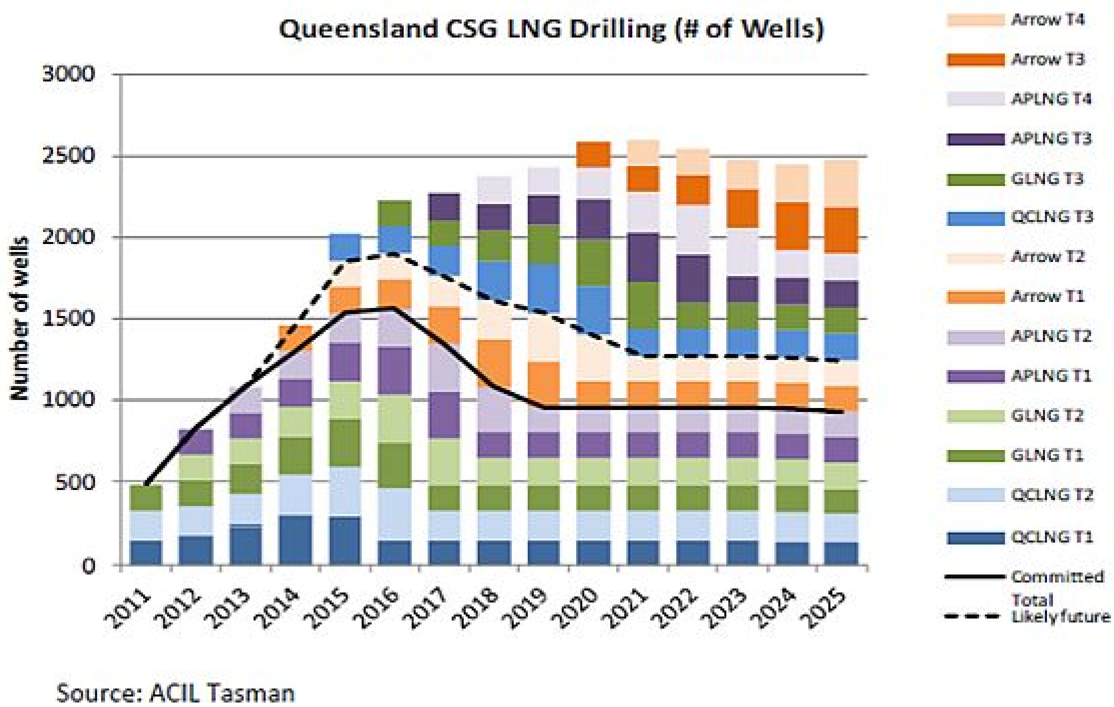
The company also reports that Hofco is progressing well, and is looking to invest in the inventory of down-hole tools available for rent, to meet demand in the CSG sector. The company's waste and water transport business has meanwhile gotten off to a good start, securing four contracts and set to make a 'modest' profit in the second half.

Outlook

Whilst management have pegged back the full year forecast, the medium term earnings outlook for Titan Energy Services remains robust in our view. Earnings upside has been provided by an investment in capacity across the business both in terms of drilling rigs and camp rooms and amenities.

The company has focussed on CSG opportunities in Queensland where activity levels are set to remain strong in the years ahead, even more so if energy prices continue to climb as we expect. There will of course be wells that may not proceed (such as Arrow LNG which is less likely) but Titan is looking to insulate itself against such disappointments.

Titan is also looking to leverage its reputation by expanding interstate (it has recently won business in Western and Southern Australia) as well as offshore.



Source Company Presentation

Balance Sheet and cash flow

<u>From a balance sheet perspective Titan is solid in our view with net debt of $10.6 million at the half year translating to a gearing level of 19%.</u> This is more than manageable and less than the company's first half operating cash flow of $11.7 million. The relatively low levels of debt also leave ample headroom for further organic investment or indeed value–adding acquisitions.

A strong level of liquidity and cash flows also provides some surety in our view for the current dividend policy. Management has set the target dividend pay-out ratio at 25% of net profits after tax.

Turning to the charts we see that the shares have rotated lower from all-time highs of $3.73 at the end of the last year. Since then the prices have been in a downtrend, which has encouragingly began to slow down over the last few months. Whilst the share price remains confined to a bearish descending triangle, support appears to have been found at $1.85. A sustained move above the $2 region will further improve the technical outlook.

Summary

We believe Titan Energy Services offers an excellent exposure to increasing activity in the oil and gas sector. From a valuation perspective the shares are moderately priced in our view, with a forward earnings multiple of 7.6 times earnings and a 3.7% dividend yield. A modest level of debt provides comfort meanwhile from a risk perspective.

The share price enjoyed a stellar run last year, but has since pulled back following the tapering of current year earnings forecasts. We believe this is a temporary setback and provides a reasonable entry point opportunity for Members.

Accordingly, we recommend Titan Energy as a buy for Members with a higher appetite for risk. The company has a small market cap of just under $100 million and patience should be exercised when buying.

Disclosure: Titan Energy Services is held within the Fat Prophets Concentrated Australian Share and Small/Mid-Cap Models.

Snapshot TTN

Titan Energy Services

Latest Closing Price: $2.03

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Market Capitalisation:$102m

	FY1	FY2
Price to Earnings	7.6	6.1
Dividend Yield (%)	3.7	4.3
Price to Book	1.59	1.35
Return on Equity (%)	21.8	22.6