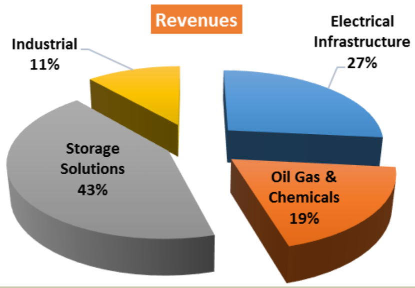
MATRIX SERVICE CO (MTRX: NSQ)

SECTOR: ENERGY SERVICES

Since:	1984
Beta (Public Source):	0.75
Valuation Type:	Value
YTD Change:	-50%



Company Description

Matrix Service Company provides engineering, fabrication, infrastructure, construction, and maintenance services primarily to the oil, gas, power, petrochemical, industrial, mining and minerals markets. The four reportable segments include: Electrical Infrastructure, Oil Gas & Chemical, Storage Solutions, and Industrial. The company services around 500 customers with TransCanada being the biggest one (14.8% Sales).

SWOT

Strength	**Weaknesses**
- Low L.T Debt. - Patents (Flex-A-Span, Flex-A-Seal etc)	- Poor business model: a highly diversified portfolio that still is linked to commodity cycles > low Op. cashflow gen. capabilities
Opportunities	**Threats**
- Commodities rebound will directly affect ~70% of revenues. - Acquisitions planned. - Cheaper on balance sheet	- Sustained low commodity prices will affect CFO (negative) - Revenues are on fixed price contracts which if have material risks of delays

Poor Man's Valuation:

(millions $) Basic Valuation	Cash From Operations 5 Years	Capex 5 Years	Free Cash Flow 5 Years	2016 Current Assets - All Liabilities	WACC	Debt	Shares Outstanding (m)	Expected Market Cap.	Share Price	Cheap or Expensive
Historical	190	91	99	90		44	26.53		$ 8.20	Cheap
Forecasted										
Base Case 20 Years	760	364	396	90	10%	44	26.53	258	$ 9.72	18%
Bull 40 Year Forecast (+100%)	1520	728	792	90	10%	44	26.53	504	$ 18.98	132%
Bear 40 Year Forecast (-40%)	456	218	238	90	10%	44	26.53	159	$ 6.01	-27%

Investment Summary

How can a business be valued at its net current receivables? Or is it that the lemmings are headed the other way? Right or wrong, a business offered with a price tag of $580 million now comes to market at $220 million? All that in a span of few months? A lousy business for sure, the revenues have risen 15% compounded annually for the last five years whereas CFO to revenues has averaged 3.4% and FCF to Revenues has averaged a dismal 1.7% during the time. Storage Solutions, Oil& Gas and Industrial Segments are commodity price dependent whereas Electrical segment saw a large loss ~$18m causing asset managers to dump the holdings. What makes the case interesting is a strong balance sheet, the firm buying out smaller firms (the only way to expand topline in cyclical downturn) and the liquidity value of the firm ((Current Assets |*excluding goodwill/intangibles*|) + Net PPE- All Liabilities) hovering around $170m. At 10% cost of capital, the market prices yearly free cashflows in range of $22m which -considering the firm going negative FCF ~$30-40m and CFO $20-30m next year – seems reasonable in short run but appalling on a longer horizon. I do not have the skill to bottom fish, so giving two straight years of negative FCF, yields a meagre bottom-line price of $11 a share. With current lowest (self calc.) margin of safety around $3, I feel the herd has sold too much too soon and will continue to do so in near future. The company still operates four different portfolio operations and has registered revenue growth in all of them over the last 5 years, even though the cashflow generation of assets is poor. The main question is, what would you pay for an enterprise that carries (high certainty) receivables $229m and generates negative free cashflow for next two years while carrying property (net) & intangibles worth $100m and a cash register that already pays off all the debts? Off course if I get my money (receivables) back, then I'm buying the entire future free cashflow generating capabilities of the enterprise for free. Timing the purchases is an issue, however since the lemmings are *fast* headed the other way, this gives for an outstanding buying opportunity.

CHEAP

P/E (Current)	22.6
Market Cap (m)	$ 219.45
EPS (TTM)	$ 0.3651
Shares Outstanding (m)	26.60
Free Float (m)	26.06

VALUATION

Base Growth Rate	2%
Wacc	10%
Forecast Period FCF (m)	40
Terminal value (m)	420
PV terminal value (m)	261
Total EV	300
Debt	44
Cash	40
Equity Value	296
Shares Outstanding (m)	26.53
Fair Value Share Price	$ 11

FINANCIALS

ROIC (10Yr Avg)	11.5%
ROE (10Yr Avg)	11.6%
Current Ratio	1.63
Quick Ratio	1.25
Debt/Equity Ratio	14%

Segments Source: Annual Reports

Revenue Split ($m)	2014	2015	2016	2017	2018	2019	2020	2021
Electrical Infrastructure	**205.6**	**257.9**	**349.0**	**383.9**	**422.3**	**464.5**	**511.0**	**613.2**
% Total	16%	19%	27%	32%	34%	34%	36%	39%
%Growth		25%	35%	10%	10%	10%	10%	20%
Oil Gas & Chemicals	**239.7**	**305.4**	**249.8**	**239.8**	**251.8**	**264.4**	**277.6**	**291.5**
% Total	19%	23%	19%	20%	20%	20%	19%	18%
%Growth		27%	-18%	-4%	5%	5%	5%	5%
Storage Solutions	**610.9**	**503.1**	**563.5**	**450.8**	**432.8**	**476.1**	**490.3**	**522.2**
% Total	48%	37%	43%	37%	35%	35%	34%	33%
%Growth		-18%	12%	-20%	-4%	10%	3%	7%
Industrial	**206.9**	**276.7**	**149.6**	**134.6**	**141.4**	**148.4**	**155.9**	**163.7**
% Total	16%	21%	11%	11%	11%	11%	11%	10%
%Growth		34%	-46%	-10%	5%	5%	5%	5%
Total	**1263.1**	**1343.1**	**1311.9**	**1209.2**	**1248.3**	**1353.4**	**1434.8**	**1590.5**

- Expected revenue contraction two years going forward with slight recovery expected thereafter (US infrastructure spending)
- Electrical Infrastructure identified as a growth case whereas others relatively stable with regards to topline (discounting oil price speculation)

Operating Income Split ($m)	2014	2015	2016	2017	2018	2019	2020	2021
Electrical Infrastructure	**7.7**	**-44.3**	**11.1**	**-12.3**	**13.5**	**14.8**	**16.3**	**23.0**
% of Segment Income.	4%	-17%	3%	**-3%**	**3%**	**3%**	**3%**	**4%**
Oil Gas & Chemicals	**9.9**	**7.1**	**-3.5**	**-4.0**	**7.6**	**7.9**	**11.5**	**12.1**
% of Segment Income.	4%	2%	-1%	**-2%**	**3%**	**3%**	**4%**	**4%**
Storage Solutions	**34.3**	**29.1**	**33.4**	**-27.0**	**-26.0**	**28.6**	**29.4**	**31.3**
% of Segment Income.	6%	6%	6%	**-6%**	**-6%**	**6%**	**6%**	**6%**
Industrial	**13.8**	**17.0**	**-0.2**	**-1.3**	**5.7**	**9.9**	**9.6**	**10.0**
% of Segment Income.	7%	6%	0%	**-1%**	**4%**	**7%**	**6%**	**6%**
Total	**65.8**	**8.8**	**40.9**	**-44.7**	**0.7**	**61.2**	**66.8**	**76.4**

- Losses expected across the board in 2017 expectedly followed by eventual recovery leading to stabilization.
- Status quo kept as storage solutions is eventually expected form the highest part of the group operating income.
- Objective is to minimize valuation multiples to come to a base case scenario that is justified by an absence of oil/commodities price recovery.

Model

Revenue Astrology	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	**1263**	**1343**	**1312**	**1209**	**1248**	**1353**	**1435**	**1591**
% Growth	41%	6%	-2%	-8%	3%	8%	6%	11%
EBIT	**59**	**9**	**41**	**-45**	**1**	**61**	**67**	**76**
% Sales	5%	1%	3%	-4%	0%	5%	5%	5%
Depreciation	**19**	**23**	**21**	**19**	**20**	**22**	**23**	**25**
% Sales	2%	2%	2%	2%	2%	2%	2%	2%
Capex	**24**	**16**	**14**	**21**	**22**	**23**	**25**	**27**
% Sales	2%	1%	1%	2%	2%	2%	2%	2%
FCF	**53**	**8**	**16**	**-22**	**-6**	**25**	**38**	**33**
% Sales	4%	1%	1%	-2%	0%	2%	3%	2%

- Negative free cashflow expected going forward ~2years
- Depreciation and capex in line with historical norms: company intends to grow with acquisitions, almost all have been cash paid deals.
- No consideration given for commodity prices recovery.

Reporting Quality

Language in Annual Report	Standard.
Auditor's Opinion	Clear.
ESG & Sustainability reporting	None.

Explanation

> Management has clearly laid down the reasons for sudden delays in projects (Electrical Infra.), mentions its impact however fails to disclose mitigating remedies (insurance, more contracts in line to replace)

> Auditor's opinion was clear.

> Thorough consensus across the board on growth through acquisitions, besides that very few indications as to how future appears to be regarding falling backlog and no/little organic topline growth.