CENTROBANCA
Gruppo UBI Banca

TREVI

Company Update | **Buy (from Hold)**

22 September 2011 | **MARKET PRICE: EUR7.8** | **TARGET PRICE: EUR9.3 (From EUR10.9)**

Encouraging signals, back to Buy

2Q11 results revealed buoyant recovery in both revenues and operating profit. The positive results coupled with some encouraging signals (huge soft backlog, better prospects for Drillmec, new high margin contracts) and share price weakness since our last report in May (-28%), now make Trevi attractive. We therefore upgrade to a Buy rating. We have also revised our estimates to reflect a weaker outlook for Italy, particularly in 2013, greater price pressure and higher tax rate and financial charges with a negative impact on the bottom line of 13% this year and about 19% in 2012-13. We have also reduced our target price to EUR9.3 from EUR10.9, reflecting a higher risk free rate (now 4.9%). However there is still nearly 20% upside to the share price while Trevi's traditional premium to peers has declined to 5% on 2011 EV/EBITDA from >13% at the time of our downgrading last May.

- Trevi's share price has fallen 28% since our rating downgrade to Hold last May. We now believe it is time to resume a positive stance following identification of positive signals in the 2Q11 results and appreciation of management's approach to higher margins.
- Trevi's revenues rose 18.3% in 2Q11, despite a weaker USD, with a sharp increase for Drillmec (+104%) and significant recovery for Soilmec and Petreven. Only Trevi was weak (-5%). EBITDA increased by 9%. Net debt was the highlight of the results, falling to EUR334 million (-18% vs. Mar-11) due to better NWC management.
- Management emphasized the buoyant prospects for oil activities, which should benefit from entry into new markets and the launch of new products. Foundations services should benefit from new contracts which do not include raw materials and by the transfer of Soilmec's low valued-added production to emerging countries. The Trevi division remains weak, however, with tough market conditions in Italy and Europe prompting us to reduce our estimates. Adding higher financial charges and taxes, our 2011-13 bottom line estimates fall 17% on average.
- Our target price has consequently fallen slightly to EUR9.3 per share from EUR10.9. This reduction also reflects a higher risk free rate. At our new target price, Trevi would trade close to a 20% premium to peers, which we believe is fully justified by Trevi's superior growth (7% vs. <4%) and higher EBITDA margins (14-15% compared with 10-12%).
- Potential upside could come from possible large new contracts, primarily the Mosul Dam where Trevi's tender was the most economic presented.

Data

Shares Outstanding (m):	70.2	
Market Cap. (EURm):	545.8	
Enterprise Value (EURm):	942.2	
Free Float (%):	47.1%	
Av. Daily Trad. Vol. (m):	0.2	
Main Shareholder:	Trevisani family 53.1%	
Reuters/Bloomberg:	TFI.MI	TFI IM
52-Week Range	6.8	11.3

Performance

	1m	3m	12m
Absolute	13.8%	-22.2%	-27.5%
Rel. to FTSE IT	16.9%	7.9%	2.9%

Financials

	2010	2011E	2012E
Revenues (EURm)	952.9	1,038.4	1,113.7
EBITDA (EURm)	137.2	146.2	163.3
Net Profit (EURm)	46.3	45.2	59.0
EPS (EUR)	0.7	0.6	0.8
CFPS (EUR)	1.4	1.4	1.6
BVPS (EUR)	5.5	6.5	6.9
DPS (EUR)	0.1	0.2	0.2

Ratios

	2010	2011E	2012E
EBITDA margin	14.4%	14.1%	14.7%
ROI	10.8%	11.4%	12.8%
ROAE	14.1%	11.2%	12.5%
Debt/Equity	1.1	0.7	0.6
Debt/EBITDA	2.9	2.4	2.0

Valuation

	2010	2011E	2012E
P/E (x)	14.7	12.1	9.2
P/CF (x)	7.4	5.8	5.0
P/BV (x)	1.9	1.2	1.1
Dividend Yield	1.2%	1.9%	2.6%
EV/Sales (x)	1.2	0.9	0.8
EV/EBITDA (x)	8.1	6.4	5.6
EV/CE (x)	1.5	1.1	1.1

Source: Centrobanca estimates

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Recent Developments

- Trevi's revenues rose more than expected in 2Q11, largely attributable to Drillmec, which more than doubled its sales. All other divisions were in line with forecasts, with Trevi still down (but stable at a constant exchange rate) and Soilmec and Petreven up by about 10-12%. It should be stressed that the value of production rose 25.5% in the quarter, much more than revenues (up 18.3%), meaning that the group is preparing to carry out new contracts in the coming months, which will translate into revenues in future. The order backlog of EUR940 million (-5% vs. Mar-11) implies estimated order intake of about EUR211 million with a book to bill of 82% (132% in the first half).
- EBITDA increased by 9%, in line with our expectations, but margins deteriorated to 12.7% with a lower margin in the Mechanical division (9.9% vs. 14.6% expected) and Services division in line at 16.7%. Net profit was unchanged from 2Q10, but was 12% below our expectations, as it was adversely affected by a higher tax rate (47.5% vs. 35% expected) which, however, should decline to 35-36% in the full year. It should be noted that Trevi's margins were better than those of its main peers in 2Q11: Bauer's was 11.1% (vs. 10.7% in 2Q10) but the company lowered its forecasts due to unrest, project delays and a weaker order intake, while Keller (operating margin of just 1.2% in the first half) confirmed rising price pressure.
- The best news from the results was the reduction of net debt to EUR334 million (from EUR406 million at Mar-11), well below our expectations, representing gearing of 0.95x, due to a sharp reduction in NWC, particularly in the mechanical division, which benefited from much higher trade payables and lower inventories of finished goods.
- The outstanding EUR70 million bond maturing in Nov-11 with a strike price of EUR11.3 (>40% above the current market price) should be converted through the cash payment of the gap between the strike and the market price (at the time of the conversion, with a cash outflow of EUR21 million based on the current market price). The conversion would create 6.2 million new shares, equivalent to 9.7% of the current shares in issue. Our estimates already assume full conversion of the bond.
- Although the company gave no specific guidance, management stated that it expects sound growth in all divisions in the second half of the year driven by higher volumes. The EBITDA margin should also strengthen due to an improved contribution from the mechanical division, which was diluted by the weak performance of Soilmec in 1H11.

Figure 1. Trevi– 2Q11 results

(EURm)	2Q10A	2Q11A	% Chg.	2Q11E	delta vs CB
Sales	**217.7**	**257.6**	**18.3%**	**242.1**	**6.4%**
o/w Trevi	107.3	101.6	-5.3%	101.8	-0.2%
o/w Soilmec	52.3	58.3	11.6%	59.4	-1.9%
o/w Petreven	20.0	22.0	10.2%	23.0	-4.2%
o/w Drillmec	45.1	91.9	104.0%	62.9	46.1%
EBITDA	**30.1**	**32.8**	**8.8%**	**33.0**	**-0.6%**
Margin (%)	**13.8%**	**12.7%**		**13.6%**	
Net Result attr.	**7.9**	**7.8**	**-1.0%**	**8.9**	**-12.5%**

Source: Company data, Centrobanca estimates

Financial Projections

- The company provided a reassuring message anticipating sound growth for all divisions in the second half of the year and into 2012.
- Drillmec's growth (350 rigs historically built of which 150 hydraulics with a solid 10% onshore market share worldwide) is expected to be driven by a huge soft backlog with strong expansion in new countries (Mexico, Eastern Europe, Russia, Belarus, China, where the company was awarded a contract for 25 hydraulic rigs plus an option for a further 125 rigs, Turkey and Brazil), by the introduction of new products such as the new HH600 which is capable of drilling to a depth of 5,000 meters and can also be used for shale gas (EUR200 million potential market) and customisation of its machinery unlike the standard configuration used by competitors which allows Trevi to avoid disruptive price competition.
- Margin recovery is expected at Trevi foundation, the weakest sector in the first half, due to three key factors: 1) Trevi is implementing new contracts (for example the City Ring metro in Copenhagen, worth EUR90 million) which do not include raw materials and related parties services and which therefore carry higher margins (as the mark up on raw materials was rather limited) while net working capital requirements and the risk of raw material price fluctuations are reduced. We believe that these new contracts are an ideal means of improving long term profitability; 2) management sees no slowdown in the US where it is benefiting from the success of its soil mixing machinery which is used to consolidate old dams. This program should continue in future (Congress is expected to unblock new investments) and should generate robust profitability; 3) Trevi leading position in dam and subway foundations, two segments which are resilient to the macroeconomic slowdown. Nevertheless we believe there are three main risks in the sector: 1) Italy, where visibility remains low. However Italy represents less than 20% of foundations sales and about 11% of consolidated revenues while the current backlog covers the majority of 2012, 2) the weak market situation in Dubai (Trevi is moving its workforce to other countries), and 3) Euro strength which has a negative translation impact: overall, the company has a positive correlation with the US currency (+5% USD implies +EUR6 million in pre-tax profit according to our estimates).
- Soilmec is expected to benefit from healthy demand in the Americas (strong interest in its innovative soil mixing machineries) and in the Far East, offsetting tough market conditions in Europe and the Middle East, and returning to pre-crisis revenues in the coming years. In addition, the group's strategy is now to create small assembly lines in emerging countries in order to be closer to clients and logistic centres and to reduce production cost. The aim is to transfer low value-added production, about 20% of the total, to emerging countries. These initiatives should support long term margins.
- Petreven, a showcase for the innovative products produced by Drillmec, relies on ongoing long term contracts (14 rigs under operation in South America with the main oil players) and therefore should contribute to stabilize the cycle while further developments in new areas are possible.
- We have fine-tuned our sales estimate for this year (revenues could exceed EUR1 billion, or +9%), but we have slightly lowered our 2012-13 forecasts,

mainly reflecting a weaker domestic market, particularly in 2013 when the current backlog will be entirely completed. Our EBITDA projections have been trimmed by an average of 9% in 2011-13 also to take into account higher price pressure in foundation services, with a negative impact on net profit of 13% this year and about 19% in 2012-13, also reflecting a higher tax rate and higher financial charges related to higher guarantee costs for new bids.

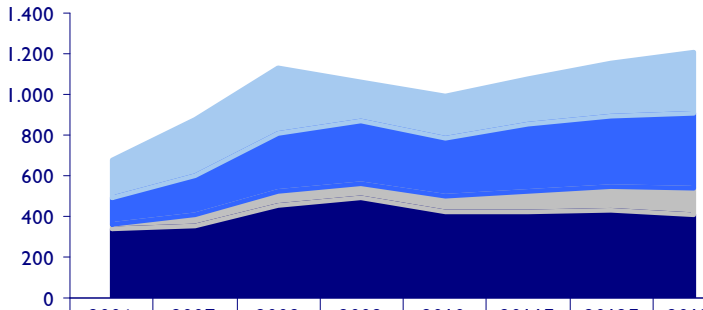
Figure 2. Trevi – Revised estimates

(EURm)	2010A	2011E		2012E		2013E	
		Old	New	Old	New	Old	New
Total Sales	953	1.028	1.038	1.136	1.114	1.222	1.166
% change			1.0%		-2.0%		-4.6%
EBITDA	**137**	**154**	**146**	**180**	**163**	**201**	**179**
% change			**-5.2%**		**-9.4%**		**-11.2%**
Net Profit	46	52	45	73	59	92	74
% change			-12.7%		-18.7%		-19.3%
Net Debt	396	365	354	329	330	247	280
% change			-3.0%		0.2%		13.5%
EPS	**0.72**	**0.74**	**0.64**	**1.04**	**0.84**	**1.31**	**1.05**
% change			**-12.7%**		**-18.7%**		**-19.3%**

Source: Company data, Centrobanca estimates

Figure 3. Trevi – Trend in divisional sales

While the estimated CAGR for 2010-13 consolidated sales is 7%, a stronger performance is expected from Soilmec (14% CAGR) and Petreven (18% CAGR) while Drillmec revenues could rise by 9% and Trevi's could decline slightly. Total Services sales could fall from 52% of the total in 2010 to 45% in 2013. Drilling activities are expected to grow much more than foundations activities (2010-13 CAGR at 11% vs. 4%).



	2006	2007	2008	2009	2010	2011E	2012E	2013E
Soilmec	190.5	280.9	319.2	187.4	202.3	226.6	260.6	299.7
Drillmec	126.6	194.1	288.8	310.5	288.4	330.0	350.0	370.0
Petraven	25.2	46.6	64.9	65.4	80.0	100.0	115.0	132.3
Trevi	338.3	357.6	456.1	495.2	419.5	423.7	428.0	406.6

Source: Company data, Centrobanca estimates

Valuation

- Based on DCF and sum-of-the-parts valuations, we have reduced our target price to EUR9.3 per share (from EUR10.9), reflecting a higher risk free rate (up to 4.9% from 4.3% previously), our new lower estimates and the sector de-rating. Our target price is based on the number of shares in circulation before the conversion of the outstanding convertible bonds expected in Nov-11.
- Despite positive share price performance vs. the FTSE all shares index over the past few months, Trevi's premium to its peers has narrowed to about 5% on 2011 EV/EBITDA compared with >13% last May. The company is also trading at a 15% discount to the average historical multiples of the past three years.
- We consequently believe it is time to return to a positive stance and upgrade our rating to Buy from Hold.

Figure 4. Trevi – Target price

We have given a higher weighting to our DCF valuation as we believe this method better reflects the long term prospects of the oil drilling business which is still in a development phase (Petreven only started operations in 2004 and Drillmec in 2000)

Valuation method	(EUR)	% Weight	(EUR)
SOP	8.87	40.0%	3.55
DCF	9.50	60.0%	5.70
TARGET PRICE			**9.25**
Current market price			7.77
% upside (downside)			+19.0%

Source: Centrobanca estimates

Figure 5. Trevi – Peer comparison

Trevi's only direct peers in the foundation business are Bauer and Keller, while National Oilwell Varco is the leader in the oil drilling sector. However, we have also included oil service companies (Saipem, Technip, Maire Tecnimont), construction companies (Vinci, Astaldi, Impregilo) and construction equipment companies (Caterpillar) in our peer comparison..

	Market Cap.	P/E		EV/EBITDA		EV/sales	
	(EURm)	2011	2012	2011	2012	2011	2012
Bauer AG	297	7.6 x	6.5 x	4.9 x	4.6 x	0.71 x	0.67 x
Keller Group PLC	257	9.5 x	7.7 x	4.0 x	3.6 x	0.29 x	0.26 x
Saipem	12.881	14.1 x	11.9 x	7.7 x	6.3 x	1.32 x	1.12 x
Technip	7.260	15.8 x	13.6 x	7.1 x	5.9 x	0.89 x	0.76 x
National Oilwell Varco	17.961	12.9 x	10.2 x	6.3 x	4.7 x	1.51 x	1.16 x
Caterpillar	37.449	11.8 x	8.8 x	6.2 x	4.7 x	0.97 x	0.78 x
Astaldi	383	5.3 x	4.6 x	3.6 x	3.4 x	0.40 x	0.39 x
Vinci	18.500	9.4 x	8.8 x	5.8 x	5.5 x	0.88 x	0.83 x
Impreglio	670	9.2 x	7.5 x	4.9 x	4.2 x	0.57 x	0.51 x
Maire Tecnimont	205		3.7 x		1.8 x	0.09 x	0.09 x
Median		**9.5 x**	**8.3 x**	**5.8 x**	**4.6 x**	**0.79 x**	**0.72 x**
Trevi	**497**	**12.1 x**	**9.2 x**	**6.1 x**	**5.3 x**	**0.86 x**	**0.78 x**
Premium (discount)		**27.3%**	**11.9%**	**5.3%**	**14.9%**	**8.6%**	**8.9%**

Source: Factset, Centrobanca estimates

Income Statement

(EURm)	2010	2011E	2012E	2013E
Net Revenues	952.9	1,038.4	1,113.7	1,166.2
EBITDA	137.2	146.2	163.3	178.8
EBITDA margin	14.4%	14.1%	14.7%	15.3%
EBIT	84.3	93.7	109.7	128.6
EBIT margin	8.8%	9.0%	9.8%	11.0%
Net financial income /expense	-14.4	-17.0	-17.0	-15.0
Associates & Others	0.2	-4.0	0.0	0.0
Profit before taxes	70.1	72.7	92.7	113.6
Taxes	-24.5	-25.5	-31.5	-37.5
Minorities & discontinued ops	0.7	-2.1	-2.1	-2.2
Net Income	46.3	45.2	59.0	73.9

Source: Company data, Centrobanca estimates

Balance Sheet

(EURm)	2010	2011E	2012E	2013E
Net working capital	402.6	443.7	462.8	469.9
Net Fixed assets	384.0	411.0	402.7	394.5
M/L term funds	-23.8	-25.4	-26.0	-26.8
Capital employed	762.8	829.3	839.5	837.7
Shareholders' equity	354.2	454.1	487.2	533.3
Minorities	12.4	20.4	21.9	24.0
Shareholders' funds	366.5	474.5	509.1	557.2
Net financial debt/(cash)	396.3	354.8	330.3	280.4

Source: Company data, Centrobanca estimates

Cash Flow Statement

(EURm)	2010	2011E	2012E	2013E
NFP Beginning of Period	-443.8	-396.3	-354.8	-330.3
Group Net Profit	46.3	45.2	59.0	73.9
Minorities	-0.7	2.1	2.1	2.2
D&A	45.3	47.4	48.6	50.2
Change in Funds & TFR	0.1	0.2	0.2	0.2
Gross Cash Flow	91.1	94.9	110.0	126.5
Change In Working Capital	10.0	-41.1	-19.1	-7.1
Other	0.0	0.0	0.0	0.0
Operating Cash Flow	101.1	53.8	90.8	119.3
Capex	-41.2	-51.9	-55.7	-58.3
Other Investments	0.0	-21.9	0.0	0.0
Disposals	0.0	0.0	0.0	0.0
Free Cash Flow	59.9	-20.0	35.2	61.0
Dividends Paid	-7.7	-8.3	-10.5	-11.0
Other & Chg in Consolid. Area	-4.8	-0.2	-0.2	-0.2
Chg in Net Worth & Capital Incr.	0.0	70.0	0.0	0.0
Change in NFP	47.5	41.5	24.5	49.9
NFP End of Period	-396.3	-354.8	-330.3	-280.4

Source: Company data, Centrobanca estimates

Financial Ratios

(%)	2010	2011E	2012E	2013E
Net Margin	4.9%	4.4%	5.3%	6.3%
ROE	14.1%	11.2%	12.5%	14.5%
ROIC - after tax	7.2%	7.7%	8.5%	10.0%
Net Fin. Debt/Equity (x)	1.1	0.7	0.6	0.5
Net Fin. Debt/EBITDA (x)	2.9	2.4	2.0	1.6
NOPAT(EURm)	56.4	62.8	73.5	86.1
ROACE	7.4%	7.9%	8.8%	10.3%

Source: Company data, Centrobanca estimates

Per Share Data

(EUR)	2010	2011E	2012E	2013E
EPS	0.7	0.6	0.8	1.1
DPS	0.1	0.2	0.2	0.2
Op. CFPS	1.6	0.8	1.3	1.7
Free CFPS	0.9	-0.3	0.5	0.9
BVPS	5.5	6.5	6.9	7.6

Source: Company data, Centrobanca estimates

Stock Market Ratios

(x)	2010	2011E	2012E	2013E
P/E	14.7	12.1	9.2	7.4
P/OpCFPS	6.7	10.1	6.0	4.6
P/Free CFPS	11.3	nm	15.5	8.9
P/BVPS	1.9	1.2	1.1	1.0
Div. Yield (%)	1.2%	1.9%	2.6%	3.2%
Free Cash Flow Yield (%)	8.8%	nm	6.4%	11.2%
EV (EURm)	1,115.3	942.2	917.9	868.2
EV/Sales	1.2	0.9	0.8	0.7
EV/EBITDA	8.1	6.4	5.6	4.9
EV/EBIT	13.2	10.1	8.4	6.8
EV/Capital Employed	1.5	1.1	1.1	1.0

Source: Company data, Centrobanca estimates

Growth Rates

(%)	2010	2011E	2012E	2013E
Growth Group Net Sales	-8.0%	9.0%	7.3%	4.7%
Growth EBITDA	-24.5%	6.5%	11.7%	9.5%
Growth EBIT	-28.2%	11.2%	17.0%	17.2%
Growth Net Profit	-43.6%	-2.4%	30.6%	25.2%

Source: Company data, Centrobanca estimates

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Date	Rating	TP (EUR)	MKT Price (EUR)
18/09/2010	Buy	11.00	8.50
29/03/2011	Buy	11.00	9.22
19/05/2011	Hold	10.90	10.80