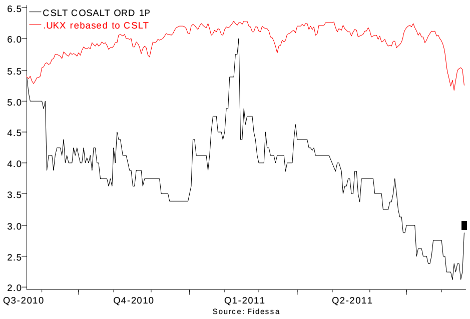
Cosalt plc

3p

19 August 2011

Selling Marine – OFT Clearance



12m High: 6p

12m Low: 2.125p

Market Cap: £12m

Shares in Issue: 404.4m

Gearing: c.40% inc. intangibles after sale

Interest Cover: N. A.

EPIC Code: CSLT.L

Sector: Diversified Industrials

Market: London Full List

Broker: Evolution Securities

PR: Cardew Group

Website: www.cosalt.com

Description: Cosalt provides services to the offshore oil and wind energy industries, and provides workwear, notably under contract to Fire Brigades..

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Cosalt shares became the best performer on the London stock markets yesterday, rising 37% on the news that the Office Of Fair Trading has decided not to refer the sale of its Marine Division to the Competition Commission. The clearance paves the way for Cosalt to receive a cash injection of a net £27m from the sale, and so earn a discharge from its banks' ICU Ward.

The formalities of the sale are likely to be concluded by the end of the first week in September. We expect the Interim Results to be issued shortly afterwards, probably in early or middle September. The interim results will make unpleasant reading – we expect losses of around £5m because of high interest charges and serious cash constraints, plus a further £2.5m of restructuring costs. We expect the Marine Division to be treated as a Discontinued Item. The June 30 balance sheet will be horrifying. But all this will be historic. From early September, Cosalt starts a new life, as a very different company.

It also has the total backing of its chairman and 15% shareholder, David Ross.

Our forecast, below, is very provisional and is subject to a considerable margin of error. We shall extend the forecasts to 2012 as soon as the interim numbers are produced. ▶

Y/E	Group Sales	Declared Profit	Adjusted Profit	Adjusted EPS	P/E Ratio	Dividend	Yield
December	£m	£m	£m	P	X	P	%
Oct 2008A	105.0	1.5	7.2	7.7	0.4	6.0	200%
Oct 2009A	107.8	-3.4	5.5	4.2	0.7	0	0
Dec 2010A*	112.0	-29.4	-0.8	-0.8	-	0	0
Dec 2011E**	47.0	-7.5	-5.0	-1.2	-	0	0

** 14 Months* *** Excluding Marine*

The Background – The 2010 Results

Cosalt's 2010 results, which were announced in May, were awful. But to set against that, an astonishingly good price was achieved for the sale of the Marine Division. This sale has enabled Cosalt to survive a very nasty financial situation.

- In 2010 the Marine Division accounted for 51% of sales, 54% of operating profit before head office costs and 'special items', and 66% of the group's employees.
- The sale price, a net £27m cash, is at a 16% premium to book value, on a p/e ratio of 27 stripping out interest charges and allowing for a normalised tax charge, and on an EV/EBITDA of 12.2. The cash should be received by Cosalt by the end of the first week in September.
- Negatives for Cosalt are that the buyer has not taken the pension scheme, or any debt.

The sale is on a 16% premium to book value and on a p/e ratio of 27

The terms indicate that the buyer, the Warburg Pincus backed Survitec which owns Cosalt's supplier RFD, Seaweather Marine and other similar businesses, will be able to achieve a significant increase it profitability by putting the businesses together. The last Cosalt Audit Report stated that without the deal, there was "the existence of a material uncertainty which may cast significant doubt on the Group's and Company's ability to continue as a going concern".

The figures for the 14 Months to end-December 2010, showed:

- A pre-tax loss of £0.8m before 'special items', worse than we expected, and of £29.4m after 'special items'.
- EBITDA of £5.1m ignoring 'special items'.
- A reduction in Shareholders' Funds from £49.4m to £25.1m; Shareholders' Funds were £9.7m negative if intangibles were stripped out.
- Net debt of £24.3m (£18.6m) and a pension deficit of £9.1m (£11.8m). Debt was up to £30.5m at end-March 2011.

After the sales of the Marine Division, Cosalt has been left with:

- Annualised sales of £47m, three quarters from its Offshore Division and the remainder from Workwear.
- An ongoing operating loss of c.£0.5m before the very significant economies that have recently been effected.
- Bank debt of £7.4m, plus £2m of loans from chairman David Ross and shareholder Sovereign Holding.
- Shareholders' Funds of c.£27m including intangibles, negative ex intangibles.

Cosalt is left with businesses that have sales of £47m a year

2011 First Half Results

Results for the six months to end-June 2011 are likely to be announced in early or mid September. We expect a substantial loss, because the interest charge will be over £1m and management has been totally occupied with the Marine Division sale process. The key points will be the sales revenues and the pre-interest profits of the remaining businesses, Offshore and Workwear.

Resignation of Neil Carrick

Neil Carrick will be resigning as a main board director. He is a past finance director and an executive director, and has intimate knowledge of the group's finances. Cosalt will now need to recruit a strong FD with skills in recovery, because earlier in the year the FD Mike Reynolds also left the company.

Carrick resigns

Offshore

The Offshore Division will be the larger of the group's two divisions following the sale of the Marine Division. Stripping out the Marine Division from the 2010 numbers, it accounted for 78% of sales revenues, and made an operating profit for the 14 months, before 'special items', of £2.1m. The £36m on an annualised basis of sales in this Division is small compared to the money spent servicing the 7,000 fixed and 200 floating platforms in the North Sea. The issue of decommissioning these structures will soon start to become a serious business proposition for those organisations with a presence in the offshore servicing industry.

The Offshore Division will be the larger part of the group going forward

A legal action against two past employees and companies associated with them is currently under way. It concerns an alleged fraud and shortfall of stock and work in progress.

Workwear

The Workwear Division accounted in 2010 for £10m of sales revenue on an annualised basis and an operating profit, before 'special items', of £0.3m. The new contract with the South Eastern Counties Fire Brigades has required £4.5m of additional working capital to date in 2011, and will require a further £4.5m before the end of the current financial year. We expect this contract to be profitable and cash flow positive from 2012 onwards, but to be a significant cash drain in 2011.

Fire Brigades contract will be a cash drain in 2011, cash positive and profitable in 2012

Bank Debt

The rise in net bank debt from £24.3m to £30.5m in the first three months of 2011 was largely explained by the extra funding required for the Fire Brigades workwear contract. Of the £7.4m. of net debt remaining following the sale, £5m will be guaranteed by David Ross and Sovereign Holding, and the £2m loan that the two are making direct to Cosalt will be additional to that. Net bank debt will probably total £9-£10m. by end-December 2011; this ought to be the peak, because the Fire Brigades contract will be cash positive from then on.

Shareholders lend money and give guarantees

Pension Scheme Deficit

Cosalt believes that in past years it has overpaid contributions to its pension fund because of administrative issues within the fund for which Cosalt was not responsible. If it is successful in arguing this case, there may be a reduction in the £9.1m pension fund deficit at some time in the future.

Our Forecasts

The 2011 results will look bad, because for the first 9 months of the year Cosalt will be paying penal interest rates on debt that will peak at £34.5m. Yet the profits from the Marine Division will probably have to be included in the accounts, both Interim and Full Year, as a Discontinued Item. This will almost certainly result in the company declaring a loss for both the Interim and Full Year.

Heavy interest charges for first 9 months of 2011

There will also be some additional reorganisation and redundancy costs, possibly of in the region of £2.5m.

Conclusion

Cosalt gets a fresh start. The new business is undoubtedly in better shape than the old one. We wait with interest to see the direction in which David Ross steers the business.

Cosalt

19 August 2011

Management

Chairman (Non Executive):	David Ross
Chief Executive Officer:	Mark Lejman
	Neil Carrick
Non-executive Directors:	Ken Murray
	Yarom Ophir
	Maurice White

Major Shareholders

Sovereign Holding	18.32%
David Ross	15.08%
Brookwell	10.5%
Henderson Global Nominees	9.0%
Chase Nominees	6.9%
Hanover/Master Fund	6.2%
Barclayshare Nominees	3.9%
BNY Gil Client Account	3.7%

Key Dates

22 July 2011: Annual and Extraordinary Meeting to vote on sale of Marine Division, completion of sale and receipt of proceeds.

FY 2010 Contract announcements:

9 Dec 2009: Babcock Rail, contract to supply specialist PPE over 3 years.

19 Feb 2010: Aker Solutions 3-year contract to supply lifting equipment and tooling in North Sea

10 May 2010: NW Fire & Rescue Services Framework agreement to supply PPE

10 May 2010: Hanson contract to supply PPE Valued at £0.25m over 2-years.

29 Jun 2010: SE Fire & Rescue Services 8-year framework contract for supply of PPE, valued at over £30m.

Other Announcements

1 November 2010: Receives potential offer for the Marine Division.

Key Milestones

Acquisitions:

December 2006: Acquisition of European marine safety business of Bofort.

July 2007: Acquisition of Barcelona-based marine safety business SSM.

September 2007: Acquisition of North Sea oilfield service business GTC.

May 2008: Acquisition of Safety at Height Services business.

June 2008: Acquisition of Norwegian North Sea oilfield servicing business Myrhe Maritime.

July 2010: Forms Cosalt Wind Energy, a JV with Danish engineering company ARPO.

Disposals of legacy businesses:

May 2008: Disposal of Banner school uniform and children's wear business.

October 2008: Disposal of Holiday Homes business.

August 2011: Disposal of Marine business

Share transactions:

December 2006: Placing to raise £1.7m (gross) at 236p.

October 2007: Placing & open offer to raise £25.5m (gross) at 330p.

September 2009: Capital reorganisation – each 25p ordinary share split into one 1p ordinary share and one 24p deferred share.

September 2009: Placing & open offer to raise £18.9m (gross) at 5p.

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