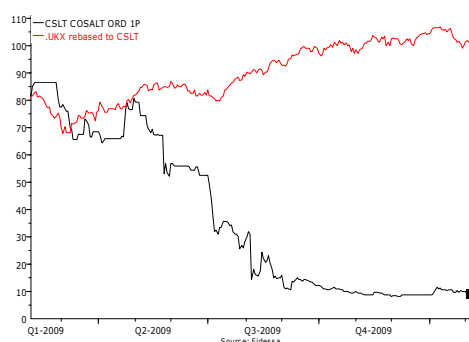


**Cosalt plc**  
Good performance in challenging markets

9p

10 February 2010

**Share Price: 9p**



**12m High:** 86.5p

**12m Low:** 8.275p

**Market Cap:** £36.4m

**Shares in Issue:** 404.4m

**Gearing:** 38%

**Interest Cover:** 3.7x

**EPIC Code:** CSLT.L

**Sector:** Diversified Industrials

**Market:** London Full List

**Broker:** Evolution Securities

**PR:** College Hill Associates

**Website:** www.cosalt.com

**Description:** Cosalt supplies the marine and offshore oil & gas markets with a range of safety and protection products and services. Its marine safety business operates in the top cargo and cruise ports in Europe and it is the only company in the industry with a pan-North Sea oilfield servicing capability.

**Analyst:** Stephen Thomas (Sonia Kaur is on leave)

**Tel:** +44 (0)20 7929 3399

**Email:** Stephen@hardmanandco.com

Cosalt has reported preliminary results for FY 2009 that are, at the operating and pre-tax profit levels, ahead of our forecast, though a higher tax charge brought the attributable result back into line. Revenues recorded growth of 2.7%, to £107.8m. While lower than our forecast, the impact was offset by more resilient margins.

The story for Cosalt Marine was one of limited revenue growth – with reduced shipping volume on the back of lower freight rates, but strong improvement in margin and contribution after costs were taken out. The division secured a number of contract wins and extensions and launched a number of new products.

Cosalt Offshore suffered from reduced project expenditure as oil prices fell at the start of the year. Revenues increased by 6%, but margins fell sharply, dragging down the contribution. This division, too, secured a number of significant contract wins and extensions, and has launched new services.

Cash flow benefited from the £17.1m of placing proceeds. This helped the Group to return its balance sheet payables to more normal levels. It also enabled a significant reduction in net debt.

The fund raising has significantly strengthened Cosalt's balance sheet, with the proceeds used primarily for creditor and debt reduction. Seen against the interim results, the Group's quick ratio has improved from 1.0x to 1.4x, while net gearing is down from 99% to 38% and the Group ended the period with cash of £1.5m.

Strengthened management's focus is now on growing the business and delivering additional cost savings. Key to the former is the introduction of new products and services, developing the ability to follow offshore customers into new oil & gas regions and the expansion of existing customer accounts by building on cross-selling opportunities.

Given the continuation of challenging market conditions in both of Cosalt's divisions, we have taken a cautious approach in our FY 2010 forecast. We have reduced revenue expectations by 7% but kept margins broadly constant. After a reduction in expectations for head office costs, our net reduction of EBITA is 7%, to £9m. We have also raised the anticipated net interest charge, to leave our adjusted PBT forecast 20% lower, at £6.0m. We expect the Group to be cash flow positive this year, without any share issue proceeds, reducing net gearing further, to 33%.

Given the recovering outlook, and the strengthened balance sheet, we assess our PER-based Fair Value Price for the shares at 10p. This gives upside of 11% from the current level, and is c34% above the 6.7p ex issue price at the placing and open offer.

Y/E	Group Sales	Declared Profit	Adjusted Profit	Adjusted EPS	P/E ratio	Dividend	Yield
October	£m	£m	£m	p	x	p	%
2008A	105.0	1.5	7.2	7.7	1.2	6.0	66.7
2009A	107.8	(3.4)	5.6	4.2	2.1	0	0
2010E	110.3	5.4	6.0	1.1	8.5	0	0
2011E	No forecasts						

Cosalt

10 February 2010

Cosalt's preliminary results for the year to October 2009 were in-line with our EBITDA forecast, at £11.44m, after lower than expected revenue, at £107.8m, was offset by a more robust margin performance. Lower than expected charges for depreciation and software amortisation, and for net interest, left underlying pre-tax profit, at £5.55m, some 5% ahead of our forecast, but this was offset by a higher tax charge – to leave underlying EPS in-line, at 4.20p. The figures are summarised in Table 1, below.

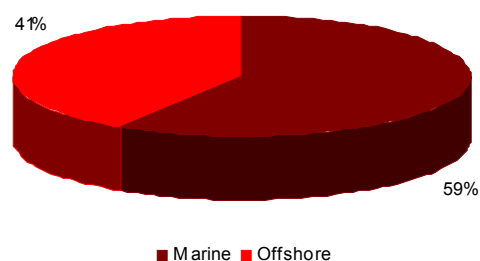
Table 1: Preliminary results

£m		FY 2009	FY 2008	% change
Revenue	Marine	63.60	63.16	+0.7
	Offshore	44.27	41.85	+5.8
	<b>Group</b>	<b>107.87</b>	<b>105.01</b>	<b>+2.7</b>
EBITA	Marine	4.86	2.10	+132.0
	Offshore	5.32	8.34	-36.2
	Central costs	(1.55)	(0.93)	+66.5
	<b>Group</b>	<b>8.62</b>	<b>9.50</b>	<b>-9.2</b>
Net Interest		(3.07)	(2.27)	+35.7
<b>Underlying pre-tax</b>		<b>5.55</b>	<b>7.23</b>	<b>-23.3</b>
Adjusted EPS		4.20p	23.24p	

Source: Cosalt plc

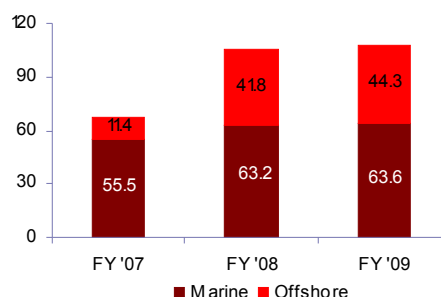
There was very little change in the relative revenue contribution of the two divisions between the two periods. As shown in Chart 1, the split in FY 2009 was 59:41 in favour of Marine. In FY 2008, it was 60:40. Chart 2 illustrates the growth in revenue of the two divisions for the period covered by the new structure. We estimate that, after stripping out the benefit of a full-year contribution from Myhre-Maritime, the underlying performance of Offshore represented a fall of almost 6% y-o-y.

Chart 1: Revenue Split FY '09



Source: Cosalt plc

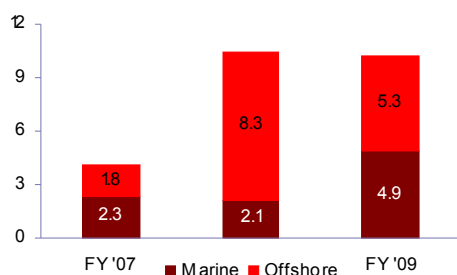
Chart 2: Revenue Growth (£m)



Source: Cosalt plc

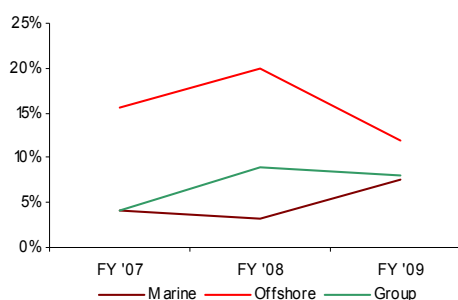
Chart 3 examines the EBITA contribution of the two divisions over the same period, which shows considerably greater volatility, and this is amplified in Chart 4, which looks at the relevant margin performance. The Group EBITA margin is struck after central costs. The performance of the two divisions is discussed below.

Chart 3: EBITA Performance (£m)



Source: Cosalt plc

Chart 4: EBITA Margins



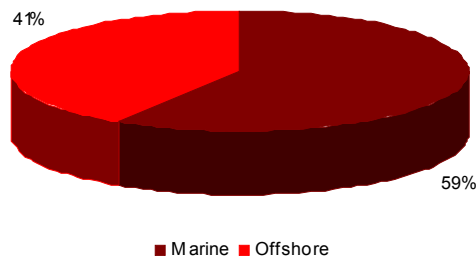
Source: Cosalt plc

**Cosalt Marine**

Cosalt Marine comprises four business units. The core Marine business, which accounts for 61% of revenues, is split between UK and Europe; in addition, there are the Workwear and Crewsaver businesses. A broad split of the business between marine (UK and Europe) and other activities (Workwear and Crewsaver) is shown in Chart 5.

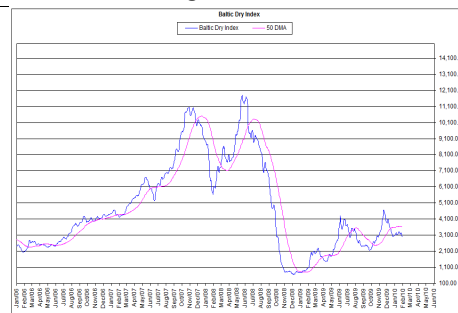
Shipping volumes, and cruise activity are major drivers for c60% of the division's business. The decline in shipping volumes toward the end FY 2008 is clearly indicated by the Baltic Dry Index, in Chart 6 which shows it remaining at a significantly lower level in FY 2009, and into FY 2010, although the 50-day moving average does detect a slow upward trend. Anecdotally, too, we understand from the Company that a number of ports have reported a very quiet year but with recent early indications of recovery.

**Chart 5: Marine Revenue Split**



Source: Cosalt plc

**Chart 6: Baltic Freight Rates**

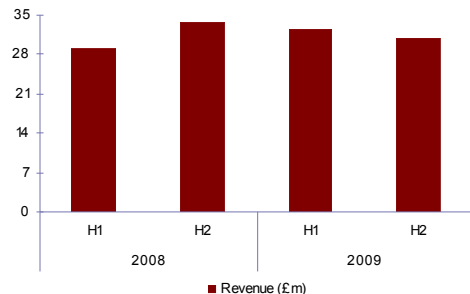


Source: www.rubbertnet.com

So, how did Cosalt Marine fare against this background? We examine this in the two charts below, with Chart 7 tracking the revenue performance over the past four six month periods and Chart 8 relating this to EBITA and margin. They show clearly EBITA and margin tracking the revenue trend in the first three periods before, in H2'10, the benefit of cost reduction measures comes through, to deliver profit and margin improvement despite a decline in sales.

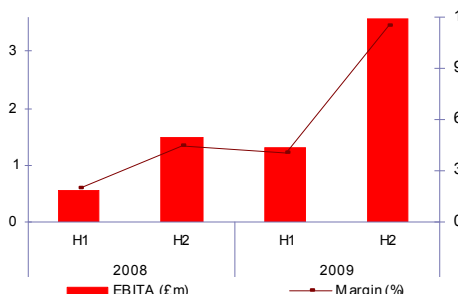
The recent emphasis in the division has been on improving returns in the business, rather than growing the top line; on securing new contracts, or extensions of existing relationships; and on broadening its product offering, including a range of new Crewsader lifejackets and several items of high-visibility clothing. It has also seen an upturn in activity on UK onshore lifting products.

**Chart 7: Marine Revenue Performance**



Source: Cosalt plc

**Chart 8: Marine EBITA Performance**



Source: Cosalt plc

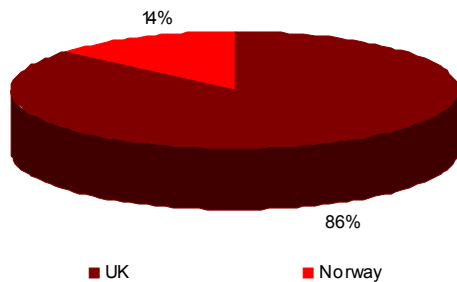
**Cosalt Offshore**

The two business units in this division are UK Offshore, which, as illustrated in Chart 9, is by the largest, and Norway Offshore. Together – operating out of sites in Aberdeen, Lowestoft and Stavanger – these provide a pan-North Sea product and service offering.

The primary driver of activity is the oil price. When this fell back in late 2008, reaching its low in January 2009, customers reduced investment commitments, particularly in higher margin project areas. The Brent crude oil price is tracked over two years in Chart 10. This shows the gradual recovery that has been seen over the past year. To date, though, there has been little sign of postponed activity coming back.

Cosalt also tracks the level of annual expenditure on the UK Continental Shelf. This shows that, looking at the last eight years, total expenditure peaked in 2006, which marked a high point for development activity, while operating costs peaked in 2007. The trend is now gently downwards – giving a driver to expand into servicing its client base in new basins.

**Chart 9: Offshore Revenue Split**



Source: Cosalt plc

**Chart 10: Brent Oil Price (\$/bbl)**

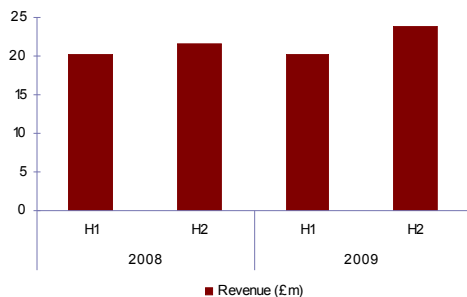


Source: thisismoney.co.uk

Against this background, Cosalt Offshore reported an underlying 6% decline in revenue in FY 2009, and saw EBITA and margins fall sharply as the revenue mix also changed. It did not lose a single contract last year, and has signed a number of three-year agreements or extensions. It should be remembered that most, if not all, of its offshore contracts are framework agreements. This, though, means that Cosalt's fortunes are tied to customers' level of activity. If this falls, then Cosalt's revenue generating capacity will fall, too. During the year, the division entered into a wire rope supply agreement with Bridon, and launched Funis Veritas, a wire rope integrity management system.

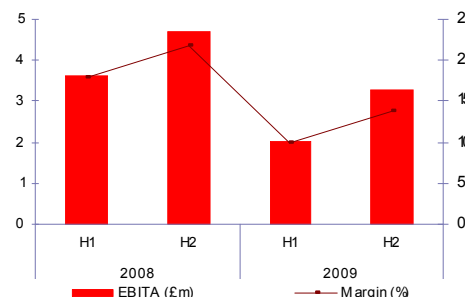
We track Offshore's reported performance over the last four six month periods below. Chart 11 looks at revenue performance, while Chart 12 relates this to EBITA and margin. Revenue picked up in H2'10, having been static in H1'10. The division's activity is second half weighted, because of the level of maintenance in summer, and it can be seen that this has a marked impact on margins, with the larger fall in profitability seen in the H1'10.

**Chart 11: Offshore Revenue Performance**



Source: Cosalt plc

**Chart 12: Offshore EBITA Performance**



Source: Cosalt plc

## Central Costs

There are two elements to these. The first is head office costs, and the second the interest charge.

At first glance, an increase of £0.65m (66%) in head office costs, to £1.55m, looks very steep. However, when compared with £1.36m for FY 2007, the rise over two years is just 14%. We understand from the Company that the FY 2008 figure was distorted by the charge-on of some costs, including pension costs, to the businesses units, including discontinued businesses, and that FY 2009 represents a return to a normal charge. We believe that the underlying position was broadly flat between FY 2008 and FY 2009.

The net interest charge was some 36% higher, at £3.07m. This was a combination of lower interest receivable and a £0.74m (31%) increase in the interest charge. However, we calculate that 80% of this increase is attributable to the increased pension charge. The underlying increase in interest was £0.15m (7%). The average 3-month Libor rate dropped by 416pp (70%). This was, though, offset by an increase in average net debt and by an increase in the margin from March 2009 on the renegotiated banking facility.

## Cash Flow & Balance Sheet

A free cash outflow of £10.3m included a £14.4m reduction in creditors as a result of the Group's strained finances ahead of the placing. Net working capital absorption, however, was only £8.7m as inventories were flat and debtor balances reduced on the slower growth in revenue. Proceeds from share issues (£17.3m) and business disposals (£2.0m) resulted in a reduction in net debt of £9.1m, significantly strengthening the Group's financial position. The position is set out in Table 2.

Table 2: Cash Flow			Table 3: Balance Sheet		
£m	FY '09	FY '08	£m	FY '09	FY '08
Adjusted EBITDA	6.70	(3.36)	Working capital	14.86	5.56
Interest & tax	(6.25)	(3.88)	Goodwill & Intangibles	51.91	52.38
Working capital	(8.72)	7.79	Non current assets	17.77	18.00
<b>Net capex</b>	<b>(2.05)</b>	<b>(4.22)</b>	<b>Net debt</b>	<b>(18.63)</b>	<b>(26.82)</b>
Dividends	0.00	(2.46)	Provisions	(4.74)	(5.29)
Acq'ns & disposals	2.05	(9.20)	Retirement obligations	(11.76)	(6.28)
Share issues	17.33	2.90	<b>Shareholders' funds</b>	<b>49.40</b>	<b>37.56</b>
<b>Move in net debt</b>	<b>9.06</b>	<b>(12.44)</b>	<i>Net gearing</i>	<i>37.7%</i>	<i>71.4%</i>

Source: Cosalt plc

Source: Cosalt plc

This strengthening financial position is visible, too, in the Balance Sheet, summarised in Table 3. This shows the 167% increase in working capital, as the creditor position has been reduced, and the 30% reduction in net debt. It also shows the near halving of net gearing – which peaked at >98% in the H1'09 result – to <38%.

The one balance sheet issue still to be addressed is retirement benefit obligations, where changes in discount rates were the primary reason for an 87% increase in the liability. About 90% of this liability relates to the main, defined benefit, scheme, which was closed to future accruals in 2006. The Company is reviewing its options to manage the liability, while also paying in £1.2m per year to reduce the deficit.

## Dividend

Conscious of the need to conserve cash in a difficult market, and to reduce net debt further, Cosalt did not declare a final dividend for FY 2009. The last dividend declared, and paid in FY 2008, was the interim dividend for that year.

## Prospects & Forecast

The nature of Cosalt's business, and its framework contracts, means that it is largely dependent upon increases in its customers' activity levels to drive growth in revenue.

Cosalt Marine is hearing anecdotal reports of an upturn in shipping volumes and port activity in Europe – notably in Antwerp and Rotterdam – on the back of the recovery in freight rates indicated in Chart 6 on page 3. The more favourable economic outlook as European countries come out of recession can be expected to help a recovery in the cruise market, too, resulting in more port calls and an increase in activity.

For Cosalt Offshore, the recovery in oil prices, shown in Chart 10 on page 4, can be expected to feed through to increased activity in due course – although we suspect that oil companies will remain cautious while they are reporting results depressed by historic prices. There tends, in any case to be a lag between oil price recovery and actual expenditure, given the time taken to plan drilling projects and secure rigs.

Cosalt, though, is not solely dependent upon external market conditions. There is a considerable amount of "self help" that it can initiate. Under this heading, we would include the winning of new contracts, the extension of existing agreements, the launch of new products – including the introduction of more "own label" equipment to meet customer resistance to the pricing of branded alternatives – and the growth of customer accounts by cross selling of the range of products and services.

In addition, there is scope for Cosalt to strengthen its market position by increasing its focus on regulatory-driven products and services; by continuing to take an active part in the ongoing consolidation of the safety sector into fewer and larger players; and by positioning its Offshore business to follow its customer base into new oil and gas provinces outside the North Sea. We also understand that the business is looking at opportunities to extend its activities into the offshore wind power generation arena.

Then, there are the further opportunities to reduce the cost base. The market is already seeing the benefit of steps taken in Marine, and there is further scope from a rationalisation of the depot network. The Group has also said that further cost reduction measures will be implemented in 2010, including extending the process to the Offshore business.

## Forecast

Table 4: FY 2010 Forecast		New	y-o-y	Old	new / old
		£ m	change	£ m	change
Revenue	Marine	62.50	-1.7%	64.46	-3.0%
	Offshore	47.81	+8.0%	54.86	-12.9%
	<b>Group</b>	<b>110.31</b>	<b>+2.3%</b>	<b>119.32</b>	<b>-7.6%</b>
EBITA	Marine	5.15	+6.0%	2.90	+77.6%
	Offshore	5.61	+5.5%	8.78	-36.1%
	Central costs	(1.76)	+13.3%	(2.00)	-12.0%
	<b>Group</b>	<b>9.00</b>	<b>+4.4%</b>	<b>9.68</b>	<b>-7.0%</b>
Net Interest	(3.00)	-2.4%	(2.20)	+36.4%	
<b>Underlying pre-tax profit</b>		<b>6.00</b>	<b>+8.1%</b>	<b>7.48</b>	<b>-19.8%</b>

Source: Hardman & Co

At this point, given the continuing tough market conditions, we have chosen to be cautious on our FY 2010 forecast, and to defer releasing a forecast for FY 2011. We have reduced our earlier FY 2010 forecast, as set out in Table 4, with the overall impact on underlying PBT being a reduction of almost 20%, on a reduction of 7.6% in revenues, as margins have been rebalanced – with an increase in Marine (4.5%→8.2%) but a reduction in Offshore (16.0→11.7%).

We expect the business to be cash generating in FY 2010, with a net inflow of £1.35m. The resulting reduction in net debt is forecast to bring net gearing down to just under 33%.

Cosalt

10 February 2010

Management	Major Shareholders
<p><b>Chairman (Non Executive):</b> David Ross</p> <p><b>Chief Executive Officer:</b> Mark Lejman</p> <p><b>Finance Director:</b> Mike Reynolds</p> <p><b>Executive Director: Cosalt Offshore</b> Calum Melville</p> <p><b>Executive Director &amp; Company Secretary</b> Neil Carrick</p> <p><b>Non-executive Directors:</b> Simon Gilbert Yarom Ophir Maurice White</p>	<p>David Ross 15.08%</p> <p>Other directors 1.40%</p> <p>Cazenove 18.16%</p> <p>Hanover General Partners 6.91%</p> <p>Henderson Global Investors 5.15%</p>
Key Dates	Key Milestones
<p><b>2 February 2010:</b> Preliminary results</p> <p><b>March 2010:</b> Interim Management Statement</p> <p><b>April 2010:</b> AGM</p> <p><b>July 2010:</b> Interim results</p> <p><b>September 2010:</b> Interim Management Statement</p>	<p><b>Acquisitions:</b></p> <p><b>December 2006:</b> Acquisition of European marine safety business of Bofort.</p> <p><b>July 2007:</b> Acquisition of Barcelona-based marine safety business SSM.</p> <p><b>September 2007:</b> Acquisition of North Sea oilfield service business GTC.</p> <p><b>May 2008:</b> Acquisition of Safety at Height Services business.</p> <p><b>June 2008:</b> Acquisition of Norwegian North Sea oilfield servicing business Myrhe Maritime.</p> <p><b>Disposal of legacy businesses:</b></p> <p><b>May 2008:</b> Disposal of Banner school uniform and children's wear business.</p> <p><b>October 2008:</b> Disposal of Holiday Homes business.</p> <p><b>Share transactions:</b></p> <p><b>December 2006:</b> Placing to raise £1.7m (gross) at 236p.</p> <p><b>October 2007:</b> Placing &amp; open offer to raise £25.5m (gross) at 330p.</p> <p><b>September 2009:</b> Capital reorganisation – each 25p ordinary share split into one 1p ordinary share and one 24p deferred share.</p> <p><b>September 2009:</b> Placing &amp; open offer to raise £18.9m (gross) at 5p.</p>

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