

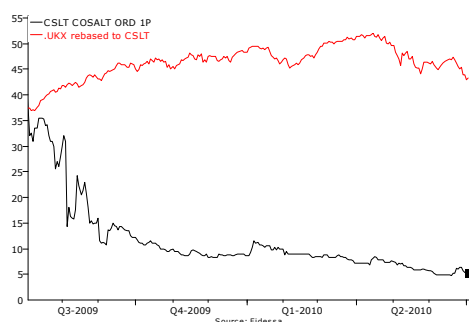
**Cosalt plc**

**5.125p**

7 July 2010

**Further Thoughts On The Interim Results**

**Share Price: 5.125p**



**12m High:** 52.5p (pre share issue)

**12m Low:** 4.75p

**Market Cap:** £21m

**Shares in Issue:** 404.4m

**Gearing:** 41%

**Interest Cover:** 3.0x (over last 12-months)

**EPIC Code:** CSLT.L

**Sector:** Diversified Industrials

**Market:** London Full List

**Broker:** Evolution Securities

**PR:** Cardew Group

**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.

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After further thoughts on the Interim Results announcement from Cosalt last week, we have decided to re-issue our 'Flash' research note, with some additional information, some slight differences in division expectations, a slightly higher Full Year 2010 pre-tax profit estimate and, most significantly, a higher 2010 EBITDA estimate.

Last week's announcement showed that while adjusted operating profit, as reported, was flat, at £2.33m, there was like-for-like growth of 4%.

This came entirely from Marine where, helped by cost savings implemented last year, the result improved by over 66%, to £2.07m. In Offshore, a sound performance in Norway and the benefit of cost reductions were insufficient to offset the impact of lower levels of activity in the UK oil and gas sector – leaving the result down by 34%, at £1.29m.

Away from the numbers, Cosalt has been able to announce that the quality of its service has enabled it to retain all contracts that came up for renewal in the first half, as well as winning a number of new contracts.

With the interims, Cosalt has announced its most significant workwear contract to date – a £30m agreement to supply personal protection equipment and related services to eleven Fire & Rescue services in the south-east of England. Cosalt is now the market leader in this sector, with an estimated 43% share of the market.

The Group says that it is beginning to see signs that the normal upturn in activity in the second half, but it does not yet see evidence of any other significant pick-up in activity in Offshore's UK business.

Our new forecasts predict a reduction of £6.2m (<6%) for revenue and of £1.3m (<11%) for EBITDA. Last week we also issued for the first time forecasts for 2011. We kept these conservative, as well. Details are set out below and on page 5.

Cosalt has headroom of 39% on its £33m banking facility. The new contract will need adjustment to the terms and the scheduled repayments, and there are indications of the support needed for this. Otherwise the facility is more than sufficient to fund its capex requirements.

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	0.7	6.0	117.1
2009A	107.8	(3.4)	5.5	4.2	1.2	0	0
2010E	104.1	0.4	4.7	0.8	6.1	0	0
2011E	109.7	2.2	5.3	0.9	5.4	0	0

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Cosalt's interim results are for period to 2 May 2010. The P&L figures are summarised in Table 1, below. Our percentage comparison figures are adjusted to reflect the fact that the FY 2010 period covered 26 weeks, against 27 in FY 2009. In addition to the performance of the two operating divisions, the table shows clearly how the result has benefited from a lower interest charge after last year's placing reduced average net debt by approximately £10m (35%).

The other feature of the table is the reduction in adjusted EPS, which results from the sharp increase in the WASC – from an adjusted 80.1m to 404.4m – as a result of the placing.

**Table 1: Preliminary results**

£m		H1 2010	H1 2009	% change
Revenue	Marine	30.76	32.59	-2.0
	Offshore	17.58	20.26	-9.9
	<b>Group</b>	<b>48.35</b>	<b>52.85</b>	<b>-5.0</b>
Adjusted EBIT	Marine	2.07	1.30	+66.2
	Offshore	1.29	2.03	-33.9
	Central costs	(1.03)	(1.00)	+7.2
	<b>Group</b>	<b>2.33</b>	<b>2.32</b>	<b>+4.2</b>
Net Interest		(1.54)	(1.87)	-14.2
<b>Underlying pre-tax</b>		<b>0.79</b>	<b>0.46</b>	<b>+78.9</b>
Adjusted EPS		0.20p	0.41p	-49.5

Source: Cosalt plc

Cosalt's core business is the provision, inspection and testing of critical safety equipment (lifeboats, liferafts, lifejackets), tools, lifting equipment and ropes into its two principal operating divisions.

**Cosalt Marine**

Cosalt Marine is the larger of the two, and includes Cosalt's *Workwear* unit, which is focused on the provision and service of workwear and personal protective equipment.

Against the background of continued subdued levels of activity as economies come out of recession, revenues fell by only 2%. The cost reduction measures implemented in the second half of last year, and running on into the current period, had a marked impact on the operating result, raising the underlying EBIT margin from 4% to 6.7% – driving a 66% increase in the reported operating profit, at £2.07m.

Within the division, *Workwear* was slightly down on last year, but *Crewsaver* had a positive start, helped by new product introductions.

**Cosalt Offshore**

Cosalt Offshore serves the offshore oil and gas industry out of bases in Aberdeen and Stavanger. It continues to be impacted adversely by the deferral of capital expenditure by its oil company clients, in response to oil price and other uncertainties. Sales fell by almost 10%, to £17.6m. While the £2.7m drop in revenue translated into a £0.7m fall in contribution, this resulted from a 267 percentage point cut in margins, to 7.35%. Cost savings achieved of £1m were not able to offset fully pricing pressures in a very competitive environment or the impact of lower volumes.

While no geographic figures are available for the interim period, we understand that Norwegian operations are performing well, and that the weakness is within the business serviced out of Aberdeen.

From an operational viewpoint, however, Cosalt can take comfort from the level of contract wins and renewals that it achieved on the back of its record of delivery of quality service.

**Central Costs**

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

At £1.03m, central costs are c7% ahead of the comparative period. The net interest charge, though has benefited from last year's placing. The proceeds from this are the primary reason for a fall of c35% in the average level of net debt. There was a 195 basis point fall in the average rate for LIBOR between the two periods. Even with an element of fixed rates on the loans, this translated into a 14% cut in the net interest charge.

## Cash Flow & Balance Sheet

The net cash outflow, at £1.39m, was significantly lower than in the prior period.

Table 2: Key Cash Flow Items		Table 3: Key Balance Sheet Items	
£m	H1 '10	£m	H1 '10
Cash flow before changes in working capital	2.47	Working capital	16.81
Movements in Working Capital and Provisions	(1.32)	Goodwill & Intangibles	50.85
Interest, tax, pref payments etc	(1.42)	Non current assets	15.91
Net capex	(1.13)	<b>Net debt</b>	<b>(20.00)</b>
Share issues	0.0	<b>Shareholders' funds</b>	<b>49.16</b>
<b>Movement in net debt</b>	<b>(1.39)</b>	<i>Net gearing</i>	<i>41%</i>

Table 3 shows only a small reduction in shareholders' funds since the year-end and a small increase in net debt in line with the normal seasonal trend. The debt figure above excludes a small amount of deferred consideration. The deferred consideration is included in the debt figure on page 5.

Cosalt has committed bank facilities of £33m – a revolving credit facility of £19.9m and term loans of £13.1m. Some £30m of the facilities attract interest at a margin of LIBOR +3.75%, with the balance of £3m at LIBOR +9%. The Group has, though, used hedging to cap the rate on £17m of debt currently drawn down. Within the figures in Table 3, headroom was £13m (39%) at the half year.

## Dividend

Conscious of the need to conserve cash in a difficult market, and awaiting clear signs of an upturn in levels of activity, Cosalt has not declared an interim dividend. 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. The two key indicators for its divisions are the oil price (for Offshore) and, as an indicator of shipping activity, Baltic freight rates (for Marine). Both are continuing to trade within the range seen over the past year, with no major signs of strength.

The interim presentation details seven contracts retained – all of those that have come up for renewal. It also lists eight new awards – of which three, valued at £1m, are one-off contracts. Of the other four, the most significant is the £30m 8-year framework agreement with, initially, eleven South East Fire and Rescue Services. The remaining three, over lives of 2-5 years, have a value of over £1.4m. The Group has also seen an improvement in the tender pipeline and a gradual increase in enquiry levels in some areas, although trading remains subdued.

Within Cosalt Offshore, Norway continues to trade well, and some recovery in UK activities, beyond the normal summer upturn, is expected. BP's Gulf of Mexico incident has introduced a measure of uncertainty as governments review the robustness of their regulatory environments; however, in the longer term, a tightening of regulation is likely to increase demand for Cosalt's products and services.

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## Forecast

Reacting to the cautious outlook expressed by the Company, we believe that it is prudent to trim our FY 2010 forecast. We have reduced anticipated revenue by £6.2m (10%), with the reduction being in Offshore. We have also dropped our expectations for EBITDA and EBIT by £1.3m, spread between both Offshore and Marine. Y-o-y performance figures in the table have been adjusted for a change in the charge-out regime.

Table 4: Forecasts		FY 2010	y-o-y	FY 2011	y-o-y
		£m	change	£m	change
Revenue	Marine	62.50	-1.7%	65.10	+4.2%
	Offshore	41.60	-6.0%	44.60	+7.2%
	<b>Group</b>	<b>104.10</b>	<b>-3.5%</b>	<b>109.70</b>	<b>+5.4%</b>
EBIT	Marine	4.60	+3.1%	5.10	+10.9%
	Offshore	5.20	-2.2%	5.80	+11.5%
	Central costs	(2.10)	+4.5%	(2.20)	+4.8%
	<b>Group</b>	<b>7.70</b>	<b>-10.1%</b>	<b>8.70</b>	<b>+13.0%</b>
Net Interest	(2.95)	-4.0%	(3.40)	+15.3%	
<b>Underlying pre-tax profit</b>		<b>4.75</b>	<b>-13.5%</b>	<b>5.30</b>	<b>+11.6%</b>

Source: Hardman & Co

We have also been cautious in our FY 2011 forecast, now released. We are looking for relatively low growth in revenues from both divisions but for an improvement in margins from a mix of the increased activity levels and the ongoing impact of cost reductions. While we are expecting interest rates to rise – the average rate for LIBOR has already risen by 15% between H1'10 and H2'10, to date and Base Rate increases over the next 12-18 months are forecast to drive further escalation – the Group's hedges are expected to give it significant protection.

We believe that these forecasts are probably conservative. However, following two downgrades we believe it right to err on the side of caution – leaving any adjustment to be on the upside.

We have factored into our cash flow forecasts a level of working capital and capital expenditure requirement to fill the new Fire & Rescue contract. This sees bank debt rising from £24.6m at the half-year to £26.2m at October 2011, on top of a £2.5m reduction in cash balances. These figures suggest that the new contract could be accommodated within existing ceiling of its bank facilities.

However, the Group states, in note 3 to the interims, that the contract will require amendment of the facility, or the availability of alternative finance, given repayments of £6.5m to be made between October 2010 and February 2011. There is also a need to vary the covenants – and particularly that relating to working capital. We understand, though, from the note, that the Company believes that the amendments can be secured on acceptable terms. The Market will be watching these discussions with interest over the next 4-8 months.

## Conclusion

Cosalt's management has been focused on new business gains and control of costs, with a considerable degree of success in both areas – success that should start to be reflected in results as the green shoots of recovery develop further. This starts to be reflected in our, albeit conservative, forecast for FY 2011.

On a longer-term view, the strengthening of regulation on process and equipment safety that is building in the aftermath of the BP catastrophe can be expected to go only one way – with the increasing demands having the potential to be beneficial for Cosalt.

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**Consolidated Financial Statements – Year End October**

£'000	2007A	2008A	2009A	2010E	2011E
<b>Profit &amp; Loss</b>					
Revenue	66,906	105,007	107,827	104,100	109,700
<i>sales change</i>	-46.0%	+56.9	+2.7%	-3.5%	+5.4%
<b>Operating profit</b>	<b>2,700</b>	<b>9,498</b>	<b>8,568</b>	<b>7,700</b>	<b>8,700</b>
<i>operating margin</i>	4.0%	9.0%	7.9%	7.4%	7.9%
Net interest payable	(1,732)	(2,265)	(3,074)	(2,950)	(3,400)
<i>interest cover</i>	1.6x	4.2x	2.8x	2.6x	2.6x
<b>Adjusted profit before tax</b>	<b>968</b>	<b>7,233</b>	<b>5,494</b>	<b>4,750</b>	<b>5,300</b>
Exceptionals	(915)	(5,743)	(8,844)	(4,310)	(3,060)
<b>Reported profit before tax</b>	<b>53</b>	<b>1,490</b>	<b>(3,350)</b>	<b>440</b>	<b>2,240</b>
Underlying taxation	(744)	(1,359)	(1,785)	(1,380)	(1,460)
Tax on exceptionals	208	488	2,548	500	130
<i>effective tax rate %</i>		19%	33%	29%	28%
<b>Continuing profit after tax</b>	<b>(483)</b>	<b>619</b>	<b>(2,587)</b>	<b>(440)</b>	<b>910</b>
Discontinued activities	2,051	(25,641)			
<b>Adjusted earnings per share</b>	<b>1.51p</b>	<b>7.69p</b>	<b>4.20p</b>	<b>0.83p</b>	<b>0.95p</b>
<b>Dividend per share</b>	<b>12.0p</b>	<b>6.0p</b>			
<i>Dividend cover</i>	0.1x	1.3x			

Cash Flow	2007A	2008A	2009A	2010E	2011E
EBITDA	7,734	(3,456)	7,463	10,700	11,900
Adjustments	(2,252)	92	(761)	(1,200)	(1,140)
Interest & taxation	(2,234)	(3,883)	(6,253)	(3,080)	(3,560)
Working capital	(1,541)	7,788	(8,719)	(3,000)	(2,000)
Net Capital Expenditure	(366)	(4,218)	(2,049)	(2,700)	(8,400)
Dividends	(2,674)	(2,462)			
<b>Net Cash Flow</b>	<b>(334)</b>	<b>(6,139)</b>	<b>(10,319)</b>	<b>720</b>	<b>(3,200)</b>
Acquisitions & Disposals	(28,384)	9,198	2,046	(1,600)	(1,400)
Share Issues	29,706	2,901	17,330		

Balance Sheet	2007A	2008A	2009A	2010E	2011E
Working capital	29,924	5,563	17,858	20,860	22,860
Goodwill & Intangibles	40,333	52,382	51,907	49,810	47,710
Tangible non current assets	13,754	9,580	9,402	9,900	14,710
Financial non current assets	7,175	8,416	8,367	8,370	8,370
<b>Net capital employed</b>	<b>91,186</b>	<b>75,951</b>	<b>87,534</b>	<b>88,940</b>	<b>93,640</b>
Net debt + deferred consid'n	(18,200)	(26,818)	(21,629)	(20,910)	(24,110)
Provisions	(5,380)	(5,288)	(4,742)	(4,750)	(4,750)
Retirement benefits	(8,796)	(6,280)	(11,759)	(11,760)	(11,760)
<b>Shareholders' funds</b>	<b>58,810</b>	<b>37,555</b>	<b>49,404</b>	<b>51,520</b>	<b>53,020</b>
<b>Net Bank Gearing</b>	<b>31%</b>	<b>72%</b>	<b>38%</b>	<b>38%</b>	<b>46%</b>

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Management		Major Shareholders	
<b>Chairman (Non Executive):</b>	David Ross	David Ross	15.08%
<b>Chief Executive Officer:</b>	Mark Lejman	Other directors	1.34%
<b>Finance Director:</b>	Mike Reynolds	Lynchwood Nominees	18.32%
<b>Executive Director: Cosalt Offshore</b>	Calum Melville	Cazenove	8.24%
<b>Executive Director &amp;: Company Secretary</b>	Neil Carrick	Chase Nominees	6.90%
<b>Non-executive Directors:</b>	Simon Gilbert	Hanover General Partners	6.23%
	Yarom Ophir	Barclayshare	3.99%
	Maurice White	BNY Gil Client Account (Nominees)	3.71%
		<b>Free Float</b>	<b>36.19%</b>
Key Dates		Key Milestones	
<p><b>2 February 2010:</b> Preliminary results</p> <p><b>18 March 2010:</b> Interim Management Statement</p> <p><b>24 March 2010:</b> AGM</p> <p><b>29 June 2010:</b> Interim results</p> <p><b>September 2010:</b> Interim Management Statement</p> <p><b><u>FY 2010 Contract announcements:</u></b></p> <p><b>9 Dec 2009:</b> Babcock Rail, contract to supply specialist PPE over 3 years.</p> <p><b>19 Feb 2010:</b> Aker Solutions 3-year contract to supply lifting equipment and tooling in North Sea</p> <p><b>10 May 2010:</b> NW Fire &amp; Rescue Services Framework agreement to supply PPE</p> <p><b>10 May 2010:</b> Hanson contract to supply PPE Valued at £0.25m over 2-year s.</p> <p><b>29 Jun 2010:</b> SE Fire &amp; Rescue Services 8-year framework contract for supply of PPE, valued at over £30m.</p>		<p><b><u>Acquisitions:</u></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><u>Disposal of legacy businesses:</u></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><u>Share transactions:</u></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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