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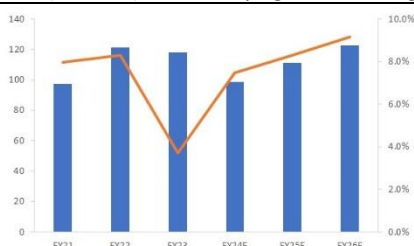
Verbrec Limited

\$4.8m in savings signals turning point

New management, a refreshed strategy and significant cost savings supports the turnaround for the business. We have updated our forecasts for these operational changes. Our DCF derived fair value moves to 21c per share (>150% upside), previously 27c.

- **Strategic review:** A strategic review has highlighted savings of up to \$4.8m in EBITDA from a combination of the divestment of training business Site Skills, overhead reductions and exiting of low margin projects. These cost savings underpin statutory EBITDA growth from - \$4.8m in FY23 to \$5.9m forecast in FY24.
- **Renewed focus:** Verbrec are set to capitalise on strong demand particularly in Asset Management and Infrastructure pipeline services as the need to build and support the gas market transition and electrification. The Site Skills divestment means management can focus on improving Competency Training’s course offering and geographical expansion. The divestment and focus on profitability means revenue is anticipated to decrease from \$118.2m in FY23 to \$98.5m in FY24, however underlying EBITDA margins are expected to improve from 3.7% to 7.5% (Figure 1). The StacksOn software also adds significant growth upside.
- **New leadership:** Recently appointed CEO Mark Read has 30+ years’ experience in engineering and construction, expanding and rebuilding companies. Mark’s skills will be of great benefit to Verbrec along with fresh eyes from a new management team with a new operational focus.
- **Improving cash conversion:** The completion of legal costs from the final legacy project and other additional one-offs in FY24 should propel statutory EBITDA toward underlying EBITDA. Improved cash flow and a planned \$4m capital raise should be sufficient to pay down \$6.7m in debt and support investment in growth.
- **More than 150% upside:** Our DCF derived fair value is \$0.21 per share puts the stock on an EV/EBITDA multiple of 5.6x in FY26, slightly below similar peers’ average. Fair value calculation includes expected cash and share count to be added from full participation in the placement and entitlement offer.

Figure 1. Revenue (\$m, LHS) vs. Underlying EBITDA Margin (% , RHS)



Source: Company data, Veritas estimates.

VBC.ASX

BUY

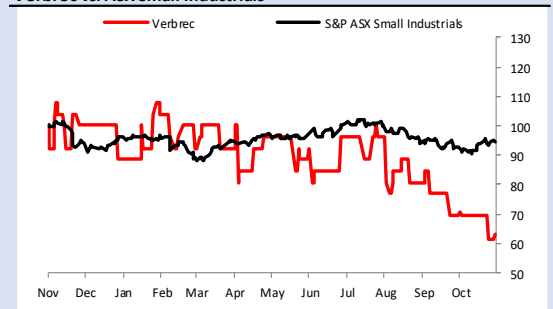
Tuesday 21 November 2023

Share Price \$0.082
 Price Target \$0.21
 Valuation Method DCF

Market capitalisation \$24m
 Enterprise value \$26m
 GICS sector Construction and Engineering
 12 month price range \$0.08 - \$0.14
 Average monthly t/o 0.3m
 Shares in issue 288.1m
 Top 20 holders 177.3m
 Previous rating Buy

Year ended June 30		FY22	FY23	FY24E	FY25E	FY26E
Revenue	\$m	121.4	118.2	98.5	111.0	122.7
Growth	%	24.6	(2.6)	(16.7)	12.7	10.6
Normalised EBITDA	\$m	10.1	4.4	7.4	9.2	11.2
Margin	%	8.3	3.7	7.5	8.3	9.2
NPAT	\$m	(3.2)	(9.5)	3.2	6.7	9.2
EPS	cps	2.1	(0.1)	1.8	2.3	3.2
CFPS	cps	1.4	(1.7)	1.4	2.9	4.3
DPS	cps	0.0	0.0	0.0	0.0	0.0
Franking	%	0.0	0.0	0.0	0.0	0.0
Dividend Yield	%	0.0	0.0	0.0	0.0	0.0
PER	x	3.8	N/A	4.5	3.5	2.6
EV/Revenue	x	0.2	0.2	0.3	0.2	0.2
EV/Gross profit	x	0.6	0.8	0.8	0.7	0.6
EV/EBITDA	x	12.4	N/A	4.5	2.9	2.3
EV/EBIT	x	5.1	177.0	4.5	3.5	2.8
Fixed charge cover	x	7.5	0.2	4.9	9.4	47.1
Return on capital	%	30.7	0.4	29.1	749.3	40.6

Verbrec vs. ASX Small Industrials



Source: Factset, Veritas

Verbrec Limited is a mid-tier engineering, training and infrastructure services business executing work across Australia and the Pacific.

<https://verbrec.com/>

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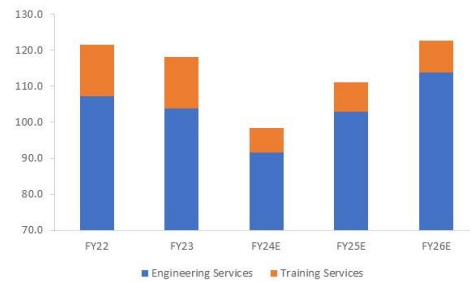
mmoore@veritassecurities.com.au

Expected up to \$4.8m in EBITDA savings

A strategic review undertaken in the previous 6-months has resulted in up to \$4.8m in EBITDA savings.

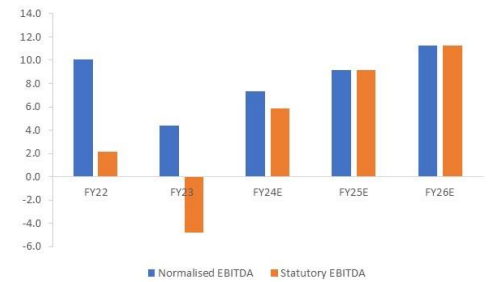
The company has made a determined effort to return to profitability via the divestment of non-profitable assets, optimising operations including the removal of \$1.8m in overheads, phasing out low margin engineering projects and focussing on high margin sustainable growth. Divestments and focus on profitable projects means revenue decreases from \$118.2m in FY23 to \$98.5m in FY24 (Figure 2) while Statutory EBITDA increases from -\$4.8m in FY23 to \$5.9m in FY24 (Figure 3).

Figure 2: Verbrec Segmental Revenue (\$m)



Source: Company data, Veritas Estimates

Figure 3: Normalised and Statutory EBITDA (\$m)



Source: Company data, Veritas Estimates

Divestment of Site Skills to save \$2m

Verbrec entered into a binding agreement to sell assets of its unprofitable training business Site Skills including staff, equipment and training materials to Harness Energy. The divestment is anticipated to result in approximately \$2m in overhead recovery. The divestment of Site Skills contributes c40% to the drop in revenue from \$118.2m in FY23 to \$98.5m in FY24.

Operational review to remove \$1.8m in annualised costs

An operational review undertaken during CEO Mark Read's first 6-months has resulted in overhead reductions of \$1.8m from adjustments to overall headcount and removal of non-essential overheads. We view the streamlining of the business as essential during the company's return to strong profitability.

Clear Air

Associated legal costs from the closure of the final legacy project with Comdain are expected to be completed in FY24. Additional costs such as a payout for ex-CEO Linton Burns has also been expensed in early FY24. The company is now reaching an inflexion point without the overhang of these costs which has plagued statutory EBITDA since FY22. We continue to anticipate approximately \$1.5m in one-off costs in FY24, however we do not forecast one-off costs going forward.

Exiting low margin projects

Significant demand in its engineering businesses (particularly Asset Management and Infrastructure) has meant management are able to exit out of low margin, higher risk activities and focus on more economically attractive projects. Management have noted that their renewed focus on higher margin projects have led to annual EBITDA savings of up to \$1m.

Growth Initiatives

On top of significant cost reductions, the company has flagged several growth initiatives and new key focus areas in their engineering and training businesses. The shift towards gas markets, the increasing prominence of sustainable commodities and the expanding electrification globally stand as central drivers for the company. Revenue growth is expected to be largely driven by growing demand in Asset Management and Infrastructure, with numerous initiatives driving revenue growth in the high-teens for these segments. Post-divestment of Site Skills, we expect engineering services to contribute 93% of revenue in FY24, up from 88% in FY23.

Engineering

The push from Verbrec's key clients to 'net zero emissions' has provided an increase in demand for the company's engineering and infrastructure services. Growth in the market means the company is in a position to turn down work in order to focus on high margin projects.

Asset Management is expected to be a key focus with a clear ability to strengthen and grow in developed geographies in Queensland and Western Australia as well as grow a presence in New Zealand, Victoria and South Australia driven by existing clients. The increasing need for efficiency and maintaining the integrity of assets for clients bodes well for Verbrec's expertise in providing asset management solutions.

Verbrec's pipeline infrastructure services also present a significant opportunity for growth with a large market to support and room for growth with modest investment in equipment required. There are currently 33,777km of pipeline in Australia, in which Verbrec operates and maintains 1,200km and is targeting another 600km. Modest investment of \$0.5m is forecast per year for required vehicles, equipment and tools to expand their market share and support existing contracts.

Training

The divestment of Site Skills is anticipated to reduce the complexity of the training business and creates increased focus on geographically expanding and delivering higher margin courses. The new focus means the company are seeking to expand into New Zealand and Victoria as well as adding business development managers to increase client relationships in existing and new areas. Growth is also expected from expanding the type of training courses offered particularly high demand, high margin courses. The company also has the opportunity to expand internationally through a franchising model, which is economically beneficial for Verbrec with limited capital required.

New Forecasts

We anticipate revenue growth of 13% from FY24 to FY25.

We have updated our forecasts to include the strategic and operational changes. The key elements to our forecasts include:

Moderate revenue growth from FY25 onwards: Divestment of assets (c\$8m in revenue) and focus on profitable projects has revenue forecast to decrease from \$118.2m in FY23 to \$98.5m in FY24. Engineering revenue growth is anticipated to grow between 11-13% from FY25 onwards driven by high demand in Asset Management and Infrastructure Services. Competency Training is forecast to grow at 15% and 12% in FY25 and FY26 respectively, from a renewed focus on its core offering and expanding into additional higher margin courses. As such, we anticipate total revenue of \$111.0m in FY25 and \$122.7m in FY26, above the historical high in FY22.

EBITDA to reach \$11.2m in FY26: Statutory EBITDA margins are forecast to increase to 9.2% in FY26, up from -4.1% in FY23 (including impairment) and 6.0% forecast in FY24. The company still anticipates one-off costs of \$1.5m in FY24, providing an underlying EBITDA margin of 7.5%, up from

3.7% in FY23. Focused investment in higher-margin engineering projects and training courses, the expansion of StacksOn (c50% EBITDA margins) and estimated annualised EBITDA savings up to \$4.8m are key drivers of the projected growth.

Net profit to rise on cost savings: We forecast underlying profit after tax of \$4.7m in FY24, rising to \$6.7m in FY25 and \$9.2m in FY26 primarily due to the improvement in EBITDA margins. It is important to note the company has unused tax losses of \$38.5m at FY23, which we expect to be used over the medium term.

Capex to slightly increase: We forecast capex to stay relatively flat in FY24 at \$1.0m, rising to \$1.1m in FY25 and \$1.2m in FY26 from the purchase of equipment and vehicles to support growth in Infrastructure services and modest investment in StacksOn.

Strong cash flow returns: Verbrec has historically maintained strong operating cash flows which we expect to return after a disappointing FY23 due to significant one-off costs. At FY23, the company held cash of \$4.5m including restricted cash of \$2.9m, required to be held under a Westpac Facility agreement and part of security for the issuance of bank guarantees. We anticipate operating cash flow of \$3.4m in FY24 due to improved quality of earnings and cash conversion. The inclusion of a \$4.0m capital raise provides the company with unrestricted cash on hand of \$2.3m in FY24.

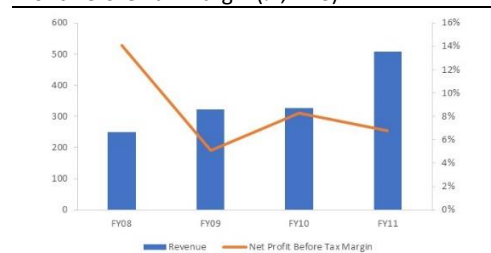
Net cash of \$3.3m in FY25: Verbrec currently has \$6.7m in borrowings and has available \$4.5m in a Flexible Options Facility that can be used for the groups working capital requirements. Importantly, covenants imposed on the Westpac debt include a Financial Debt to Adjusted EBITDA ratio of less than 3.5x and an Adjusted Equity Ratio greater than or equal to 40%. We anticipate the equity ratio to be achieved in FY25 through strong operating cash flows. We forecast \$2.8m in debt to be repaid in FY24 and the remaining \$4.4m of debt to be repaid in FY25. As such, we expect net cash of \$3.1m in FY25.

Proven Management Team

Verbrec’s new CEO Mark Read, appointed in March 2023, has a notable history in the engineering and construction sectors, having held leadership positions at Sedgman and Sinclair Knight Merz.

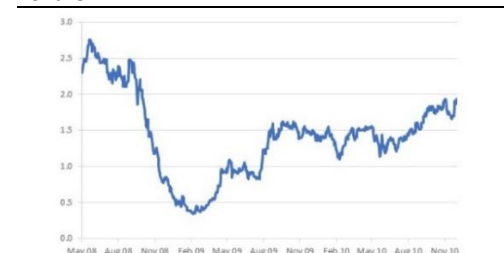
At Sedgman (previously ASX:SDM), a leading provider of mineral processing and infrastructure solutions, Mark served as CEO from May 2008 to November 2010, where he was recognised for renewing the company’s strategic growth and overseeing its global expansion. Despite having to navigate the impacts of the GFC in FY09, under his leadership the company was able to achieve revenue growth of 28% and positive net profit before tax from FY08 to FY09 (Figure 4). In the globally weakened years following, Sedgman was able to continue to grow revenues (16% CAGR from FY09-FY11) and net profit before tax (16% CAGR from FY09-FY11). His successful initiatives in expanding its reach and reinforcing its market position also set the company up for future growth after his resignation, where he budgeted revenue growth of 55% in FY11. Importantly, the share price increased from a low of \$0.34 to \$1.93 at time of Marks departure (Figure 5).

Figure 4: Sedgman Revenue (\$m, LHS) vs. Net Profit Before Tax Margin (% , RHS)



Note: Mark Read joined during late FY08 and resigned early FY11
Source: Company data, Veritas

Figure 5: Sedgman Share Price over Mark Read’s Tenure



Source: Company data, Veritas

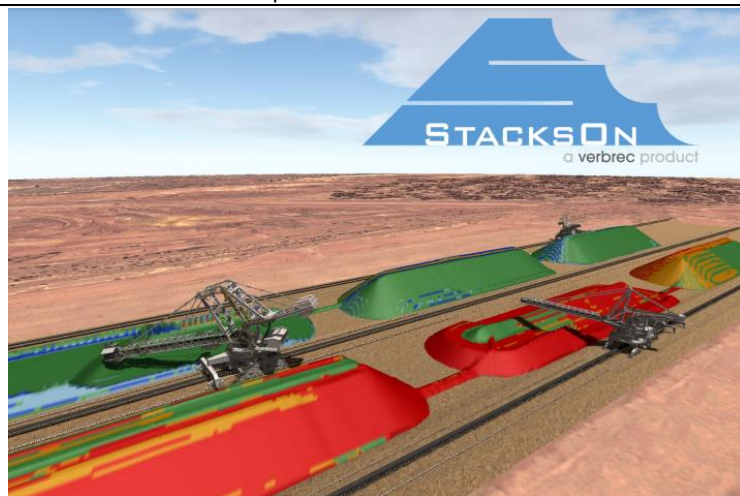
Prior to his role at Sedgman, Mark Read was COO (2000-2004) and later GM Mining and Metals (2004-2008) at Sinclair Knight Merz, a private engineering and consulting firm. Over his 4 years as COO in Asia Pacific, the company achieved revenue CAGR of 20% in the Australian business. In his role as GM Mining and Metals, Mark was able to increase the business unit from \$50m to \$350m in revenue and achieve strong profit growth while growing staff from 350 to over 2000 in his 4-year tenure.

His other experience includes managerial and leadership roles at engineering and construction firms KBR Ltd, GHD and AEP Elical where he led development of struggling businesses, successfully completed mergers and achieved continued revenue growth. We view Mark’s addition to Verbrec as pivotal for the company with his successful track record and extensive industry knowledge to lead the company in a renewed direction.

StacksOn

Verbrec’s 3D stockpile yard modelling software StacksOn is anticipated to provide significant growth upside for the company. The internally developed software provides a solution for companies with stackers and reclaimers to manage the visibility of grade and tonnes of products to allow decisions on reclaim strategies and managing product variability (Figure 6). This is particularly important for managing the grade quality of iron ore prior to being shipped in order to maximise the required iron ore grade tonnage while minimising costs from providing lower grades. Notably, the company has commented StacksOn creates tens of millions of dollars of value for clients by reducing variability and increasing accuracy.

Figure 6: StacksOn 3D visualisation example



Source: Company Data, Veritas

The company is currently contracted with BHP across several of its Western Australian iron ore stockyards and ports with 26 machines. Management is also in discussions with several other major iron ore producers. For Australian iron ore mines alone, there are over 150 stackers and reclaimers which could use the product.

The software is a high margin business unit which we anticipate will generate \$1.58m in revenue in FY24, of which management forecast \$1.06m is annual recurring revenue. Recent indicative offers received for StacksOn suggest a multiple of 6-8x EV/ARR. At the multiple midpoint, this would value StacksOn at \$7.5m, approximately 42% of the current market capitalisation. We believe there is significant upside from further contract wins within BHP and new mining companies.

Potential opportunities also include agriculture, cement, coal and other mining operations which would add approximately 1200 stackers and reclaimers. Client relationships could also see additional opportunities for growth in overseas markets.

Potential growth for StacksOn is impressive. A 25% market penetration of Australia’s total current Iron Ore stackers and reclaimers at an ARR per machine of \$100k would indicate \$3.8m in ARR (Figure 7). We believe current ARR per machine isn’t a true representation due to the current client being a foundation customer and using limited modules. We expect this to improve to the range of \$100-200k ARR per machine in the medium term. Additional market penetration in both Iron Ore and Other sectors as well as expected improvements in ARR per machine would see significant growth.

Figure 7: StacksOn scenario analysis

	Current	Scenario Analysis			
No. of Machines (Iron Ore)	26	38	60	90	150
Aus Market Penetration (150 Total)	17%	25%	40%	60%	100%
No. of Machines (Other)	0	0	24	60	120
Aus Market Penetration (1200 Total)	0%	0%	2%	5%	10%
Total Machines	26	38	84	150	270
ARR per Machine (\$k)	41	100	200	200	200
ARR (\$m)	1.1	3.8	16.8	30.0	54.0

Source: Company Data, Veritas

Fair value of 21c per share

Our DCF derived fair value is 21c per share.

Our DCF derived value for Verbrec moves to 21c per share, previously 27c (Figure 8). The primary assumptions of the DCF include revenue growth fading to 0.5%, a terminal EBITDA margin of 8.5% achievable compared to similar companies, terminal capex to depreciation of 1.0x and a WACC of 11%. Note: the cash and share count used to calculate the fair value includes the expected amount to be added from full participation in the placement and entitlement offer.

Figure 8: DCF valuation for Verbrec

Year end July	Units	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	TV
Revenue	\$m	98.5	111.0	122.7	128.8	133.3	134.7	135.4	136.0	136.7	137.4	136.7
Revenue growth	%	-16.7	12.7	10.6	5.0	3.5	1.0	0.5	0.5	0.5	0.5	0.5
EBITDA	\$m	5.9	9.2	11.2	11.0	11.3	11.4	11.5	11.6	11.6	11.7	11.6
EBITDA margin	%	6.0	8.3	9.2	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5
EBIT	\$m	5.9	7.5	9.4	8.8	8.9	8.9	8.8	8.8	8.6	8.7	8.2
Tax rate	%	0.0	0.0	0.0	0.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
NOPAT	\$m	5.9	7.5	9.4	8.8	6.3	6.2	6.2	6.2	6.0	6.1	5.7
DA	\$m	1.5	1.7	1.8	2.2	2.4	2.6	2.7	2.7	3.0	3.0	3.4
Margin	%	1.5%	1.5%	1.5%	1.7%	1.8%	1.9%	2.0%	2.0%	2.2%	2.2%	2.5%
Working capital	\$m	-1.2	0.0	1.3	0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0
As % of incremental sales	%	6.2%	0.0%	11.1%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Capex	\$m	-1.0	-1.1	-1.2	-1.5	-2.2	-2.6	-2.7	-2.7	-3.0	-3.0	-3.4
Capex/D&A	x	0.6	0.6	0.7	0.7	0.9	1.0	1.0	1.0	1.0	1.0	1.0
FCF	\$m	5.2	8.1	11.3	9.7	6.7	6.3	6.2	6.2	6.1	6.1	5.8
Discount factor	%	90%	81%	73%	66%	59%	53%	48%	43%	39%	35%	
NPV of FCF	\$m	4.7	6.6	8.3	6.4	4.0	3.4	3.0	2.7	2.4	2.1	
		1.8	2.2	2.8	2.6	2.7	2.7	2.6	2.7	2.6	2.6	

Item	Units	Value	Item	Units	Value
NPV of the forecast period	\$m	43.5	WACC	%	11.0
NPV of terminal value	\$m	19.4	Terminal growth	%	0.5
NPV of cash flows	\$m	62.9	Terminal EBITDA margin	%	8.5
Minus net debt	\$m	2.7	Terminal value nominal	\$m	55
Fair value of equity	\$m	60.1	Terminal EV/EBITDA	x	4.7
Fair value of equity per share	\$ps	0.21	Terminal EV/NOPAT	x	9.6
Share count	m	288.1			

Source: Veritas estimates

A 63% EV/EBITDA discount to peers in FY26

Our forecasts for Verbrec’s EBITDA margins are similar to average consensus forecasts for medium to large scale engineering and construction firms, specialising in mining, oil, gas, construction and pipeline industries. Revenue growth is slightly higher as Verbrec rebounds to its FY22 revenue levels from an improved strategy and renewed focus on higher quality projects.

Verbrec trades at an EV/EBITDA multiple of 2.3x in FY26, a 63% discount to the peer group average.

Verbrec currently trades on an EV/EBITDA multiple of 2.3x in FY26, a 63% discount to the 6.4x peer average (Figure 9). Our fair value of 21c per share puts the stock on an EV/EBITDA multiple of 5.6x in FY26, remaining lower than the peer average. Verbrec also looks cheap on an EV/Revenue of 0.2x in FY26 versus the peer average of 0.7x.

Figure 9: Verbrec valuation versus listed peers

Stock	Code	Price LC	Mkt Cap \$m	EV \$m	EV/Revenue (x)				EV/EBITDA (x)				EBITDA Margin (%)			
					FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E
Verbrec Limited	VBC-ASX	0.082	24	26	0.2	0.3	0.2	0.2	4.5	2.9	2.3	4.1	6.0	8.3	9.2	
Monadelphous Group Ltd	MND-ASX	14.40	1,396	1,306	0.7	0.6	0.6	0.6	12.0	10.4	9.2	8.7	6.0	6.2	6.5	6.4
GR Engineering Services Ltd	GNG-ASX	2.25	371	292	0.5	0.6	0.6		7.3	7.1	7.2		7.3	8.2	8.4	
Srg Global Ltd	SRG-ASX	0.655	341	385	0.5	0.4	0.4	0.4	5.3	4.0	3.7	3.6	9.0	9.9	10.0	9.8
Worley Ltd	WOR-ASX	17.15	9,034	10,846	1.0	0.9	0.8	0.8	13.6	11.5	10.2	9.3	7.3	7.8	8.0	8.0
Decmil Group Ltd	DCG-ASX	0.16	25	61	0.1	0.1	0.1	0.1	6.8	3.6	2.5	2.3	1.8	3.5	4.0	4.0
Lycopodium Ltd	LYL-ASX	10.39	413	346	1.1	1.0	1.0	0.9	5.0	4.5	4.7	4.4	21.3	21.9	20.7	21.2
Resource Development Group Ltd	RDG-ASX	0.045	130	223	4.0	1.4	1.5	1.6	11.8	12.4	8.9	10.1	34.1	11.3	16.9	15.7
Average					1.1	0.7	0.7	0.7	8.8	7.7	6.6	6.4	12.4	9.8	10.6	10.9

Stock	Revenue (\$m)				Revenue Growth (%)				Statutory EBITDA (\$m)				EBITDA Growth (%)			
	FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E	FY23	FY24E	FY25E	FY26E
Verbrec Limited	118.2	98.5	111.0	122.7	-2.6	-16.7	12.7	10.6	-4.8	5.9	9.2	11.2	-327.0	221.5	56.8	22.1
Monadelphous Group Ltd	1828.8	2010.1	2195.4	2327.3	-5.2	9.9	9.2	6.0	109.1	125.3	142.3	149.8	-1.9	14.8	13.6	5.2
GR Engineering Services Ltd	551.4	500.0	487.5		-15.4	-9.3	-2.5		40.1	41.2	40.8		-28.1	2.5	-1.0	
Srg Global Ltd	809.0	967.3	1039.9	1090.4	25.6	19.6	7.5	4.9	73.1	96.2	103.7	107.4	-88.7	31.6	7.8	3.6
Worley Ltd	10928.0	12028.6	13391.4	14442.8	20.6	10.1	11.3	7.9	800.0	939.1	1066.9	1161.0	12.0	17.4	13.6	8.8
Decmil Group Ltd	489.2	486.9	613.1	655.2	29.5	-0.5	25.9	6.9	9.0	17.2	24.5	26.2	-120.6	91.1	42.4	6.9
Lycopodium Ltd	327.6	349.0	357.6	371.0	41.1	6.5	2.4	3.8	69.7	76.3	74.0	78.5	53.4	9.5	-3.0	6.1
Resource Development Group Ltd	55.7	159.0	148.0	140.0	9.7	185.6	-6.9	-5.4	19.0	18.0	25.0	22.0	216.7	-5.3	38.9	-12.0
Average	2141.4	2357.3	2604.7	3171.1	15.1	31.7	6.7	4.0	160.0	187.6	211.0	257.5	6.1	23.1	16.0	3.1

Source: FactSet consensus as of market close on 20/11/23, Veritas estimates for Verbrec.

RATING

BUY – anticipated stock return is greater than 10%

SELL – anticipated stock return is less than -10%

HOLD – anticipated stock return is between -10% and +10%

SPECULATIVE – high risk with stock price likely to fluctuate by 50% or more

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