BEACON Securities Limited

Enterprise Group Inc (E-T)

Q3 Underwhelms, But Artic Therm To Heat Story Up

November 15, 2012
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- **Enterprise reported Q3 results that were below expectations.** Revenue was down 10% to $4.3 million. This generated adjusted EBITDA of $1.0 million and adjusted EPS of $0.01. Our forecast was for $6.5 million, $1.6 million and $0.02, respectively. We had expected higher contribution from the utilities division, and higher revenues from the pipeline/E-One heavy equipment rental division. There was no revenue contribution from the Artic Therm acquisition that closed on Sept 13/12.
- The closing of a second, smaller acquisition on the utilities side continues to face delays due to the seller undergoing a corporate reorganization. Closing is expected shortly, with the deal being retroactive to Oct 1/12.
- **In terms of our forecast, we are taking a more conservative view on growth in the core utilities division and a more precipitous decline in the pipeline business.** We do expect the small utilities acquisition to boost results, but the primary driver of substantial top and bottom line growth in 2013 will be Artic Therm. We look for revenue of $1.5 million in Q4/12 and $7.5 million in 2013 from this new division. Overall, we model revenue growth of 6% in 2012 and 62% in 2013.
- **On a TTM basis, the Company has generated EPS of $0.04, without any benefit from the accretive Artic Therm deal.** We forecast EPS of $0.04 (was $0.07) in F2012 and $0.10 (was $0.12) in F2013.
- **We are maintaining our BUY rating, but lowering our 12-month price target to $0.50.** Our target remains based on conservative 5x forward EPS and 4x forward EBITDA. Trading at just 2.8x F2013 EBITDA and 2.5x F2013 EPS, we see little downside risk at current levels.

Q3 Results

BUY (unch) — $0.50 target (was $0.60)

Previous Close	$0.25
12-month Target Price	$0.50
Potential Return	100%
52 Week Price Range	$0.11-$0.28

Estimates

YE: Dec 31	FY11A	FY12E	FY13E
Revenue ($000s)	$17,884	$18,913	$30,589
EBITDA ($000s)	$1,744	$4,515	$10,107
FD EPS	$0.00	$0.04	$0.10

Valuation

	FY11A	FY12E	FY13E
EV/Revenue	1.6x	1.5x	0.9x
EV/EBITDA	16.0x	6.2x	2.8x
P/E	n/a	6.3x	2.5x

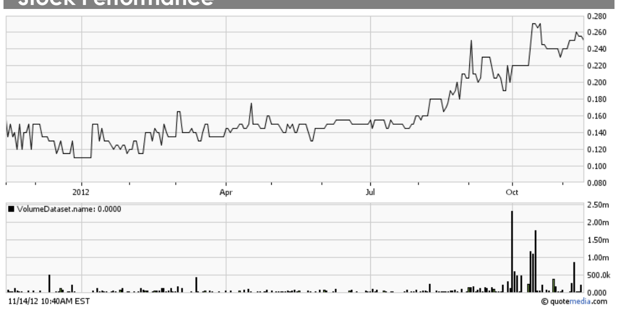
Stock Data

FD Shares O/S	69,002
Market Cap.	$17,251
Enterprise Value	$28,040
Net Debt	$10,789

About the Company

Enterprise is a construction services company in the energy, utility and transportation industries that operates primarily in central and northern Alberta. Headquartered in St. Albert, Alberta, the company operates four divisions and has over 200 pieces of heavy equipment. The Company was founded and went public in 2004, and currently employs over 105 people. www.enterprisegrp.ca

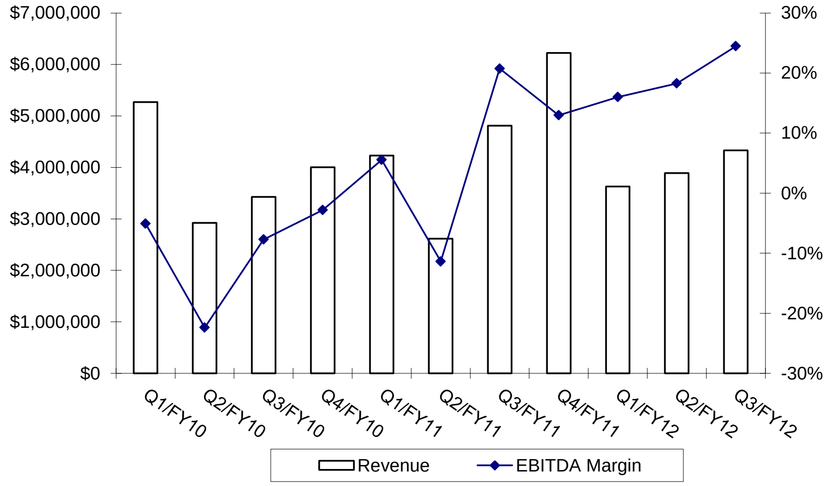
Stock Performance



Financial Results

Q3 sales fell 10% year-over-year to $4.3 million. The utilities segment, which accounted for 91% of sales, grew by 13% y/y. However, the pipeline and rentals division saw sales fall 71%, leading to an overall decline. The results were well below our $6.5 million estimate. Gross margins were solid at 36.3% in the quarter, flat with last year. With operating expenses inline with expectations, when we exclude the $400k in one-time financing and acquisition costs, we saw adjusted EBITDA of $1.0 million (unchanged from one year ago). Adjusted EBITDA margin was therefore 24.5%, up from 20.7% last year. The Company reported earnings of $0.1 million, or breakeven. However, when we strip out one-time costs, we arrive at a normalized EPS figure of $0.01. This was still shy of our $0.02 estimate.

Exhibit 1: Historical Quarterly Performance



Source: Company reports, Beacon Securities

Balance Sheet & Capital Structure

Enterprise ended Q3 with cash on hand of $1.9 million and debt of $12.7 million. This includes $5 million related to the acquisition of Artic Therm during the quarter. During Q4, we will see E acquired another small utilities business for $1 million in total consideration ($0.5 million in cash, $250k in stock and $250k in vendor take-back). EG has a $12.5 million credit facility with PNC Bank Canada at Prime + 2%, under a three year term (maturing September 2015). In Q3, cash from operations was $0.4 million (or $0.7 million prior to non-cash WC items), while capex was $1.3 million. Year-to-date CFO was $2.2 million and capex was $2.4 million. We do expect improved free cash flow in the coming quarters, allowing for a reduction in net debt levels.

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Outlook & Forecast

Given the shortfall with Q3 results, we are lowering our forward estimates as we take a more conservative approach to growth at the legacy utility business. We also cut our forecast for the small pipeline business due to customer pullbacks.. The soon to be completed utilities bolt-on acquisition will be the main driver of growth in that division in 2013. We know that E continues to bid for additional work in the utilities space, which could provide upside to our forecast.

The primary growth accelerator in the coming months will be Artic Therm. We expect that this new rental segment will contribute approximately $1.5 million in sales in Q4 and $7.5 million in 2013. This does not include upside next year should they have demand for additional high BTU units (pre-selling capacity this winter). We expect that within the next two years this business will generate $10-$15 million a year in revenues.

Overall, we look for revenue growth in 2012 to come in at a modest 6%, followed by 62% growth in 2013. With the addition of the high gross margin business in heating rentals, we expect impressive margin expansion in the next several quarters.

Exhibit 2: Beacon Securities' Forecast ($ millions, except EPS)

Dec. Year End	**F2012E - New**	F2012E - Old	**F2013E - New**	F2013E - Old
Revenues	**$18.9**	$25.1	**$30.6**	$36.4
Gross Margins	**38.2%**	38.3%	**44.5%**	43.9%
EBITDA	**$4.5**	$6.3	**$10.1**	$11.8
EBITDA Margin	**23.9%**	25.2%	**33.0%**	32.4%
Net Earnings	**$2.5**	$4.3	**$7.0**	$8.0
FD EPS	**$0.04**	$0.07	**$0.10**	$0.12

Source: Beacon Securities, Company reports

Enterprise has significant tax losses that will offset approximately $9.5 million of future income. Based on our forecast, we do not expect the Company to pay cash taxes until early 2014.

Recommendation and Valuation

We are reiterating our BUY rating, but lowering our 12-month price target to $0.50 (from $0.60). Our target is based on very conservative valuation of just 5x F2013 EPS and roughly 4x F2013 EBITDA. This story now is all about execution, with the growth levers in place and strong fundamentals on the demand side. Trading at just 2.8x F2013 EBITDA and 2.5x F2013 EPS, we see little downside risk at current levels.

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Key Risks

- **Alberta Economic Conditions** – Enterprise's business interests are significantly levered to the general health of the provincial economy, led by the oil and gas sector. The business segments are all subject to economic downturns.

- **Competitive Pressures** – The Company faces competition, from firms big and small, for contracts. Safety, reputation, and pricing are key components to success. There is also competition for skilled labour.

- **Interest Rate Exposure** – Enterprise is exposed to rising interest rates on its credit facility with interest based on Prime + 2%. In the near-term, we believe the risk of rising rates is low.

- **Weather and Seasonal Factors** – Poor weather conditions (extreme cold & wet conditions) can negatively impact operations in any given quarter. The addition of the heating rental business is expected to offset seasonality impacts.

- **Customer Contracts** – The ten largest customers accounted for 76% of revenue during 2011. This is a contract based business, and any change, termination or non-renewal of work can impact results.

- **Acquisition Integration and Strategy** – Enterprise has launched two take-overs in recent months and has other targets in sight. It will be important to integrate the assets well and have a cohesive growth strategy going forward.

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Ending Q3 2012	# Stocks	Distribution
BUY	12	85.7%
Spec. Buy	1	7.1%
HOLD	1	7.1%
SELL	0	0.0%
Restricted	0	0.0%
Total	14	100.0%
*as of quarter end		

BUY	Total 12-month return expected to be >15%
SPECULATIVE BUY	Potential total 12-month return is high (>15%), but given elevated risk, investment could result in a material loss
HOLD	Total 12-month return expected to be between 0% and 15%
SELL	Total 12-month return expected to be negative

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