Vallourec Plc

Analyst: Tomas Mannion +44 203 457 0392 Leading Producer of tubular solutions for the Oil & Gas sector Last Update 2.3.2023

Post Transaction (Expected Structure)

Capital Structure £ mm	Sep-22 Amount	Dec-22 Funded	Book Val. Multiples	Coupon (a)	Maturity	Market Value	Market Value	Market Val. Multiples	YTW	Comment
Cash		(552)				100%	(552)			
Reinstated RCF	462	-		€ + 5%	Jun-26	100%	-			
Other ST borrowings		43				100%	43			
PGE Facility	208	220			Jun-26	100%	220			
ACC ACE	282	282				100%	282			
New ABL Facility	210	-			Nov-27	100%	-			New, arranged in Nov 22, Inventory & Receivables
Reinstated Bonds	1,178	1,135		8.50%	Jun-26	101.5%	1,152		7.9%	Callable Jun '23 at par
Net Debt	2,340	1,128	1.6 x				1,145	1.6 x		
Equity	229	3,205				€ 14.00	3,205			
Enterprise Value		4,333	6.1 x				4,333	6.1 x		
2022 EBITDA	715									

Notes Valuation:	
Sum of the Parts	5,066
plus Cash	552
EV	5,618
Debt	1,680
Debt Recovery	334%

Shareholders: Apollo 26.88%, Other creditors 36%, Nippon Steel 3.4%, BpiFrance 2.3%, previous shareholders 22%

Relevant Credit Statistics

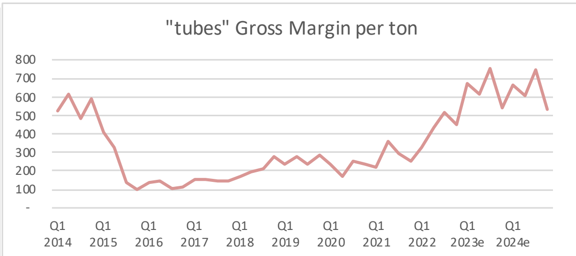
Sum of the Parts

	LTM EBITDA	Market	Valuation	Sarria	Valuation
Tubes	436	10.0 x	4,355	9.0 x	3,920
Iron Ore	118	6.0 x	711	5.0 x	592
		7.1 x	5,066	6.3 x	4,512
Net Debt			1,128		1,128
Equity Value			3,938		3,384
per share		€	17.20	€	14.78
Upsizde/Downside			23%		6%

Quick Valuation:

- Vallourec has two distinct businesses - the core Tubes business and their iron ore mine.
- The core Tubes business can be valued at similar levels to traded peer, Tenaris, that trades at 10-11x LTM EBITDA. However, we note Tenaris has rebounded earlier due to higher exposure in North America.
- Historically, Vallourec has always traded at a discount to Tenaris, given its poorer cashflow generation, and lower exposure to shale gas in the US.
- The iron ore mine is valued at 3-4x, in line with Vale's valuation. We are reducing the multiple by 1x given the exceptionally high iron ore prices and profitability currently been

	FY18	FY19	FY20	FY21	FY22	FY23e	FY24e
Revenue	3,921	4,173	3,242	3,442	4,882	5,518	5,921
Tonnage	2,364	2,291	1,599	1,640	1,804	1,857	1,905
Adjusted EBITDA	150	347	257	492	714	982	1,106
Operating CashFlow	(341)	292	230	(50)	(62)	490	628
CAPEX	(150)	(150)	(210)	1,401	(97)	(200)	(200)
Interest	(175)	(174)	(203)	(95)	(10)	(142)	(146)
Net Change in Net Debt	(666)	(32)	(183)	1,256	(169)	148	282
Net Debt	2,144	2,055	2,348	1,013	1,199	1,051	769
Net Leverage	14.3 x	5.9 x	9.1 x	2.1 x	1.7 x	1.1 x	0.7 x



Investment Rationale

- We maintain our 5% long positon in the bond we took in early October at 94%. There is limited no upside from current trading levels, but for investors looking for safe havens, this yield to call paper has significant strengths. We take added comfort from the high cash coupon, reducing refinancing risk from a cashflow perspective.
- Although Vallourec's Q1 results had significant asterisk attached, Vallourec's 2nd quarter highlighted the performance of their "tubes" business. Vallourec are not expecting full production at their mine to resume until H2 2023, they are expecting to end the year at less than 1.5x leveraged on actual FY22 EBITDA. With their 8.5% bond callable in June 2023 at par, there remains the possibility that the bond will be refinanced at the first opportunity.
- Management has indicated they are comfortable with the market consensus of €600m EBITDA (versus our €675m) and all indications show the Company should actual beat this target. This will allow the Company to easily refinance the bonds in H1 2023. The equity market values the business at near 5.5x, and although we remain cautious on these valuations, the bond has significant cover at only 2.0x leveraged.
- The improvement in performance is driven by the "tubes" business, and the improved Gross Profit per ton metric we have shown in the graph above.
- Due to the increase in Iron ore and energy costs, the cost base for Vallourec has risen substantially. However, it appears that Vallourec are able to pass on these increases, and more, to its customers, given the overall bouyancy of the oil and gas sector.

Opportunities

- Sale of mine: Although throughout the distressed trading of Vallourec, management resisted selling the mine, now that the increased production size is nearly complete, it can't be ruled out. The realisation of this non-core asset would further bolster the balance sheet and has the potential to trigger a special dividend.
  Potential take-out: If Vallourec sold its mine, it would leave the rump of the business vulnerable to consolidation, which given the shareholder structure (majority converted debt holders) would be supportive of quick exit.
- Unrest in Ukraine: Oil prices generally move upwards during times of geopolitic uncertainty. Coupled with any Russian invasion in Ukraine, European gas prices are likely to rise further. This is likely to boost oil demand and oil prices.
- Exploration Recovery: Any recovery in exploration levels, especially in the Brazilian market, would benefit Vallourec. Vallourec is generally viewed as the preferred supplier to Petrobras, and Petrobras have indicated an increase in exploration expenditure over the coming years.
- Significant cost reduction achieved: Vallourec have been in restructuring mode since 2014, and although this leaves the business with very little further cost reduction, Vallourec should benefit from a recovery in margins given the significant costs extracted from the business over the last couple of years.

Risks

- Mine Issues: In early January, following heavy rainfall, some material from a waste pile associated with Valourec's Pau Branco mine slid into a rainwater dam, causing it to overflow, and resulting in damage to a local highway. Thankfully, no structural damage was done to the dam, and there was no causalties. However, operations were temporarily suspended. Vallourec expect operations to restart in the coming weeks without using the waste pile, with full capacity reached during Q2, subject to receiving the necessary consents.
- Share overhang: Former creditors account for over 70% of the shares outstanding and although the largest shareholders have indicated their willingness to view the investment as medium/long term, there could be some selling pressure from distressed investors who view the restructuring trade as over.
- Oil Price: Ultimately, the demand cycle for future oil exploration is driven by level and stability of oil prices. Covid 19 has pushed back investment decisions of large capital expenditures although some positive noises are emerging from both North and South American participants.
- ESG Concerns: Partially linked to oil prices, Vallourec is exposed to the renewed focus on ESG, especially the move away from traditional fossil fuels towards newer cleaner technology. With more and more pressure put on the large IOC (Independent Oil Companies), Vallourec customer base could become smaller and/or less well capitalised.

Shareholder Structure

- Following the debt for equity swap, the shareholder structure is dominated by former creditors.
- Apollo (23.2%) and SVP (12.3% are the largest shareholders with former creditors accounting for a further 36.3%. SVP announced on the 26th May that they were placing c.6.5% of their holdings via GS and Barclays and have subsequently reduced their holdings below 5%.
- The two previous key shareholders, Nippon Steel and BpiFrance have been diluted to 3.4% and 2.3% respectively. Previous existing shareholders account for 22% of the register.
- All of the above numbers are prior to the exercise of Warrants, given to the Commercial banks, with an exercise price of €10.11
- Of the 8 board members, Apollo are able to appoint 2 members, with SVP able to appoint one. Additionally, Apollo and SVP are able to appoint one individual each as non-voting

Recent Trading

- Vallourec reports a strong set of numbers in Q2, secured mainly from the positive trajectory in the "tubes" business. Volume has increased by 13% versus Q2 2021, but more importantly, price has increased by 20%. The numbers are in line with our numbers, with EBITDA coming in at €160m versus €148m in Q2 2021. The mine contributed €34m in Q2 (Q1 was negligible as the mine was closed). If the mine was operating at full capacity, Q2 EBITDA for the mine would have been in the €120-130m range.
- The free cashflow remains negative, but the driving force of the outflow is the large Working capital outflow due to higher volume expectations in the coming quarters which is impacted by the increased raw material prices. The expectation is for cashflow to be positive as Working Capital stabilises at current levels.

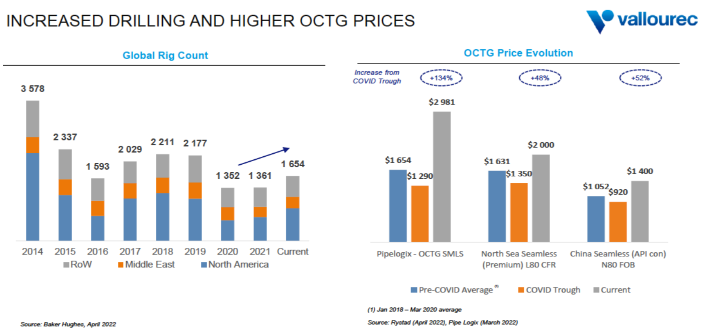
Guidance

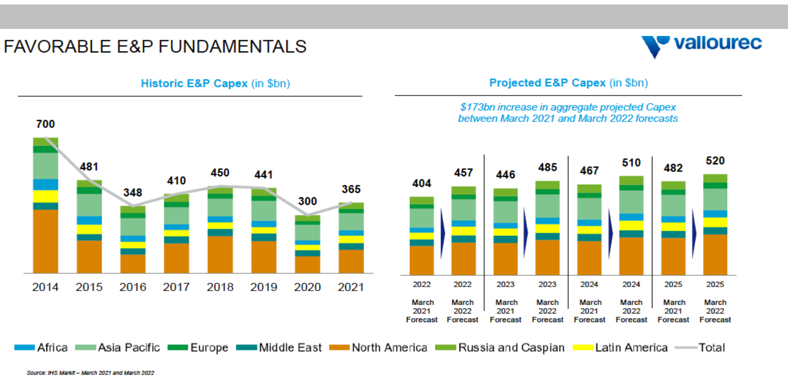
- Vallourec did not provide any guidance at their Q1 numbers due to the uncertainty in the market, but management currently feel comfortable giving a guidance for remainder of FY22. FY22 EBITDA guidance of €650 to €750 million assumes conservative iron ore mine production.
- H1 EBITDA is €205m, with "tubes" generating c.€170m. EBITDA in H2 is guided to €480-580m and as the Company have guided to low single digit contribution from the mine at the EBITDA level, the majority of the EBITDA is from the "tubes" business. This is underpinned by the strong operating environment including strong pricing dynamics.

Description

- Leading global producer of premium tubular solutions primarily servicing the energy market. Company is headquartered in France, but has production facilities globally, with operations in Brazil, North America, China and in Europe.
- Main segment is the Oil, Gas and Petrochemicals, historically accounting for 72% of the revenue. This segment is premium tubes (steel pipes), connections and services for exploration and operation of oil and gas fields, including the most complex. Vallourec has a leading position in extreme conditions of deep wells and corrosive environments with high pressure/high temperature environments. Also in this segment is OCTG tubes for geothermal renewables.
- However, over recent years, the Industry segment, and specifically the mine segment which is not reported separately, but included in "Construction & Other" has increased its share of overall revenue from 20% historically to currently 38% YTD. Apart from the mine, the Industry segment includes the supply of lightweight and resistant tubes for a wide range of applications including mechanical (cranes, agricultural machinery), automotive and Construction of bridges and stadiums.
- Last segment is the declining Power generation segment – which has mainly focused on tubes for conventional and nuclear power plants. Market for conventional power plants under severe environmental pressure. Vallourec has previously tried to sell this business and it is earmarked for closure.
- In China, Vallourec's acquisition of Tianda Oil Pipe (''TOP'') in 2016 (a company in which it previously held a 19.7% interest) has given the Group full access to a highly efficient, state-of-the-art mill with finishing capabilities. Vallourec's facilities in Brazil and China are expected to have production costs that are approximately 30-40% lower than European production costs for comparable products.

Favourable E&P Funfamentals

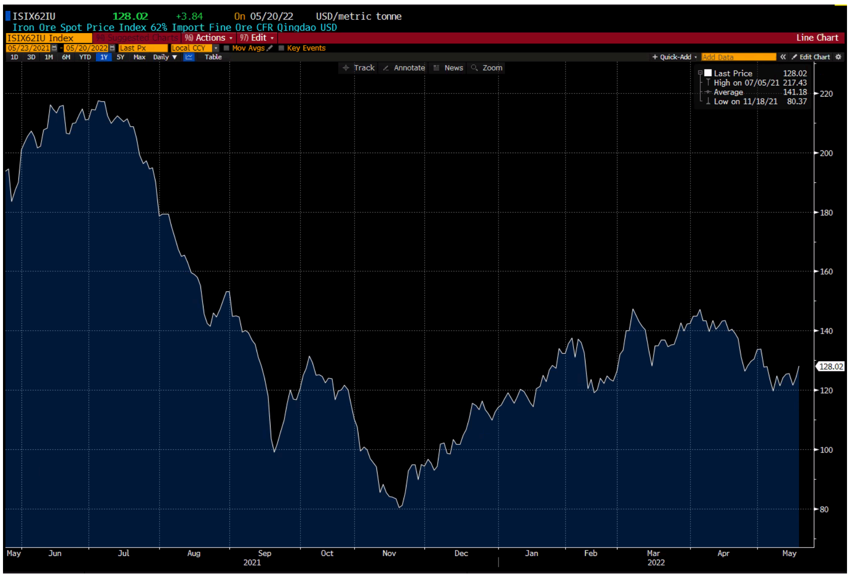




Mining Segment

- Background: Following significant CAPEX investment, Vallourec has increased production capacity of its Iron Ore mine in Brazil from 4.0-4.5mt in FY15-18 to 8mt in FY21 and increasing to 8.5mt in FY22. We estimate that c.3mt are used internally so the percentage increase in spare capacity is more dramatic, from 1.0-1.5mt to 5.5mt, 440% increase. Add in the 70-100% increase in iron ore prices, what was a minor component of the overall Vallourec Group is now the dominating segment.
- EBITDA: The impact on EBITDA is likely to be higher, with margins at the iron ore mine significantly higher than those enjoyed by the rest of the Vallourec Group. Assuming a 50% Gross Profit margin at the iron ore segment, the mining operations of Group Gross Profit increases from 10% to 45%. This would equate with the increased guidance for FY21 EBITDA from the Company which is predominately from the mine.
- With limited SG&A directly associated with the mining operations, the EBITDA associated with mining could be as high as 50% of the overall Group EBITDA.
- Through the restructuring, many analysts called on the Company to divest the mine and/or disclose better segmental information of their mining operations, but our simple analysis highlights the underlying problem of poor EBITDA and cash generation at the remainder of the Group.
- Analysis below: The Company report annually the Gross Tonnage Produced and guidance for FY21 and FY22 (highlighted), with our estimate of how much is used internally and therefore available for sale in the open market. Additionally, sporadically, the Company disclose the price $/t achieved for these sales.
- 50% margin: Our 50% margin assumption may actually be low in light of the increase in guidance from October 2020 to February and April 2021 guidance. IF we take the change from February guidance to April guidance, an uplift in EBITDA of €225m.

Mining Segment		FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22e	FY23e	FY24e
Tonnage Produced (mt)		4.23	4.23	4.00	4.39	4.69	6.27	7.90	8.10	8.50	7.00	8.50
Volume Sold (mt)		1.23	1.23	1.00	1.39	1.69	3.27	4.90	5.10	8.50	5.08	5.50
Price $/t		-	-	-	-	73	93	109	159	115	110	110
Revenue (€m)		298	161	143	210	109	272	462	686	263	387	605
Revenue (% of Group Reve		80%	80%	80%	80%	54%	60%	98%	101%	49%	55%	65%
Gross Profit	45%	134	72	64	95	49	122	208	309	118	174	272
GP (% of Group GP)		**9%**	**16%**	**27%**	**21%**	**8%**	**17%**	**34%**	**37%**	**11%**	**13%**	**18%**



Iron Ore Prices:

- Vallourec has benefitted from expanding its iron ore mine to coinside with a significant rally in commodity prices. Iron ore prices has declined from FY21 highs but are expected to remain in the $130/t range.
- Vallourec's Brazilian mine was closed for majority of Q1, due to slippage in their waste pile. Operations recommenced in early May are expected to be at 100% capacity by the end Q2.
- Capacity has grown from 4mt p.a. to 8.5mt p.a. Vallourec uses 3mt internally, so benefits from selling the balance at current high prices.
- Previous management released limited information on the mine, but early indications point to increased disclosure going forward. We await the Q2 numbers to clarify some of our assumptions on the "iron ore" segment.

Core Group (ex Mining)

- Given the above analysis, difficult to call the non-iron ore business of producing tubes the core business. Deducting the estimated mining revenue and Gross Profit/EBITDA from the figures, highlights the issue Vallourec is facing. The tubes business, mainly in the Oil & Gas segment, should benefit from an increase in exploration activity as guided by the Company and its peers in recent quarterly reports.
- However, this is the same guidance that the industry was expecting in Q4 2020, when the Company produced its initial 5yr plan. The problem with the Q4 2020 5yr plan, was the minute cashflow generation projected in that period.
- From FY21 to FY25 the business is projected to generate €40m cash. In fact, the Company's own projections, FCF will remain negative for FY21 and FY22. We acknowledge that the significant increase in iron ore prices are not included in the Q4 2020 projections, it should be noted the expansion of the mine was planned and therefore was included in the Company's projections.
- We estimate Vallourec (ex Iron Ore) EBITDA to have been c.€100m in FY18/19 and unlikely to increase much beyond this in FY21/FY22, although we project it to further increase to €200m in FY23/24.

Group (ex mining Segmer	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales Volumes (k ton)	2,323	1,411	1,281	2,256	2,364	2,291	1,599	1,640	1,804	1,857	1,905
Revenue Per ton	2,326	2,581	2,203	1,569	1,612	1,703	1,739	1,680	2,473	2,763	2,791
Revenue (Eur M)	5,403	3,642	2,822	3,540	3,812	3,901	2,780	2,756	4,462	5,131	5,316
Gross Profit	1,289	363	159	337	519	589	353	459	788	1,189	1,208
EBITDA	691	(165)	(299)	(114)	90	198	3	114	436	808	834

Key Financial Indicators

	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
Sales - core Group	5,403	3,642	2,822	3,540	3,812	3,901	2,780	2,756	4,462	5,131	5,316
Sales - mining segment	298	161	143	210	109	272	462	686	263	387	605
Sales	5,701	3,803	2,965	3,750	3,921	4,173	3,242	3,442	4,882	5,518	5,921
EBITDA - core Group	691	(165)	(299)	(114)	90	198	3	114	436	808	834
EBITDA - mining segmen	134	72	64	95	49	122	208	309	118	174	272
EBITDA	**855**	**(77)**	**(220)**	**2**	**150**	**347**	**257**	**492**	**714**	**982**	**1,106**
margin - core Group	13%	-5%	-11%	-3%	2%	5%	0%	4%	10%	16%	16%
margin - mining segment	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%
EBITDA margin	15%	-2%	-7%	0%	4%	8%	8%	14%	15%	18%	19%
Net Interest Expense	(89)	(75)	(95)	(129)	(175)	(174)	(203)	(95)	(10)	(142)	(146)
CAPEX	(388)	(268)	(175)	(152)	(129)	(159)	(138)	(138)	(191)	(200)	(200)
FCF (before disposals)	(581)	212	(175)	(425)	(645)	(41)	(111)	(283)	(263)	148	282
Net Leverage	1.8 x	-19.7 x	n/a	n/a	14.3 x	5.9 x	9.1 x	2.1 x	1.7 x	1.1 x	0.7 x
Implied Net Leverage	1,547	1,519	1,287	1,542	2,144	2,055	2,348	1,013	1,199	1,051	769

Original Guidance (October 2020, from the Company)

	FY20	FY21	FY22	FY25
Revenue	3,242	3,103	3,591	4,473
EBITDA	258	212	422	690
EBITDA margin	8.0%	6.8%	11.8%	15.4%
Net Interest expense	(196)	(151)	(105)	(109)
CAPEX	(138)	(160)	(180)	(190)
FCF	(111)	(273)	(139)	185
Net Leverage	8.6 x	4.1 x	2.5 x	1.2 x
Implied Net Leverage	2,219	869	1,055	828
FCF in FY23 & FY24				**(42)**

Cashflow

- Ultimately, we remain negative on Vallourec due to their cash generation (or lack of).
- And it isn't just our assumptions that is driving the poor FCF. The Company's own projections from October 2020 shows limited FCF until FY25.
- Our model shows positive FCF in FY23 & FY24 due to the impact of the mining segment.
- The projections in October 2020 included the increased iron ore production levels, and by deduction, implies very poor FCF from the core "tubes" business.

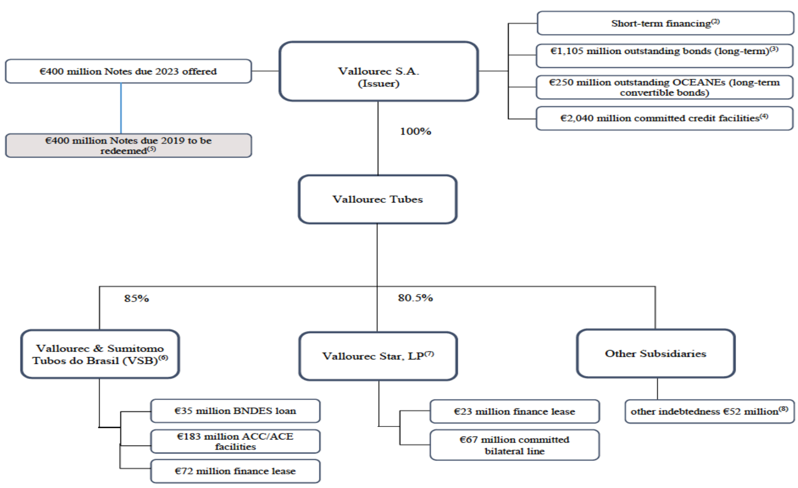
Change in Guidance

Projections			Sarria's	Company's	Company's	Company's	Company's
				Oct-20	Feb-21	Apr-21	Jul-21
	FY19	FY20	FY21e	FY21e	FY21e	FY21e	FY21e
Sales	4,173	3,242	3,442	3,103			
EBITDA	**347**	**257**	**492**	**212**	**250-300m**	**350-400m**	**475-525**
EBITDA margin	8.3%	7.9%	14.3%	6.8%			
Net Interest Expense	(174)	(196)	(95)	(151)			
CAPEX	(159)	(138)	(138)	(160)			
FCF (before disposals)	(41)	(111)	(283)	(273)	(380-300m)	(340-260m)	(240-160m)

- Vallourec increased its guidance 3x during H1FY21.
- In July, the Company acknowledged the largest driver of the upgrade was due to higher contributions from iron ore mine. This corresponds with the 30% increase in iron ore prices from April to July.
- Previous upgrades was a combination of iron ore pricing and better visibility in the Oil & Gas segment.
- Note, the FCF projections has been guided downwards, partially on Working capital, plus an additional €65m outflow from the exercise of an option for the debt of a lease contract in Brazil.

Legal

Corporate and financing structure as of December 31, 2017, as adjusted(1)



REINSTATED BONDS KEY TERMS

Amount	• €1,023m
Issuer	• Vallourec S.A.
Participants	• Creditors (except Commercial Banks) pro rata to their claims
Maturity	• 5 years from closing of the financial restructuring; bullet repayment
Prepayment	• NC2 then par
Coupon	• 8.50%
Financial covenant	• None
Guarantee / Security	• Unsecured, unguaranteed
Listing	• Bonds listed on Euro-MTF

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