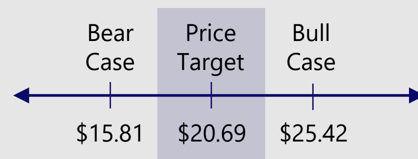
RESEARCH REPORT

October 17, 2022

Stock Rating	BUY
Price Target	$20.69
Current Price	$9.01



TSX:	SCL
Market Cap (MM)	$550
2021 EV / EBITDA	8.2x
2021 P / E	(18.1x)

52 Week Performance

Shawcor Ltd.

What a Shawcor!

For QUIC's E&U team's first pitch of the year, the team decided to explore a lesser known industrials-heavy oilfield services (OFS) company called Shawcor. With little coverage due to its small-cap nature and play in non-ESG sectors which are often dismissed by larger Canadian institutions, the team found Shawcor to be an interesting name that appears to be fruitful with long-term shareholder value despite recent manager turnover and questions regarding near-term strategic decisions.

Within this report, the team has provided an overview of the company and its history, as well as a competitive analysis that is followed by two theses regarding i) Shawcor's operational excellence and ii) the company's noncyclical growth trajectory underpinned by strategic changes within the organization.

The report concludes with an overview of our three-statement discounted cash flow analysis which yielded an intrinsic value that indicates the company is trading at an attractive entry point. Although the team believes there is more to learn about the company as it competes within extremely specialized and niche industries, there is certainly value at hand on an intrinsic basis. Pending industry calls and touchpoints with investor relations, the team has strong conviction and intends to enter the name with a price target of ~$20.69.

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Company Overview

Company History

Shawcor Ltd. (TSX:SCL) is an oilfield services (OFS) and material sciences company headquartered in Toronto, Ontario. Originally founded as a construction company in 1930 by Francis Shaw, the company later expanded into pipeline coating and cable television, among other ventures. The cable business was eventually split off into the well-known Shaw Communications. Since then, the business has grown substantially, with 3,800+ employees in 18 different countries and Q2 2022 LTM revenue of ~C$1.1B. SCL currently runs 6 operating units after Shawcor Inspection Services was sold in December 2021.

Composite Systems

This segment is composed of the Composite Production Systems (CPS) and Oilfield Asset Management (OAM) operating units. The Composite Systems segment manufactures specialty pipes and storage tanks used for oil and gas gathering, water disposal, and other corrosion-resistant/high-pressure applications. The segment also provides tubular management services for upstream producers in the Western Canadian onshore market. The CPS brand Flexpipe produces spoolable pipes for oil and gas applications. The advantage over conventional steel pipe is the, ease of installation and lighter weight, allowing for cost savings. Flexpipe retains an important position in the O&G ecosystem through local distributors in the Permian Basin. In April 2019, Shawcor acquired ZCL: a company primarily specializing in underground fuel tanks. At the time of acquisition, the brand was almost entirely serving retail fuel distributors like 7-Eleven and Kwik Trip. Over time, the products have transitioned to serve markets for water storage, as well as tanks for O&G storage applications to insulate the business from the expected transition to electric vehicles.

Automotive & Industrial

This segment consists of the Connection Systems operating unit, which manufactures heat-shrinkable tubing sleeves and related products. This segment also manufactures highly-engineered wire and cable for specialized applications. Shawflex is the main cable brand, making up about 30% of this segment's revenue. Typically, competitive players in this market sell high-volume, multipurpose cables; instead, Shawcor focuses on low-volume opportunities in niche markets where cable specifications are regulated and highly specific. The barriers and smaller market sizes incentivize less competition, creating favourable conditions for Shawcor. DSG-Canusa is the heat-shrink brand that makes up the remainder of the segment, with a large presence in the German automotive OEM sector. By nature, this business faces constant pressure to lower costs, but the EV transition is poised to drive more demand. Historically, A&I has been the best-performing regarding growth and margins.

Pipeline & Pipe Services (PPS)

The operating units under this segment are the Pipeline Performance Group (PPG), Shaw Pipeline Services (SPS), and Lake Superior Consulting (LSC) Group. The segment deals with specialized pipe coating, insulation, and weighting projects. They also provide testing, engineering, and integrity management services for onshore and offshore markets. The heavily regulated nature of offshore pipe laying leaves very little competition for Shawcor in the space. Contracts are valuable due to scarcity-driven pricing power. The only real competitor is a Malaysian firm called Wasco; Shawcor has historically been able to win out on quality, as well as their far superior ability to mobilize for projects, allowing Shawcor to price in what the client is saving on shipping costs. The small-diameter offshore market used to be 80-90% Shawcor, but the simplicity and low-barrier conditions relative to offshore attracted many small regional competitors, leading to a mass divestiture from the U.S. onshore position. LSC Group and Shaw Pipeline Services are the smaller components of the segment. The pipeline service model produces revenues that are relatively sticky since pipelines require regular testing and inspection that is contract-based.

Company Overview

Segment Trends

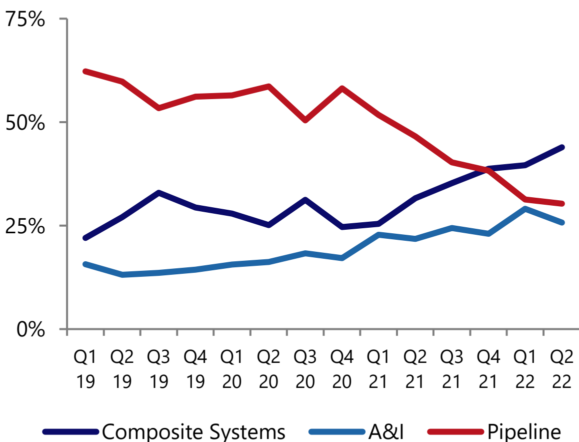
Over the last few fiscal periods, Shawcor has divested heavily from its Pipeline and Pipe Services segment, driven by the stated goal of reducing its exposure to O&G markets. Recently the company announced a strategic review of their PPG, SPS and OAM operating units, potentially resulting in a divestiture from all three. In terms of margins and revenue quality, the A&I and Composite Systems segments offer more value. This is nudging management to reconsider not only their inspection and engineering practice, but also their uniquely advantaged offshore coating segment.

Management Team

Michael E. Reeves – CEO & President
Joined SCL in March 2021 as President with 25+ years of progressively senior experience in firms such as NOV and Schlumberger. Previously the CEO of Rubicon Oilfield International, Mr. Reeves became CEO in June 2021 after the previous CEO retired.

EXHIBIT I

Segment Revenue as % of Total Revenue



Source(s): Company filings

Thomas R. Holloway – CFO & SVP
Joined SCL in December 2021 in the interim position of VP & Chief Accounting Officer in order to replace the outgoing CFO effective May 31, 2022. Currently serving as the SVP & CFO, Mr. Holloway held several senior finance and accounting positions in energy companies, amounting to 23+ years in the industry.

Four Group Presidents make up the remaining NEOs, with an average of 10+ years at Shawcor and 21+ years in industry each. Generally speaking, the team is experienced yet relatively new and unproven as NEOs.

Incentive Compensation

SCL's management is compensated under a pay-for-performance structure. Currently, about 78.4% of CEO compensation is at-risk, assuming at-target performance on compensation metrics; across all NEO positions, 50% of compensation must be at-risk as a minimum. SCL also maintains a policy of minimum share ownership, expressed as a multiple of salary. NEOs are incentivized across short-, medium-, and long-term horizons with a robust compensation structure including salary, a cash-based senior executive incentive plan (SEIP), a cash-settled performance share plan (SPSP), an employee share unit plan, and an employee stock option plan.

The value of SPSP awards are based on share price before grant, but also adjusted from 0x to up to 2x based on the total shareholder return (TSR) relative to the benchmarking peer group, factoring in industry-wide stock trends outside of NEO control. In 2021, SEIP awards were based on Adjusted EBITDA, Operating FCF and predetermined personal objectives (each weighted at 50%, 25%, and 25%, respectively). Group Presidents are compensated based on the figures under their respective segment, drawing a connection between NEO scope and compensation. Historically, the SEIP tracked more capital structure-dependent metrics such as ROIC, ROCE, and EPS growth: a rather unfounded shift in compensation philosophy that leave more room for excessive capital usage.

Competitive Analysis

In lieu of a comprehensive industry deep-dive – which disposes substantial word count and presentation time in efforts to explain (often to little avail) the complexities of energy subsectors – the E&U Team has opted to summarize pitch names' market dynamics into a single component of a new section: the competitive analysis. This section will granularly examine target companies in a side-by-side with its nearest comparable based on classic value investment considerations. Thinking in terms of, "why CNRL instead of Suncor", is important in heavily commoditized sectors such as E&U and has been underemphasized by our team in past years.

Unlike most E&U names, Shawcor has few to no true comparable companies. With a unique offering mix, Shawcor only has competitors with moderately overlapping operations. One is Enerflex: a Calgary-based O&G equipment services and industrials player.

Markets and Product Mix

As mentioned, Shawcor operates three business segments: Composite Systems ($450MM LTM revenue), Automotive & Industrials ($290MM), and Pipeline & Pipe Services ($398MM). One of the Company's most notable offerings, FlexPipe, is highly differentiated and poised for particular success given rising well count across North America, upstream emphasis on easy pipe installment, and prevailing concern for carbon emissions (which this product mitigates). The Pipeline & Pipe Services segment is currently under strategic review and will be discussed in further detail. Enerflex has a much larger portfolio of products and services. This is certainly a viable strategy since upstream players tend to value one-stop shops.

At a high level, the E&U Team views Shawcor's narrower but more differentiated-on-a-product-level portfolio as prolific in the current competitive landscape. Consumers are generally willing to pay a premium for highly differentiated, tech-enabled, and advanced solutions; these are factors that typically create a more sustainable edge than cost savings.

Customers and Contracts

Through actively tracking and bidding on multi-year offshore construction project up-cycles, Shawcor has established a strong foothold. Secured revenue backlog in Q2 2022 was substantial at $859MM (~83% LTM revenue) and increasing (up 7% quarter-over-quarter).

The only threats to this revenue are counterparty default risk; fortunately, Shawcor caters to creditworthy customers: O&G supermajors like Chevron, and Occidental Petroleum, convenience store franchises such as 7Eleven and Kwik Trip, and automotive brands such as Mercedes and Tesla. Beyond confirmed contracts, the Company is in auction processes with a cumulative value of $1.4bn – a consistently-improving track record should aid in further project wins.

Enerflex also has a slightly less impressive backlog on its books – $737MM, or ~60% of LTM revenue.

EXHIBIT II

Favourable Macro Trends

Trend	Drivers
1. Aging Infrastructure	- Tank replacements - Utility upgrades - Pipeline refurbishments
2. Population Movement	- Comm. network buildout - Mass transit expansion - More retail fuel stations
3. Resource Scarcity	- Water/wastewater mgmt. - Alternative energy solutions - New pipelines
4. Climate Change	- Renewable energy sources - Lower operating emissions - Rise of EVs

Source(s): Company Filings

Competitive Analysis

Financial Profile

Approximately two-thirds of Shawcor's capital structure is comprised of common equity, of which a mere 0.5% is owned by insiders. The Company is financially healthy with adj. EBITDA margins near 10%, a current ratio of ~2.0x, cash interest coverage of 3.2x, and no worrisome debt walls in the coming years.

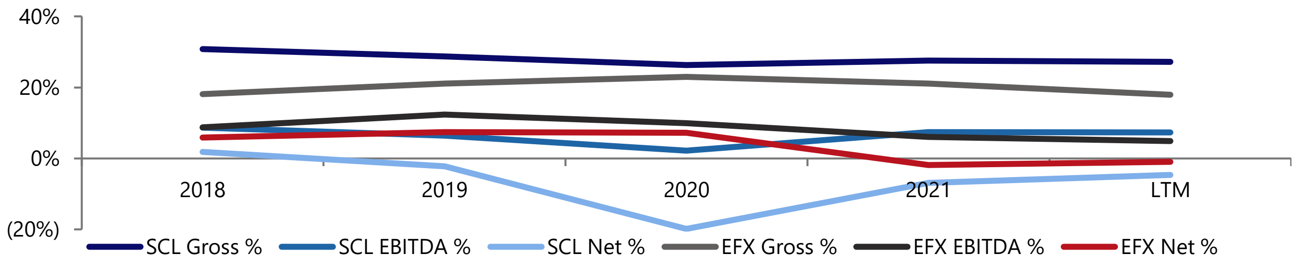
Enerflex is remarkably similar to Shawcor financially but has less debt and boasts a slightly greater insider stake at 0.7%. However, the company has seen interest coverage fall more drastically over the half-decade.

Managerial Acumen

Although Shawcor's management team has recently shifted under the company's management succession plan, the E&U team firmly believes that masters are at the helm. NEOs all have significant industry experience and impressive track records. Their accomplishments with Shawcor include reducing leverage to 2.0x from 5.1x three years ago, cutting scope 1 and 2 emissions by 32%, and electing to review and possibly divest from its pipeline and pipe services. The segment's variability in winning projects is largely responsible for historical volatility and will be further discussed later.

EXHIBIT III

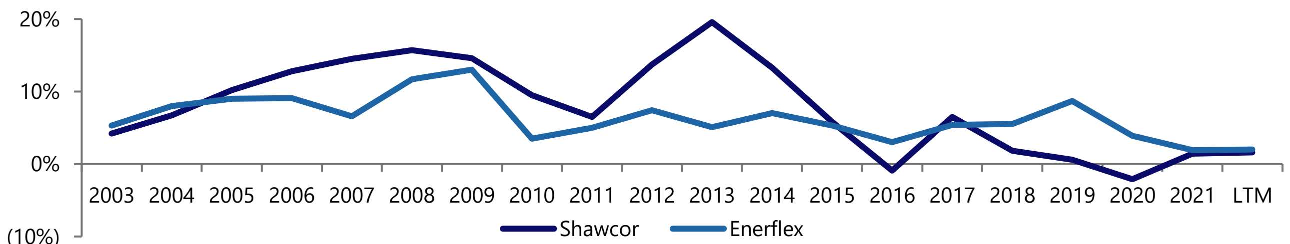
Historical Margins



Source(s): Company Filings, S&P Capital IQ

EXHIBIT IV

Trending Return on Invested Capital



Source(s): Company Filings, S&P Capital IQ

Competitive Analysis

Enerflex's management has more internal experience, but no recent moves suggest greater capabilities.

Valuation Commentary

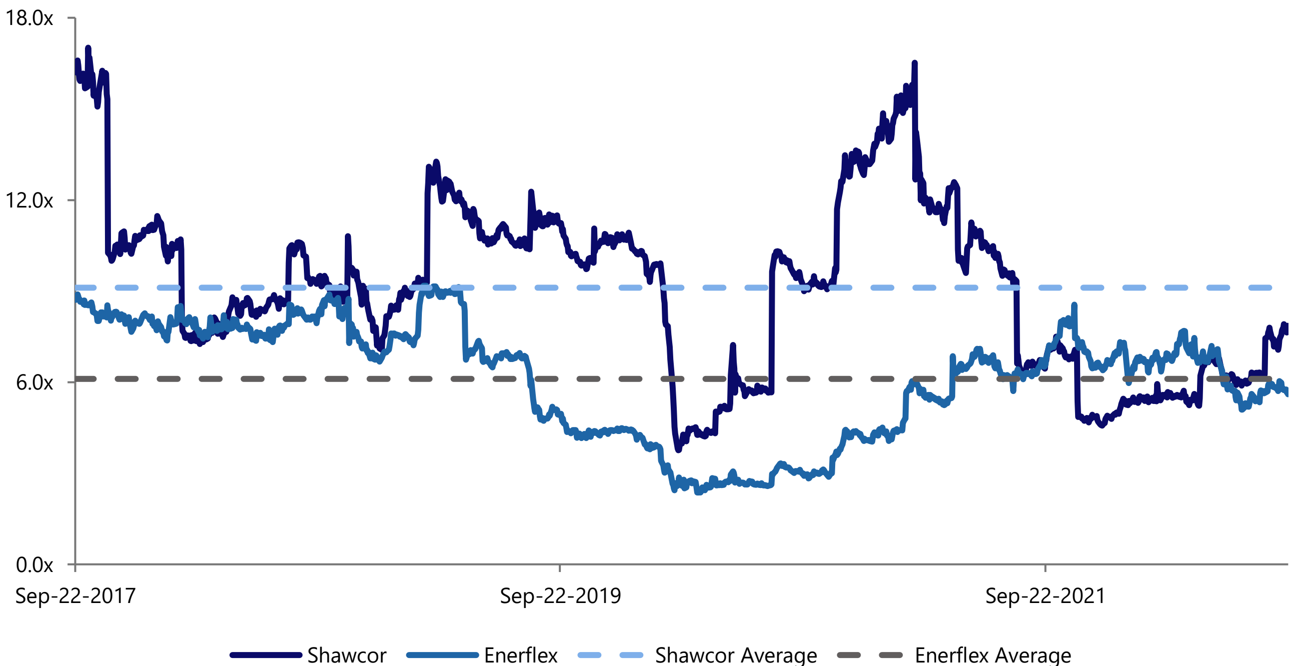
Shawcor has traded at an average EV/EBITDA multiple of 9.1x over the last five years, a ~50% premium to Enerflex's 6.1x. However, Shawcor has been much more volatile, with a standard deviation of 2.8 compared to 1.9 for Enerflex. This simple comparison does little to suggest undervaluation and the E&U Team reserves judgement of value for our three-statement model. However, the important thing to remember is that Enerflex is not a true comparable company, let alone a marking point for pricing; the name was simply used as an example of an opportunity cost of investing in Shawcor.

Conclusion

Overall, while Shawcor and Enerflex both operate in favourable markets and boast strong fundamentals such as contracted cash flows, the E&U team slightly prefers Shawcor. The key differences lie in product strategy (where we prefer a narrower, deeper portfolio), project backlog (~83% LTM revenue vs. ~60%), and management (to be examined further).

EXHIBIT V

Historical EV/EBITDA Trading Multiples



Source(s): S&P Capital IQ

Thesis I: Operational Excellence

Historical Observations

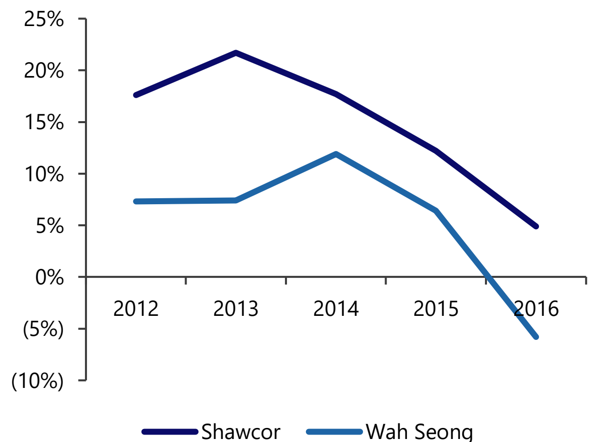
Shawcor's globally renowned business and reputable client base come as the direct result of decades of operational superiority. A family-owned business, Shawcor aggressively expanded its key pipeline coating business throughout the latter half of the 20th century, to the point where it was eventually operating over 43 pipeline coating plants in over 20 countries. Despite this rapid growth, management kept debt levels low, around 15% of equity, to maintain operational flexibility. While some investors were puzzled by this seemingly over-conservative capital allocation strategy, the company's understanding of the highly cyclical nature of its industry meant that lower debt levels allowed it to better navigate downcycles, while simultaneously enabling opportunistic acquisitions during upcycles. Eventually, Shawcor became known for ignoring external noise. It did not release guidance, as the unpredictability of project contracts made projections virtually impossible, and it developed segments that investors perceived as too distant from the core business. Among these was the Composite Systems business, which has become extremely valuable as a countercyclical hedge against oil and gas. The segment currently represents approximately 30% of total revenue.

More conventionally, Shawcor has also historically invested ~1% of its revenue into R&D., recognizing that the importance of innovation has allowed the company to firmly establish itself as the market leader. Key advancements include the development and early adoption of polypropylene sleeve technology to protect high-temperature pipelines, as well as an entire line of pipeline integrity detection technology. These practices have now become industry standards, exhibiting the effectiveness of Shawcor's R&D investments. All in all, the company holds 61 proprietary formulations and 120+ patents, creating a formidable technological advantage over competitors, which then creates an incentive for prospective customers to bring on Shawcor for new projects.

In 2002, Shawcor bought out the Shaw family's stake in the business, taking on over $300 million of long-term debt in the process, a sharp turn from the prior focus on long-term solvency and operational flexibility. However, new management still recognized Shawcor's clear competitive advantages in the pipeline coating and composite businesses. Still twice the size of its closest competitor in the pipeline coating business, with a broader geographic presence, Shawcor maintained its position as the go-to pipeline coating firm. It signed several high-margin projects in Brazil, the Permian basin in the U.S., Australia, and most recently, Mexico. According to various experts, Shawcor still secures approximately 75% of all contracts within the space. Another element of Shawcor's unique approach to pipeline coating is its implementation of mobile plants, which it can build on short notice in close proximity to a new project. While this does incur sizeable overhead, it is offset either by Shawcor's pricing power (the result of limited competition in specific regions) or the elimination of shipping-related expenses.

EXHIBIT VI

EBITDA Margins Relative to Competitors



Source(s): S&P Capital IQ

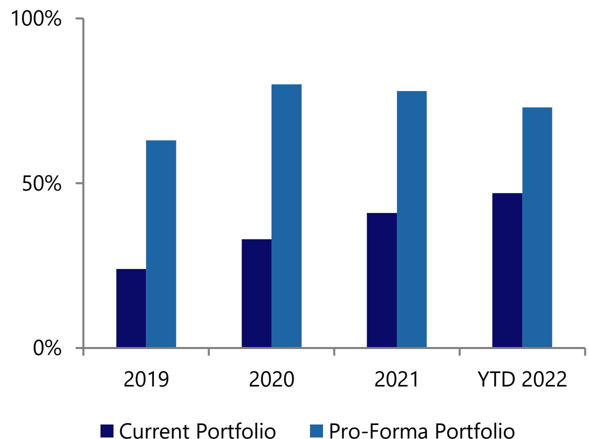
Thesis I: Operational Excellence

Simply put, competitors, like Bayou and Wah Seong, do not have the scale or the resources to effectively mimic this strategy. Both are geographically specialized businesses, so Shawcor's ability to compete with both of them speaks to management's impressive ability to navigate this regulation-laden industry. Shawcor's worldwide reach also allows it to capitalize on the booming potential for OFS in developing economies who are only beginning to realize their hydrocarbon reserves. Being the first mover in many of these economies (e.g. Mexico) also affords Shawcor the unique opportunity to establish lasting client relationships. Case in point, Shawcor's experience with Mexican pipeline coating at the Sur de Texas – Tuxpan transmission line in 2018 inevitably contributed to SCL being awarded the recent $500 million deal from the same company, TC Energy.

Despite this, it must be noted that pipeline coating is an industry with costly mistakes. There are several instances within the company's history where the wrong coating was used for a project, resulting in multi-million-dollar losses. These issues should be easier to mitigate, especially once the company fully divests from its pipeline services segment and is able to direct more resources towards higher margin businesses, like pipeline coating.

EXHIBIT VII

Current and Pro-Forma Industrials Segment Revenue



Source(s): Investor Presentation

Forecasted Continuation

The previous segment illustrates management's aptitude for navigating the cyclical OFS industry, both domestically and internationally. While this should give investors conviction in Shawcor's long-term vision, the E&U team believes that recent changes in leadership and company direction warrant further inspection. First, the circumstances surrounding the new CEO's (Mike Reeves) appointment were greatly accelerated relative to typical leadership transitions. As the company is currently undergoing a significant shift in direction, speculation is that the company wants to speed up the process. This is concerning, mainly because it could rush the transaction of valuable assets, resulting in sales below fair value. Further complicating the process is the fact that Shawcor is selling and closing international plants as part of its announced divestitures. The company's strength in pipeline services originates almost entirely from its global leadership position, which subsequently makes portions of the business difficult to sell, given the absence of suitable buyers in certain geographies.

Having considered this, the team believes that the overarching divestitures are still necessary as they simplify the business, making it leaner and more profitable. Although the timing of the sales are disputable, management has consistently displayed a commitment to long-term growth, giving the team conviction that SCL will be able to navigate this critical period. Exhibit VII illustrates part of management's plan to replace PPS revenue. Equity research analysts seem to also be aligned with this perspective. Expectations are that segment EBITDA margins will move back into the ~15% range in 2023 due to the O&G upcycle, higher oil prices, and the revamped business model.

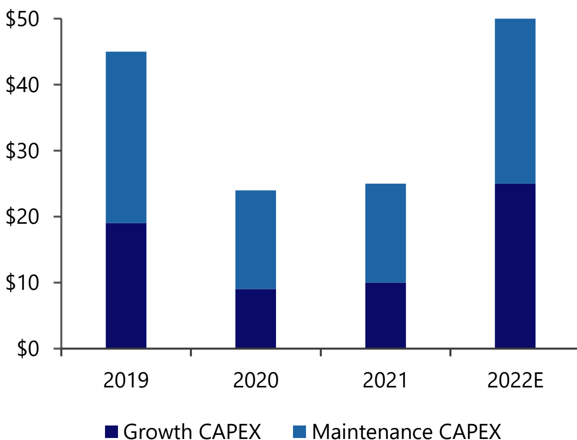
Thesis I: Operational Excellence

Management's deployment of this capital is also critical to the team's conviction in SCL's string of divestments. Shawcor plans to use the proceeds to pay down debt, perhaps shifting back towards the low leverage approach that helped it get to its market leading position today. As of June 2022, Shawcor had repaid $153 million in long-term debt, lowering its net debt/EBITDA ratio from 5.1x in 2020 to 2.0x today. In total, the company exited 9 pipe coating facilities and divested from 6 subsegments, generating annualized SG&A savings in excess of $100 million.

This newfound flexibility will also allow Shawcor to opportunistically acquire businesses that will supplement its transition towards becoming a full-fledged industrials company. Its most significant acquisition to date happened in 2019, with the purchase of ZCL Composites. If the company truly aims to develop a market leading position in either of its new target industries, (composite systems/automobiles and industrials) it will certainly have to roll-up competitors to gain market share.

EXHIBIT VIII

Historical and 2022E Capex Breakdown (C$M)



Source(s): Investor Presentation

Management also forecasts doubling capex to $50 million to support stable organic growth opportunities. While verbal commitments are a great beginning, only time will tell if management can effectively grow the company post-transition.

In terms of returning capital to shareholders, SCL is taking full advantage of its depressed share price, recently filing a $25 million normal course issuer bid. SCL currently trades almost three turns below its 2014 forward EV/EBITDA average, as well as significantly below peer group averages for each of its reporting segments. In an ideal world, the scale of the share repurchase could be greater, but the unique timing during the company's re-positioning reinforces the fact that management still has shareholders' best interests at heart.

Key Takeaways

While the timing of Shawcor's strategic review warrants further discussion with industry and company experts, the E&U team believes that the historical groundwork of operational excellence laid out by both current and former executives gives conviction in the firm's capacity to sustainably grow the business. The O&G down cycle over the past few years has put disproportionate downward pressure on margins, which makes the name all the more attractive.

In summary:

1) Shawcor's new, but high-potential management team is clearly aligned with shareholder interests.

2) Divesting from a historically volatile and cyclical pipeline and product services segment makes the business more efficient and more profitable.

3) Reduced debt levels provide the flexibility to pursue a diverse array of growth opportunities in newly targeted industries.

Thesis II: Noncyclical Growth Trajectory Offered via Strategic Revolution

Rationale for an Operational Shift

Shawcor has often been praised as a high-quality business hallmarked by its deep portfolio of leading tech-enabled solutions and its ability to fulfill large projects on a global scale. Its main obstacles are largely a function of its exposure to offshore energy cyclicality and the high upfront/fixed cost standards that are absorbed in the process. After landing a $500MM pipe coating contract for a natural gas provider in Mexico in August, on top of a proclaimed backlog of ~12 months (totalling ~$800-900MM), the pipeline business is undoubtedly reaching a key inflection point in the near-term. However, longer-term structural volatility and outsized operating leverage remain key concerns for newly-formed management to overcome. As such, the business has outlined a strategic review of their O&G-affected segments, along with a company name change, to reflect an outlook centered on stable industrial cash flows. The underlying strength of the business model has hardly been priced in due to volatility concerns. Looking forward, the E&U portfolio sees this as an attractive opportunity to deep-dive as a catalyst for shareholder value creation once fundamentals begin to be priced in. If the business grows its legs as a cash-generative, full-cycle margin business, the E&U portfolio stands to benefit from its positioning relative to traditional O&G.

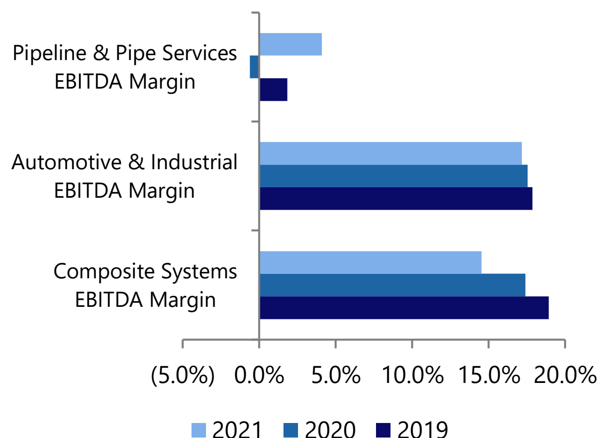
Operating Portfolio Commentary

Shawcor's successful management of 3 distinct operating segments has long been a key strategy for the company's broad success. However, with the PP&S segment likely to be divested from their book, the E&U took careful consideration in assessing the strength of the remaining business functions standalone. The composite systems segment has been hallmarked by an impressive array of accretive acquisitions, notably ZCL Composites. The segment is attributable to ~30% of revenues, and has maintained EBITDA margins in the mid-to-high teens historically. The segment has a highly promising growth trajectory underpinned by U.S. well count growth of ~13% YoY, and more so the 32% growth seen in Canada. This offers a positive outlook for FlexPipe's growth trajectory directly. Flexpipe also recently developed a 6-inch spoolable product which will expand their addressable market by ~15%. Further opportunities for market share capture lie in the Xerxes segment which is currently selling against ~16,000 tanks that age out of warranty every year. It is atypical to see a segment with revenues solely linked to industrial/energy end markets be poised to attain such growth, all while maintaining industry-leading margins too.

The Automotive and Industrial segment has also proven to offer highly consistent topline growth and impressive margins, seeing a 3-year sales CAGR of 9.21% with an EBITDA margin of ~18%. ShawFlex is the notable subsegment here, offering highly specialized wire and cable products under recurring government contracts. The subsegment plans to support the fulfilment of $25B worth of nuclear reactor repairments, and $26B toward 5G networks in Canada.

EXHIBIT IX

3-Year Segmented Margin Profiles



Source(s): Company Filings

Thesis II: Noncyclical Growth Trajectory Offered via Strategic Revolution

Overall, in the event of a PP&S sale, therein lies a simplified portfolio of assets with are poised to benefit from strong exogenous tailwinds and a narrowed scope toward stabilized end markets which detract from topline and margin volatility.

What Could a PP&S Sale Mean For Shareholders?

Aside from evaluating the strength of the remaining business segments, the E&U team recognized considerable shareholder value creation opportunities from the sale of the PP&S segment itself. A successful sale of the segment at an attractive multiple would exhibit management's ability to prudently capitalize on surrounding market upcycles in O&G while shedding their most volatile source of earnings. From a marketability standpoint, management has done an excellent job. They recently secured a $500M contract and have a considerable backlog, while aggressively drilling down on overhead costs wherever possible, to support elevate pricing. Further, we are entering a prolonged upcycle for pipeline usage broadly, likely attracting a larger pool of buyer prospects. The current book value of the PP&S segment (as at 2H22) is $183MM – marking the "price floor" for a sale. If the company were to attract a "ceiling" buyer at ~6.0x of our 2024 EBITDA, it could result in a range of $2.15/share to $12.82 in value creation for shareholders.

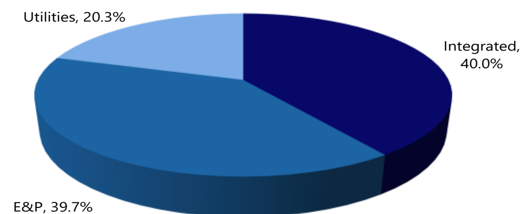
Correlation Analysis

An analysis of SCL's LTM performance was compared against QUIC's E&U benchmark index to better understand the relationship between the two. On the basis of share price performance, Exhibit XII helps visualize the stark different in price volatility, as SCL rendered a standard deviation of ~1, while TSX Capped outputted ~2.5. Further, a regression analysis was run on the two to determine their relativity to one another. The "r" coefficient determined was 0.44x – indicating a "weak positive correlation" between the two. As the E&U team is confident in the energy sector outlook but aiming to underpin it with stable tertiary exposures, this name offers a strong balance.

EXHIBIT X

QUIC E&U Canadian Capital Allocation

E&U is 2.1% below our allocation benchmark for Energy Services in Canada



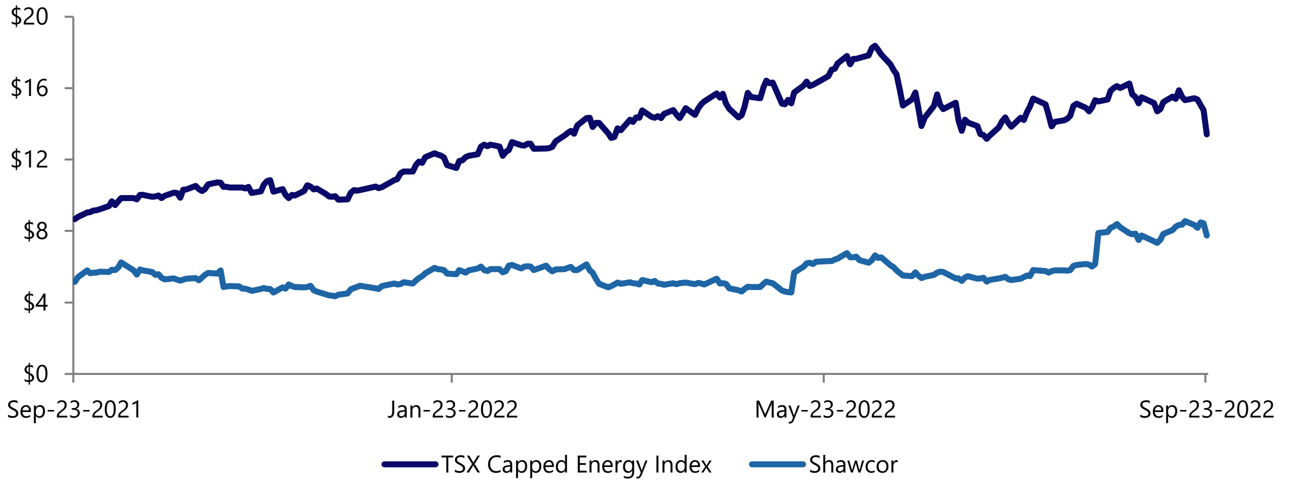
Source(s): S&P Capital IQ

QUIC Portfolio Fit

Marking a major directional pivot, the E&U portfolio allocation strategy for the FY2022-2023 year outlined a well-diversified resilient portfolio generally torqued toward high-quality upstream names. As the team holds high conviction in our current E&P names, we sought out to generate diversification from adjacent players along the value chain that would add stabilizing effects to mitigate commodity price risk. Shawcor allows for an idiosyncratic opportunity to make a calculated hedge. Through its PP&S segment, largely tied to E&P/Midstream discretionary spend and new project starts in offshore locations, the business can participate in upcycles driven by outsized commodity performance. The end markets to which this segment serves are also well diversified; with 54% of revenues coming from international/offshore projects, 34% from North American midstream, and 12% from North American E&P. On the other hand, the name offers downside protection too – as ~45% of revenues come from their industrial and infrastructure segments. These offer non-cyclical, stable cash generation opportunities for E&U to participate in to minimize our risk exposure. From an allocation standpoint, an investment into SCL plays on-thesis for the E&U team's near-term outlook.

EXHIBIT XI

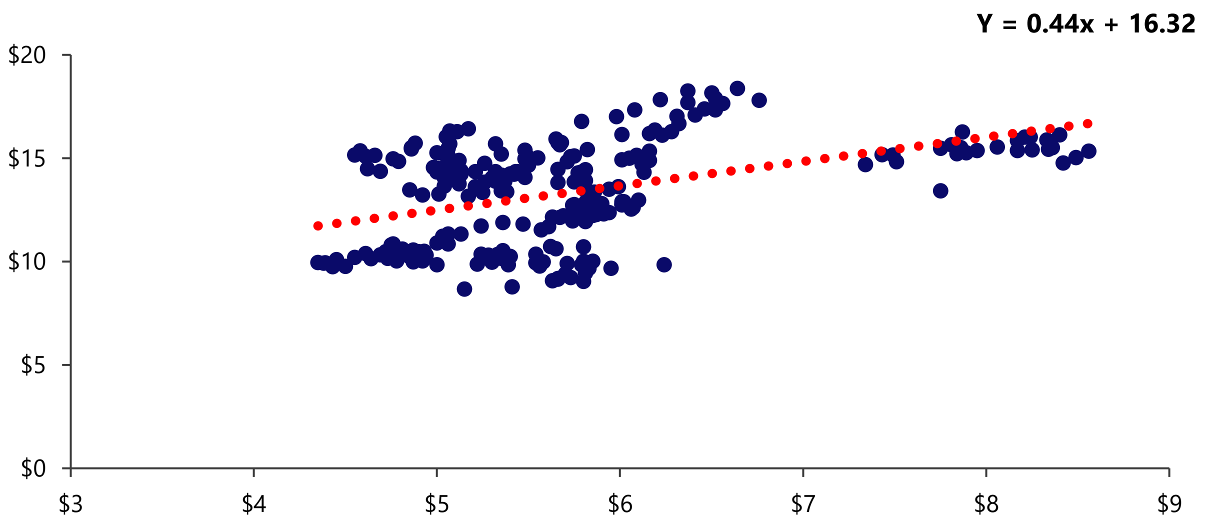
LTM Price Performance SCL vs. TSX Capped Energy Index



Source(s): S&P Capital IQ

EXHIBIT XII

Correlation Model of SCL vs. TSX Capped Energy Index



Source(s): S&P Capital IQ

Notable Risks

Industrial End-Market Contraction

Targeting the industrial and automotive end-markets opposed to highly volatile O&G projects is a smart long-term strategic shift. However, with interest rates in the Western world rising on a near-quarterly basis, demand for Shawcor's new products are certain to experience some decline. As governments enact contractionary monetary policy, spending will slow, reducing the number of new transportation and power generation projects in Canada. Automobiles and real estate, two key end-markets, project to be among the most affected. Growing a business in this environment will undoubtedly be challenging, but Shawcor's newfound financial flexibility should allow it to capitalize on inexpensive growth opportunities, should management retain its long-term focus.

Lack of Buyers for Potential Sale

Currently under strategic review, Shawcor's pipeline and product services business used to be the pride of the business. While the outlook for North American energy is extremely rosy at the moment, one of the company's major obstacles will be finding the right buyer. The segment has been EBITDA-negative for the past year and industry experts are not confident that the company will receive an adequate price relative to asset value. Even though the company has a sizeable backlog of projects, they are all due to be completed by 2025, meaning that any potential buyer would have to already be a significant player in the industry to truly see the benefit of the acquisition. This is made worse by the fact that there are already a limited array of potential buyers with the scale and capacity to take on such a complex business. Despite this, it is important to note that Shawcor does not necessarily *have* to divest from its PPS segment. If management cannot find a favourable transaction, it could simply ride out the energy-favourable environment projected for the next few years. While not ideal, this is certainly preferable to disposing of assets below market value.

Obstacles Integrating New Acquisitions

Shawcor was built as an energy business and is run by executives with an energy background. While its composites and industrials businesses have grown nicely over the past few years, the fact remains that the bulk of its revenue was generated from pipelines and pipeline coating. Hence, it is a valid concern to question whether management is adequately equipped to navigate the intricacies associated with a new industry focus. There is a case to be made that the Xerxes acquisition of 2019 is still not yet fully integrated into the rest of the composites industry so management's ability to realize synergies as Shawcor expands will be critical to the success of the overall pivot. Furthermore, in spite of Shawcor's history of operational excellence, there are numerous instances of the firm delaying the optimization of inefficient processes, namely overhead costs surrounding its PPS segment. SCL must rectify this issue in order to accelerate its transition period and maximize the bottom-line impact of new acquisitions. To mitigate, management appears to be taking a prudent approach to inorganic growth, focusing instead on paying off debt for the time being.

Unforeseen Consequences of PPS Sale

While the E&U team believes unanimously that a sale of the PPS segment is a benefit to the business, it is undeniable that this is the segment on which the others were developed. Shawcor's brand and reputation is attached to its pipeline business. Even though the company plans to rebrand as Mattr, it is difficult to project whether SCL will be capable of retaining its existing client and supplier relations. Furthermore, it is very probably that Shawcor will have to sell its PPS segment piece by piece, elongating the transaction process and inhibiting the firm's operational shift. In a nutshell, the PPS business becomes a distraction to the improvements that management is attempting to implement.

Valuation

Our estimation of Shawcor's intrinsic value is based upon forecasting sales growth and EBITDA margins by segment. Tertiary items like capex, debt, and working capital are in line with guidance over the near-term and move to a normalized rate within ~3 years. QUIC's E&U team believes in Shawcor's ability to hone in on higher-EBITDA margin business in the automotive & industrial and composite systems segments, and the company's expansion targets and efforts are reflected in the forecast. In terms of the pipeline & pipe services business, management has indicated a lesser focus on offshore pipe coating and even a potential sale of this operating segment. Hence, we taper off the operations of this piece of the business quite heavily; the segment only adds ~$0.60 in per-share intrinsic value. Despite our probabilistic and arguably conservative forecasts across Shawcor's three segments (strong growth in near-term is booked in from backlog), we see a strong value opportunity in the name, with a price target hovering around ~$20 per share.

Shawcor is a small-cap, difficult to understand, OFS business that recently saw management turnover with average trading volume at around ~200,000 (this is equivalent to only ~$1.6MM worth of shares being traded each day!). Essentially, we believe Shawcor is a misunderstood and ill-covered name in the Canadian energy/industrials landscape that has been beat down from institutional investing mandates, poor headlines, and shaky belief in long-term cash flows from sell-side analysts. This is certainly a cheap name we could see fitting into the QUIC E&U portfolio, though we have a ways to go in terms of learning about the business.

EXHIBIT XIII

Valuation Summary

Valuation at December 31, 2021					
WACC	**8.50%**	**8.75%**	**9.00%**	**9.25%**	**9.50%**
Enterprise Value	897,773	883,483	869,515	855,860	842,509
Equity Value	1,597,240	1,525,991	1,460,165	1,399,161	1,342,466
Intrinsic Value Per Share	$22.64	$21.63	$20.69	$19.83	$19.02
2020 Multiples					
EV / EBITDA	12.1x	11.9x	11.7x	11.5x	11.4x
P / E	(6.8x)	(6.5x)	(6.2x)	(6.0x)	(5.7x)
2021 Multiples					
EV / EBITDA	8.4x	8.3x	8.2x	8.1x	7.9x
P / E	(19.8x)	(18.9x)	(18.1x)	(17.4x)	(16.7x)

Source(s): Company Filings

EXHIBIT XIV

Operational Summary

Operational Summary	2017A	2018A	2019A	2020A	2021A	2022E	2023E	2024E	2025E	2026E
	Actual					Forecast				
Composite Systems	0.0	347,758.0	417,329.0	320,833.0	374,908.0	531,699.4	691,209.2	746,506.0	776,366.2	807,420.8
Automotive & Industrial	194,207.0	202,254.0	211,103.0	198,290.0	263,477.0	317,244.8	380,693.8	403,535.4	415,641.4	428,110.7
Pipeline & Pipe Services	1,372,556.0	861,289.0	863,848.0	662,220.0	507,463.0	331,734.0	248,800.5	228,896.5	219,740.6	210,951.0
Gross Revenue	1,566,763.0	1,411,301.0	1,492,280.0	1,181,343.0	1,145,848.0	1,180,678.2	1,320,703.5	1,378,937.8	1,411,748.2	1,446,482.5
Revenue Growth		*-9.9%*	*5.7%*	*-20.8%*	*-3.0%*	*3.0%*	*11.9%*	*4.4%*	*2.4%*	*2.5%*
QUIC EBITDA	232,200.0	133,836.0	119,206.0	74,158.0	106,282.0	99,763.5	173,375.3	180,851.9	186,922.0	193,232.1
EBITDA Margin	*14.8%*	*9.5%*	*8.0%*	*6.3%*	*9.3%*	*8.4%*	*13.1%*	*13.1%*	*13.2%*	*13.4%*
Net Income	71,028.0	26,179.0	(33,295.0)	(234,555.0)	(80,620.0)	17,701.5	64,476.1	73,513.4	81,605.4	88,931.5
Earnings per Share (FD)	$1.01	$0.37	-$0.47	-$3.33	-$1.14	$0.25	$0.91	$1.04	$1.16	$1.26

Source(s): Company Filings

References

1. BMO Capital Markets
2. Company Filings
3. iA Financial
4. National Bank Financial
5. S&P Capital IQ
6. Tegus Expert Calls