BEACON Securities Limited

Aveda Transportation and Energy Services Inc. (AVE-V)

Solid Q1 But Business Slowing; Hodges Deal To Spur Growth

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- **Q1 results were solid is a very challenging operating environment.** Sales were up 3% to $36.6 million, generating adjusted EBITDA of $4.4 million (down 33% y/y). We had forecast of $32.2 million and $5.1 million, respectively. Contribution from the acquired PD assets (new OK branch) and CAD dollar weakness helped deliver the small sales growth. Margins are getting squeezed by falling contract pricing. US sales comprised 87% of total sales, with Canadian operations contracting by 56% y/y.
- We think the announced acquisition of Hodges Trucking out of Oklahoma overshadows near-term results. This is a transformative deal, nearly doubling the fleet size and topline of Aveda. What we don't know is what AVE is paying for this 82 year old trucking company. **We have pegged a price of US$40-$45 million, or ~3x 2014 EBITDA of US$14.1 million.** Hodges will be funded through existing credit facilities and a vendor take-back. We expect leverage to increase materially from the current 1.9x level.
- Aveda is clearly using the industry downturn to position for the next upcycle. This deal, once it closes on June 15th, will make AVE the largest rig mover in North America by revenue. **We have incorporated the Hodges deal into our forecast, including the introduction of F2016 estimates.** Hodges has a lower margin profile than AVE, and coupled with a tough macro environment, we expect margins to soften.
- We roll forward valuation to F2016 and use a 5x multiple with projected net debt to reach our **new 12-month price target of $3.75** (was $3.00). We maintain a Speculative BUY rating due to uncertain deal metrics.

Q1/FY15 Results	
Spec. BUY (UNCH) **$3.75**	(was $3.00)
Intraday	$2.74
12-month Target Price	$3.75
Potential Return	37%
52 Week Price Range	$1.77-$5.95

Estimates

YE: Dec 31	FY14A	FY15E	FY16E
Revenue (MM)	$155.9	$154.7	$206.4
Adj. EBITDA (MM)	$24.5	$17.9	$27.7
FD EPS	$0.13	-$0.38	-$0.19

Valuation

	FY14A	FY15E	FY16E
EV/Revenue	0.9x	0.9x	0.7x
EV/EBITDA	5.7x	7.8x	5.1x
P/E	21.7x	nmf	nmf

Stock Data (MM except per share item)

FD Shares O/S	19.1	
Market Cap.	$52.3	
Enterprise Value	$140.4	
Net Debt	$88.1	(incl Hodges acq debt)

About the Company

Aveda Transportation and Energy Services is an oilfield hauling and rentals company serving customers' rig moving, oilfield services, specialized transportation and oilfield rentals needs across North America. Headquartered in Calgary, Alberta, the company was founded in 1994 and went public in 2006.

www.avedaenergy.com

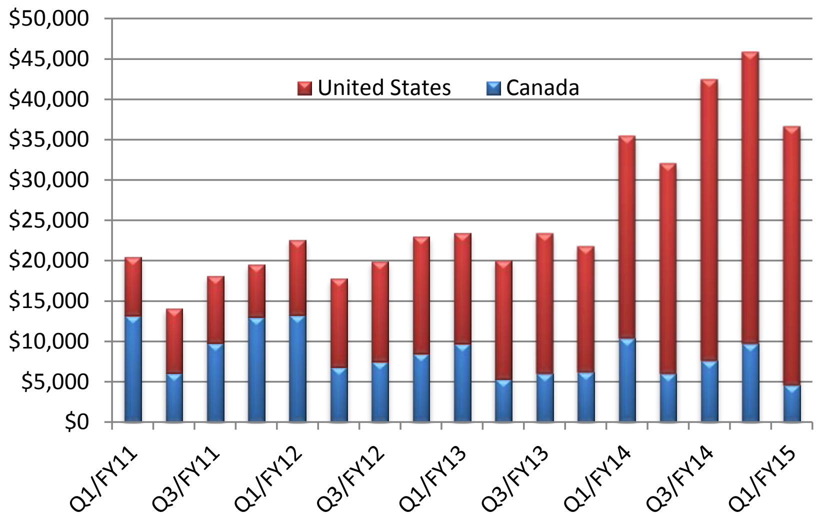
All prices in C$ unless otherwise stated

Stock Performance

Financial Results

Q1 sales grew 3% year-over-year, with strong US results (up 28%) offset by weakness in Canadian operations (down 56%). Sales came in at $36.6 million (vs our forecast of $32.2), with US revenues accounting for 87% of that total. The US division sales benefitted by $2.7 million from the opening of the Cherokee, OK branch last summer (using assets from Precision Drilling). Use of third party contractors accounted for sales of $9.3 million, or 25 % of sales versus 31% of sales one year ago. Translation of stronger USD into CAD was a positive to sales by about $3.8 million.

Exhibit 1: Geographic Revenue Split By Quarter



Source: Company reports, Beacon Securities

Gross margin was 11.2% as compared to 21.3% last year, impacted by lower pricing and increased US operating costs. Adjusted EBITDA was $4.4 million, down 33% from last year, and below our $5.1 million estimate. EBITDA margin was 12.0% versus 18.5% last year. The bottom line was a loss of $1.1 million, or $0.06 per share. We had forecast a $0.02 loss.

Balance Sheet & Capital Structure

Aveda ended the quarter with cash of $1.0 million. The company is currently utilizing $43.9 million of its $125 million credit facility, with borrowing availability of $58.8 million as of March 31st. We note that the operating facility does not carry any covenants as long as borrowing availability remains above $25 million. If less than this, the leverage test stands at 3.0x, whereas AVE was at 1.9x at the end of March. We expect leverage to increase following the acquisition of Hodges (see next section). The Company generated cash from operations of $12.4 million in Q1 (incl. $10 million from WC), while capex was just $0.25 million. Remaining cash flow was used to reduce debt. Net debt is

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down about $10 million from one year ago, despite the PD asset acquisition for US$24 million last summer.

Hodges Trucking Company Acquisition

The above mentioned credit availability will be used to partially fund the acquisition of Hodges Trucking Company for an undisclosed amount. A portion of the purchase will be in the form of a vendor take-back note. Upon the June 15th closing, Aveda will be the largest rig moving company in North America by revenue and will have over 2,000 pieces of equipment (including rentals). Hodges owns approximately 900 pieces of rig moving and heavy haul equipment and has over 300 employees.

Aveda has provided a three year historical financial record for Hodges, as follows (all in USD):
2012: sales of $166.0mm, EBITDA $34.0mm (20.5% margin)
2013: $139.4mm and $13.6mm (9.8% margin)
2014: $123.7mm and $14.1mm (11.4% margin)

We think that 2015 results from Hodges will be meaningfully weaker than 2014. Hodges operates in Oklahoma, Texas and Ohio – regions that have been hit hard by the downturn in drilling operations. Aveda disclosed that Hodges posted a net loss in Q1. We have pegged the deal value at between US$40mm to US$45mm, representing roughly 3.5x 2014 EBITDA.

Outlook and Forecast

The next couple of quarters will be "especially challenging" according to management. We think the full impact of lower pricing will begin to show on the margin profile. In addition, revenue has been falling each month since January (Jan. sales were 40-50% of Q1 sales). We expect Q2 EBITDA to be the lowest in three years, but still positive.

Exposure in Texas, North Dakota and Oklahoma will now be very significant. In our view these are the three regions, plus Pennsylvania, that will determine Aveda's operating strength. As the charts below indicate, all three of these big drilling states have suffered dramatic declines in rig activity YTD in 2015. Pennsylvania, where gas drilling is king, has suffered relatively small declines so far. The situation in Canada is worse, with just 95 land rigs working last week, down from 196 one year ago. The good news is that Canadian rig counts are now off their bottoms as road bans get lifted. We understand the huge drop in activity has led to very competitive pricing (down generally 20%-25%) in the rig moving industry. This is impacting on margins and we expect this trend will continue as overcapacity is likely to continue for at least several quarters. Aveda management is combating lower pricing through reduced fixed costs and wages, branch consolidations, and layoffs.

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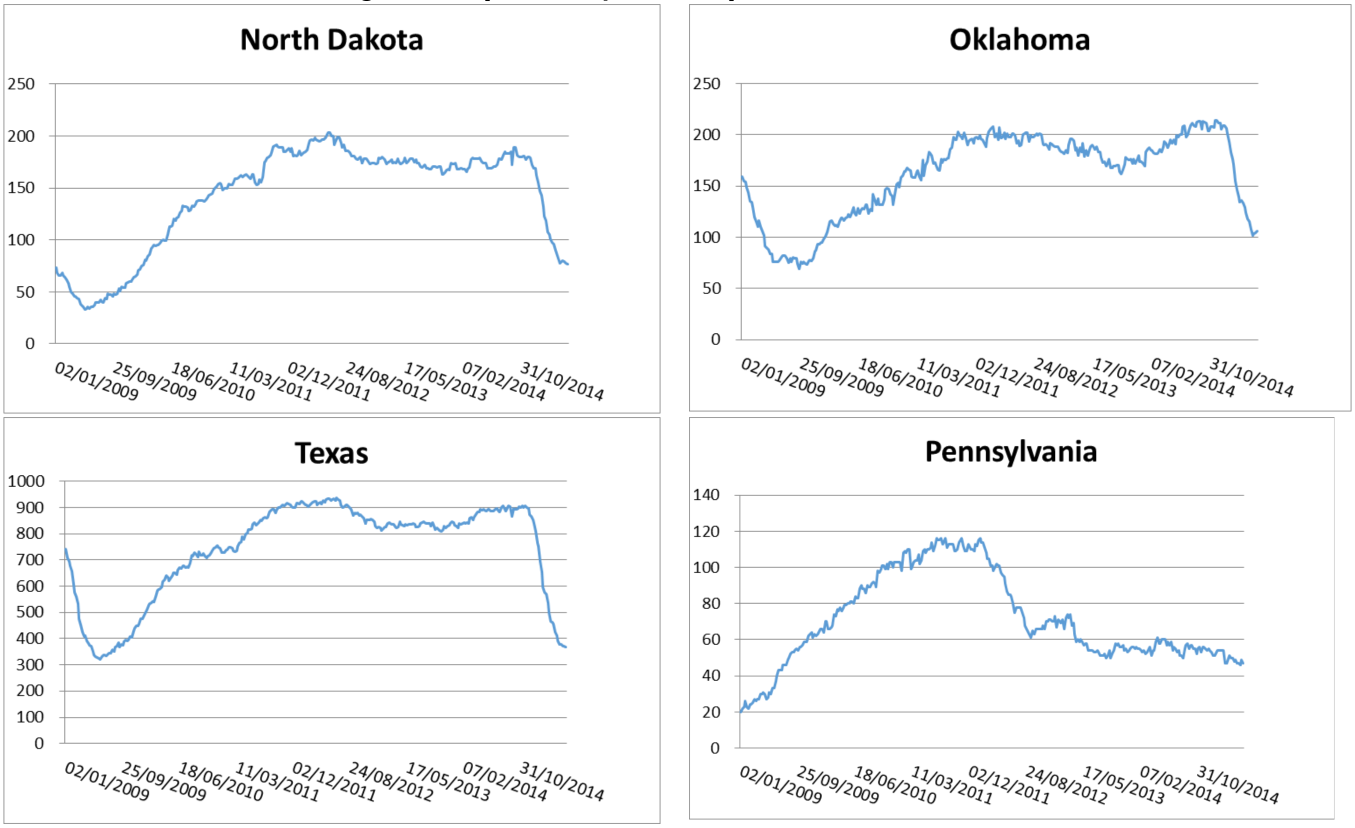
Exhibit 2: Rig Counts (as of May 29, 2015)



Source: Baker Hughes, Beacon Securities

Adding Hodges to the Mix

With the Hodges acquisition scheduled to close in two weeks – on June 15th – we are incorporating the deal into our forecast. The two big assumptions are 1) what will Hodges contribute given the lower rig counts, and 2) how much is Aveda paying for Hodges. The deal almost doubles the company's topline, with a slightly smaller impact on EBITDA due to Hodges lower margin profile.

We believe Hodges is likely to generate roughly $80-$100 million (CAD) over the next 12 months (vs ~$150 million in 2014). We expect EBITDA to be under $10 million (vs ~$17 million in 2014, all CAD figures). Our second assumption around price uses $50 million (CAD), which increases balance sheet leverage fairly meaningfully in the near-term. At least part of this debt will be in the form of a vendor take-back note. We believe the enlarged Aveda could temporarily see leverage exceed 3x in the short-term. Following the acquisition of Hodges, we anticipate that > 90% of sales will be US generated. One benefit of a large US business is the removal of the seasonal impact from WCSB spring break-up. However, with Aveda reporting in CAD, the translation swings from FX will become even more pronounced. At this time there is no plan to change reporting currencies, although it could be contemplated in 2016 or 2017. We note that there is a fairly large natural hedge as the majority of labour, along with equipment purchases, are in USD.

Exhibit 3: Beacon Securities' Forecast ($ millions, except EPS)

Dec. Year End	**F2015E - New**	F2015E - Old	**F2016E - New**
Revenues	**$154.7**	$110.2	**$206.4**
Adjusted EBITDA	**$17.9**	$15.4	**$27.7**
EBITDA Margin	**11.6%**	14.0%	**13.4%**
FD EPS	**-$0.38**	-$0.25	**-$0.19**

Source: Beacon Securities, Company reports

The above forecast reflects current market realities, but we think it is important to also mention the financial performance potential from the enlarged organization in a strong market environment. We believe the "new" Aveda could generate $350-$400 million in sales from its existing fleet and deliver EBITDA north of $60 million. While clearly a long way from this scenario, this provides context to the organizational capacity that will be in place.

Recommendation and Valuation

We are increasing our 12-month target price to $3.75 (from $3.00) and maintaining a Speculative BUY rating due to the yet to be disclosed deal metrics. Our target reflects a 5x multiple on our newly unveiled 2016 EBITDA estimate. Management is certainly betting on a recovery in rig activity, but has also eliminated a key competitor and is seeing others close their doors. Over time, we expect the Hodges deal will prove to be a great strategic move. Operations will be challenged in the near-term, but we expect the newly enlarged business can support its borrowings through cash generation. We note AVE has been active with its NCIB, buying back over 800k shares in Q1 and reducing the share count to approximately 19.1 million.

Key Risks

- **Oil & Gas Industry Dynamics** – Aveda is significantly levered to the general health of the oil and gas industry in North America.
- **Competitive Pressures** – The Company faces competition, from firms big and small, for contracts. Safety, reputation, and pricing are key components to success. Competition for skilled labour is now reduced.
- **Interest Rate Exposure** – Aveda is exposed to rising interest rates on its credit facility with interest based on variable Prime rate.
- **Weather and Seasonal Factors** – Poor weather conditions can impact operations in any quarter, particularly in Canada during Q2 spring break-up.
- **Customer Contracts** – This is a contract based business, typically booked on short notice (few days to a few weeks in advance).
- **Acquisition Integration and Strategy** – Aveda has aggressive growth targets in place and is likely to pursue further acquisitions.
- **Foreign Exchange** - With a significant shift towards US-based revenues, there will be increased FX translation risk.

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Buy	47	65.7%
Speculative Buy	15	20.9%
Hold	3	4.5%
Sell	0	0.0%
Under Review	5	9.0%
Total	70	100.0%

Buy	Total 12-month return expected to be > 15%
Speculative Buy	Potential 12-month return is high (>15%) but given elevated risk, investment could result in a material loss
Hold	Total 12-month return is expected to be between 0% and 15%
Sell	Total 12-month return is expected to be negative
Under Review	Currently undergoing a change of analyst coverage

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