



**Industrial Note**

**9 February 2007**

# Advanced Engine Components (ACE) – Long Term Spec Buy

**Investment Data:**

Share Price (cents)	22
Ord Shares (m)	105
Market Capitalisation (\$'m)	23.10
Avg daily vol (3 mths)	110,735
52 week Low/High (cents)	8 - 22

**Major Shareholders:**

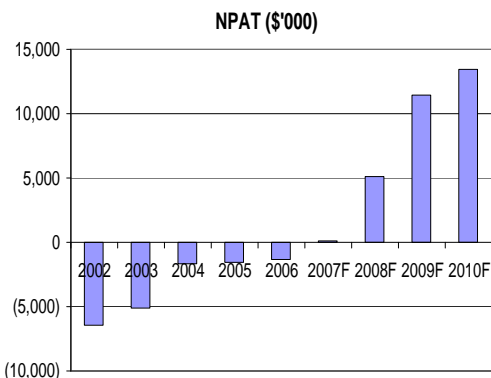
698 Capital International	45.6%
Lim Asia Arbitrage Fund	16.4%
Westpac Noms	6.6%

**Balance Sheet (\$'000)**

<b>Total Assets</b>	<b>6,022</b>
Cash	1,088
Current Assets	3,192
Intangibles	1,892
<b>Total Liabilities</b>	<b>5,974</b>
Current Liabilities	2,210
Total Debt	4,900

<b>Equity</b>	<b>48</b>
---------------	-----------

**Current Ratio** 1.4



<b>Share Price:</b>	<b>23 cents</b>
<b>12 Month Target:</b>	<b>35 cents</b>
<b>12 Month Upside:</b>	<b>52%</b>
<b>Buy Below:</b>	<b>27 cents</b>
<b>Reduce Above:</b>	<b>36 cents</b>

**Growth Potential**

Advanced Engine Components (ACE) is ideally positioned to exploit the growing alternative fuels market with its certified low emission technology. It has proven technology that has been in operation for over 5 years in more than 600 buses in Europe and 35 buses in Australia travelling in excess of a combined 90 million km. On the back of this track record, ACE has started to generate significant sales of its Natural Gas Vehicle Systems (NGVS). In Q2 of FY07 ACE's revenue exceeded \$2 million and the company recorded its maiden quarterly EBITDA profit. Expectations are that FY07 will see ACE produce a maiden profit after tax, with FY08 producing a positive cash flow.

**Strengths**

ACE holds patents over a tried and tested technology which:

- enables the retrofitting of gas conversion kits to diesel engines; and
- enables the manufacture of gas engines on OEM assembly lines.

It is a market leader in achieving Euro 4 emission standards where others have failed. It has strong connections in Asia, with three of China's largest engine manufacturers amongst its clients. ACE is exploring several joint venture opportunities, with a high probability of one of these opportunities coming to fruition this year.

Once an engine manufacturer commits to ACE's technology it is expensive to switch to new technology, which provides ACE with a continuing significant income stream from sales of spare parts and ongoing services. In addition ACE's management is very experienced and committed to ACE, with its Managing Director not serving as a Director for any other Australian listed company during the past 3 years.

**Weaknesses**

ACE has not been able to patent its technology in China which opens it to the significant risk of large manufacturers copying its technology and manufacturing their own in-house NGVS. The best protection against this is the complexity of the Electronic Control Unit (ECU) and the fact that even if it can be copied it will only be compatible with one type of engine.

**Recommendation**

As ACE is yet to produce a profit and show a consistent track record, we classify it as a long term Spec. Buy with large growth potential. Using what we consider conservative earnings projections and (i) applying a FY08 PE of 8 and (ii) a Free Cash Flow discount model, we have valued ACE at 38 cents and 35 cents respectively.



## Earnings Projections

YE June (\$'000)	2002	2003	2004	2005	2006	2007F	2008F	2009F	2010F
<b>Revenue</b>	2,271	4,448	3,968	1,766	2,571	8,000	24,000	40,500	60,000
<b>EBITDA</b>	(4,841)	(4,493)	(1,008)	(943)	(795)	728	6,476	12,587	19,751
Depreciation	174	190	107	127	212	140	450	300	350
Amortisation	1,255	205	107	68	37	110	531	531	531
<b>EBIT</b>	(6,270)	(4,888)	(1,222)	(1,138)	(1,044)	478	5,495	11,756	18,870
Interest	143	264	460	368	347	400	350	300	300
Tax	0	0	0	5	(5)	0	0	0	5,140
<b>NPAT</b>	<b>(6,413)</b>	<b>(5,152)</b>	<b>(1,682)</b>	<b>(1,511)</b>	<b>(1,387)</b>	<b>78</b>	<b>5,145</b>	<b>11,456</b>	<b>13,430</b>

Cronje Wolvaardt  
Investment Analyst

## Advisory Team

Alan Hill  
Managing Director  
Phone: +61 8 9288 3388  
ahill@stateone.com.au

Sophia Bingard  
Dealers Assistant  
Phone: +61 8 9288 3341  
sbingard@stateone.com.au

Ryan Davis  
Equities & Derivatives Advisor  
Phone: +61 2 9024 9106  
rdavis@stateone.com.au

Brendan Fogarty  
Equities & Derivatives Advisor  
Phone: +61 8 9288 3304  
bfogarty@stateone.com.au

Jason Fung  
Equities Advisor  
Phone: +61 8 9288 3328  
jfung@stateone.com.au

Roland Gotthard  
Resource Analyst  
Phone: +61 8 9288 3302  
rgotthard@stateone.com.au

John Haddad  
Industrial Analyst  
Phone: +61 2 9024 9105  
jhaddad@stateone.com.au

Graeme Johnson  
Equities Advisor  
Phone: +61 8 9288 3316  
gjohnson@stateone.com.au

Eugene Loy  
Equities & Derivatives Advisor  
Phone: +61 2 9024 9109  
eloy@stateone.com.au

George de san Miguel  
Equities Advisor  
Phone: +61 8 9288 3334  
gmiguel@stateone.com.au

Xuan Pham  
Equities & Derivatives Advisor  
Phone: +61 2 9024 9110  
xpham@stateone.com.au

Matthew Racovalis  
Equities Advisor  
Phone: +61 8 9288 3307  
mracovalis@stateone.com.au

Tim Shrimpton  
Equities Advisor  
Phone: +61 2 9024 9108  
tshrimpton@stateone.com.au

Kenny Siew  
Executive Director  
Phone: +61 8 9288 3318  
ksiew@stateone.com.au

Paulina Slivkoff  
Dealers Assistant  
Phone: +61 8 9288 3313  
pslivkoff@stateone.com.au

Francis Tan  
Senior Equities Analyst  
Phone: + 2 9024 9112  
ftan@stateone.com.au

Charles Thomas  
Equities Advisor  
Phone: +61 8 9288 3308  
cthomas@stateone.com.au

Brett Walker  
Equities Advisor  
Phone: +61 8 9288 3337  
bwalker@stateone.com.au

Cronje Wolvaardt  
Investment Analyst  
Phone: +61 8 9288 3340  
cronje@stateone.com.au

Peter Wong  
Equities Advisor  
Phone: +61 8 9288 3330  
pwong@stateone.com.au

## General Advice Warning

The contents of this document have been prepared without taking account of your objectives, financial situation or needs. You should, before taking any action to acquire or deal in, or follow a recommendation (if any) in respect of any of the financial products or information mentioned in this document, consult your own investment advisor to consider whether that is appropriate having regard to your own objectives, financial situation and needs.

Whilst State One Stockbroking Ltd believes information contained in this document is based on information which is believed to be reliable, its accuracy and completeness are not guaranteed and no warranty of accuracy or reliability is given or implied and no responsibility for any loss or damage arising in any way for any representation, act or omission is accepted by State One Stockbroking Ltd or any officer, agent or employee of State One Stockbroking Ltd.

If applicable, you should obtain the Product Disclosure Statement relating to the relevant financial product mentioned in this document (which contains full details of the terms and conditions of the financial product) and consider it before making any decision about whether to acquire the financial product.

## Disclosure

The directors and associated persons of State One Stockbroking Ltd. may have an interest in the financial products discussed in this document and they may earn brokerage, commissions, fees and advantages, pecuniary or otherwise, in connection with the making of a recommendation or dealing by a client in such financial products.