SMALL CAP SHARE COMMENT
Commissioned Commentary

THALASSA HOLDINGS
(AIM:THAL)
Share price 163p

Date: **1st August 2013**
Sector: Oil Equipment, Services & Distribution
Market Cap: c£27m (cUS$41m)
www.thalassaholdingsltd.com

Outstanding interim results with plenty in the pipeline!

The AIM quoted marine seismic operations business has issued outstanding results for the 6 months ending 30 June 2013 with a first clear indication of the current level of order-enquiry and tenders submitted, highlighting the huge potential.

- Summary

Revenue was up 193% to US$11.6m, operating profit up 272% to US$1.3m and earnings per share (diluted) up 115.3% to US$0.07 (£0.05) (1H12: US$0.03 (£0.02)).

The Balance Sheet is in great shape with period end cash of US$16.8m (FY12: US$2.5m) and tangible net assets of US$18.8m underpinning the valuation.

- Period of high activity

It proved to be an extremely active period for the Group with the clear highlight being the contract awards from Statoil covering the manufacture of a new Dual Portable Modular Source System ("D-PMSS™") for US$19.8m and the provision of long term seismic acquisition services for permanent reservoir monitoring with a value up to US$65.0m. The results statement confirmed that manufacture of the D-PMSS™ unit for Statoil is underway.

The period also featured the successful completion of the first phase of the seismic data acquisition surveys conducted in Ecuador on behalf of Sevmorgeo S.A., (www.sevmorgeo.com) a subsidiary of Joint Stock Company Sevmorgeo ("SMG").

- Financials

Income statement
Revenue of US$11.6m includes US$7.0m from the project in Ecuador for SMG and US$4.5m recognized in the period in relation to the manufacture of D-PMSS™ for Statoil.

Gross Profit in the half year was US$3.9m, a 109% increase compared to 1H12 (US$1.9m). Cost of sales of US$7.7m includes direct operational costs largely relating to the provision and fabrication of equipment, charter fees, personnel and project management costs on marine seismic acquisition services for the project in Ecuador and costs associated with the manufacturing the D-PMSS™ system.

Resulting gross margin of 33.54% (2012:46.8%) was lower than previously, largely due to increased contingency allowance for the increased work load, to cover potential operating snags. Clearly there could be potential for margin expansion should these "snags" not materialise!

Operating profit (EBIT) was US$1.3m, an increase of 272% from 1H12 (US$0.4m) with administrative expenses of US$2.3m increasing from US$1.4m in the prior period and the increase commensurate with the expansion of the business and the growth in revenue seen in the first half of 2013; 1H13 represents 19.7% of revenue as compared to 34.2% in 1H12.

Basic earnings and diluted earnings per share was US$0.07 (£0.05) compared to basic earnings per share of US$0.04

(£0.03) and diluted earnings per share of US$0.03 (£0.02) in the prior period.

The depreciation charge of US$0.3m (US$0.1m) in the period relates to the two owned PMSS™ units plus the two compressors purchased in the prior period. No impairment charge was determined as required in the period (1H12: US$nil).

Balance sheet
Net assets at 30 June 2013 amounted to US$19.1m (FY12: US$10.3m) with net asset value per share (diluted) US$1.16 (£0.76) in comparison to US$0.85 (£0.53) for FY12 and US$0.79 (£0.50) for 1H12.

Current ratio was 1.84x (FY12: 1.3x) with period end cash of US$16.8m boosted by strong operational cash flow (see below) as well as the placing.

Cash flow
Net cash flow from operating activities was a highly positive US$7.7m largely reflecting the attractive cash flow model of the Statoil contract as illustrated by the deferred revenue line of US$9.4m. Clearly this will unwind in the 2nd half as the equipment is delivered.

Net cash flow from financing activities was US$6.6m relating to the placing of 4,500,000 new shares at £1.20 per share raising gross proceeds of £5.4m.

- Foreign exchange impact

Net financial income/(expense) of US$0.07m includes foreign exchange gains in the period offset by interest expense. While most of the Group's revenues are US$ denominated and the Group reports in US$, foreign exchange exposure for expenditure is in various currencies including GBP, Euro and Norwegian Krone. Where costs are known, measures are put in place to mitigate the Group's exposure to foreign exchange movements.

- Over £2m of hidden value in Treasury shares

We have commented before on 1,462,000 shares which continue to be held in Treasury, having been acquired at an aggregate cost of US$384,226 (c£253k), or only 26 cents per share, and still in the books at this value. With the current share price 163p or approx US$2.45 the hidden value is £2.13m (US$3.24m equivalent), a significant amount and equivalent to an uplift of approximately 17% of the current net book value.

- Focus on manufacturing excellence

In order to ensure the efficient manufacture of the D-PMSS™ for Statoil the Group has enlisted the help of SGS SA (www.sgs.com) to analyse the manufacturing process and monitor the supply chain, a commendable initiative. Zurich listed SGS (SGSN:VTX) is the world's leading inspection, verification, testing and certification company with a market capitalisation of approx £12bn.

- Growing interest in Permanent Reservoir Monitoring

The Group's PMSS™ equipment is installed on vessels in order to provide the seismic (sound) source to allow Oil and Gas Exploration & Production companies to primarily perform Permanent Reservoir Monitoring ("PRM") or Life of Field Seismic in which there appears to be growing interest.

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With PRM surveys increasingly being undertaken well ahead of drilling activity the Group's expertise in this area, acquired over more than 10 years, combined with the compelling features of the D-PMSS™ cable/node system, means it is well placed to benefit.

Management commented that industry insiders estimate that the PRM market has the potential to grow to US$20bn over the next 30 years peaking in 2025.

The following link to the Statoil web site illustrates the benefits of PRM, specifically for the Thalassa contract for the Snorre and Grane oil fields:

http://www.statoil.com/en/NewsAndMedia/News/2012/Pages/13Dec_Permanent_Reservoir_Monitoring.aspx

- Significant pipeline

The interim results announcement indicated a current level of order-enquiry and tenders submitted for 2014/2015 in excess of US$100m (1H12: US$38m) – this comment in itself was a significant event from a very cautious business!

Management also alluded to the additional demands associated with delivering on this, notably an increase in personnel needs and increased capital requirements.

Up to now growth has been admirably managed, long may this continue!

- Attraction of the Thalassa model

Specific investment exposure to the seismic sector has traditionally been gained through the large operators such as CGG S.A. (CGG:PAR), Fugro (FUR:AEX) or Petroleum Geo-Services (PGS:OSL) whose capital intensive business models are not to everyone's liking.

A notable outperformer in the seismic sector has been tangible asset light TGS Nopec Geophysical (TGS:OSL) which has delivered consistently for shareholders over the last 5 years.

We believe THAL offers investors a compelling investment model, despite its small size. With the Group's core cost base now supported by long term contracts they can more effectively plan and invest capital.

- Broker estimates cautious

For the year ending December 2013 house broker estimates remain for revenue of US$30.6m, pre-tax profit to US$2.7m and eps of 15.2 cents (10p) resulting in a one year PER of approximately 16.3x at the current share price (163p).

With the Group having delivered revenue of US$11.6m and pre-tax profit of US$1.4m in the first half estimates may come across as overly cautious and suggest a dramatically reduced margin on the Statoil procurement contract which will be completed in the current financial year and therefore contribute US$19.8m of revenue for the full year.

We appreciate the broker's caution and acknowledgement that the Group needs to ensure efficient mobilisation of the D-

PMSS™. There will also be the added pressure of delivering a first seismic shoot for Statoil as efficiently as possible from October of this year. But in summary, there appears to be plenty of upside should they indeed deliver to plan with contingency for a few minor hiccups!

We should also emphasise that 2013 full year estimates are only based on contracted revenue.

For 2014 broker estimates are for sales of US$20.6m and pre-tax profit of US$3.0m with revenue estimates seemingly only allowing for US$11m of new contracts from the pipeline of US$100m referred to and therefore clear scope for upgrades should further contracts be secured.

It remains an exciting story!

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