



# Diamond in the rough?

Roger Montgomery finds a promising player in the largely out-of-favour mining services sector

**W**ITH THE BEST YEARS OF the mining capital expenditure boom now behind us, resource services companies have quickly fallen from favour. There are no surprises here – there is a lot of operational leverage in these businesses and that means their fortunes can swing suddenly for the worse when demand starts to disappear. In addition, some high-profile downgrades and contract disasters have reminded investors of the downside risks.

For a cautious long-term investor, the first thought that comes to mind may be that this part of the market is fraught with peril and best avoided. That's a view for which we have some sympathy, but we also think it is good to challenge the first thought that comes to mind and ask whether a more nuanced view may be appropriate.

Having the same view as everyone else in the market is seldom the path to success, and it can pay to push yourself to think a little harder. When everyone is a seller and nobody is a buyer, prices can diverge from fair value and opportunities can appear.

In thinking about the mining services sector (as for any sector) it is important to note that not all companies are created equal. In the case of mining services, good management is important and a team that is capable and honest and has shareholders' interests in mind is likely to deliver a much better result than one lacking in these traits.

The ability to identify and control risks, to know when to pass up a poorly structured contract at an inadequate margin and to give a true and accurate account of how the business is performing are all important in avoiding large-scale shareholder disappointment.

A good example of doing this well may be Monadelphous (ASX code MND), which has established an excellent long-term track record of delivering for shareholders. While the Monadelphous share price has fallen significantly in the past 12 months, long-term owners are still enjoying a price some 15 times higher than it was 10 years ago. Having a few of these investments in



your portfolio can make a big difference. With these thoughts in mind, we have been examining the resource services sector to see whether we can spot something with the right long-term prospects trading at a beaten-down price. We think we may have a candidate.

RCR Tomlinson is a little different from some other businesses in the space. It delivered strong earnings per share (EPS) growth in its 2013 financial year and is forecast to do the same again in FY2014.

RCR is a business that has a couple of things going for it. First, with a market capitalisation less than \$500 million, it is

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not large. This means that even in a challenging market, there is room for it to grow by executing well and taking share off less nimble competitors. Mind you, good execution is important.

This brings us to the thing we quite like about RCR – management. CEO Paul Dagleish joined RCR from UGL in 2009, and since then has made impressive progress

in improving what had been a problematic business. Profitability has improved; cash flows have received particular attention and have risen sharply, giving the business an excellent capacity to pay down debt and increase financial flexibility.

Dagleish is not what you might expect: he has spent a large part of his life studying, including PhD theses in science and business, has a keen interest in drawing and sculpture and he is a deep thinker. He combines this “renaissance man” side with a tough-minded focus on getting the job done. Having spent some time with him, we think this might be a good combination of qualities for his business. We say this with one eye on his track record.

Since 2009, Dagleish has rebuilt the management team and the financial performance of RCR, and is now setting to work on the recently acquired Norfolk business. There are no guarantees in investing, but we think RCR has a good chance of succeeding in this next phase of its growth and a better-than-average chance of turning out to be a long-term investment gem.

*Roger Montgomery is a portfolio manager at Montgomery Investment Management. For his book, Value.Able, see [www.rogermontgomery.com](http://www.rogermontgomery.com).*