

MINCON GROUP PLC
(“Mincon” or the “Group”)

INTERIM TRADING UPDATE

Mincon Group plc (*ESM:MIO AIM:MCON*), the Irish engineering group specialising in the design, manufacture, sale and servicing of rock drilling tools and associated products, today provides an interim trading update for the period from 1st January, 2019 to date, incorporating the first nine months of trading to 30th September, 2019.

This was the weakest quarter of the year, and a considerable step down from the same record quarter last year when we cleared the final backlog in orders. While this was a disappointment, the stance we took in reducing overheads in H1, fed through into Q3, and we believe we are beginning to see the recovery in profits and cash.

Key elements (comparison of the first nine months of 2019 to 2018):

Revenue flat for the first nine months

Mincon product sales decreased by 3%, of which;

- **Hardtekno disposal accounted for c. 1%**
- **Premier disposal accounted for c. 3%**

The acquisition of Pacific Bit of Canada added 1% to Mincon product sales

Third party product sales, excluding rig sales was up 5%

Excluding write-offs and exceptional items reported at H1 2019;

Gross margin down 3% to 35%

Operating profit down 3% to 11%

Profit before tax down 2% to 11%

Including write-offs and exceptional items reported at H1 2019, profit before tax was down 0.5%

This has been a challenging year to date, and we have had many issues to address;

- Inability to supply consistent quality due to continued use of outsourced heat treatment suppliers
- some regional weakness and poor regulatory behaviours in Africa
- some increased competition, and distributor weakness
- and some costs incurred as we opened new markets like Russia, or new product release delays as older inventory is run off.

From early in 2019, we have been unwinding our historical sales and distribution structure in favour of a regional, high-service structure which we have seen is now winning contracts. This process is now substantially complete, and we have appointed a good team to lead these regions. We have returned to positive cash generation as working capital stabilises, depreciation is half capital expenditure, and profitability drops through.

Our advantage is to be faster-moving, flexible, and responsive, with better engineering delivered by a higher level of support service to customers. Promoting this approach, with better engineering solutions, has won us several large contracts in recent months, and we should see revenues from these recently won contracts flow through in the final quarter of 2019 and beyond.

Along with the flat sales, we had ramped up costs to support sales levels that have, as yet, not delivered. We decided to reduce overheads at the same time as the change in business model, and while this has been expensive and time consuming, it was necessary and has been implemented. We also cut back the direct labour in the factories as the new revenue level stabilised at or around the level of last year.

The capital expenditure approved in the last year has been at about €2 million, about half the rate of depreciation, and outside of requirements in GeoTech, should we decide to take production in-house, may run at that level for the coming periods.

Revenue

Revenue is flat on last year at this period, at just over €86 million, with the small acquisitions being compensated for by the small disposals. Profitability is at or around the same levels as 2018, with some reduction in the quality of those profits due to the amount of corporate reorganisation and activity. This is disappointing, and since we are geared for higher turnover, when this does not materialise it has a significant effect on our margins, which were softer than at the end of H1.

By the same token, when sales grow, the improvement in margins should also be significant. It should be recalled that the 2018 revenue contained millions of euro of backlogged revenue, while 2019 has a normal four-week manufacturing cycle. 2018 was a cycle of forcing revenue through the factories, while 2019 and beyond will be about efficiency at these current levels.

As a Group, we stepped up our fixed costs base for higher anticipated revenue levels and when these sales were not achieved, we moved to reduce the overheads. The disequilibrium occurred in the last two quarters, with Q3 being notably weak, but we managed significant cost cuts while absorbing the disruption and costs.

We have now completed the cost reduction programme and paid for any significant cost cutting, and we look forward to improved margins in Q4 and beyond, while noting that this is directly a function of the sales volumes achieved. We will of course, continue to redeploy the investment and overheads of the Group where they can deliver better value and reward, but that is part of the ongoing costs programmes.

We restructured the organisation of the Group as a core element of the refocus. We have divided the Group into the four regions, Americas, Australia Pacific, Europe/Middle East and Africa, and internally appointed new managers to the latter two regions. Africa had fallen back considerably and has required reinvigoration and relaunch. This is well in hand, as is the development of our Black Empowerment planning in the South African market. We believe this is key to success in Africa, equitable treatment of staff, honest behaviour with the state and regulatory authorities, and a long-term view of our commitments in the region.

Europe remains successful and continues to develop. The revenue from the Americas has grown significantly with new contract wins, and Australia is a key region both for the Greenhammer launch in the coming months, and the commissioning of its heat treatment investment to support regional supply.

The hydraulic hammer range

We have recently completed extended testing over a fifteen-day period and drilled sustained metres over several shifts as part of that programme. We set out to test different variations of the hammer system to determine the best combination of parts to ensure drilling speed and reliability. Of the different systems tested, incorporating the drill strings, hydraulic management systems and bits, one particular configuration performed very well, beyond any engineered or forecast level which bodes well for the future of this product.

This latter set up and model has become the selected hammer product at the core of the system and, all other elements remaining equal, will form the launch model. This launch is expected in the coming months, perhaps commencing to invoice in the last quarter of 2019, but certainly in Q1, 2020. The designs and the delivery system appear robust after the recent testing, and the new designs of bits have also functioned well within specification.

Margins

The gross margin continues to run at about three per cent lower than last year, with approximately half of this due to product mix changes, and with the balance due to loss of contracts we could not supply, and some softness in the mid-range hammer and bit sizes arising from that. This has tracked through to the operating margin line in Q3.

With the exceptional gains and write-offs this is not immediately visible in the financial statements, nor will it be at the year-end, due to, inter alia, to the requirements of the accounting standards, so we intend to expand our comment accordingly at that time, as we did at the half year.

We expect the distortions caused by the reorganisation activity to fall away in Q4, and with the lower cost base, the gross and operating margins should begin to normalise again.

Driconeq has been a very successful addition to the Group, though with large turnover and relatively small margins thereby contributing to the downward change on margins, as has the disposal of HardTekno, a small but higher margin company that did not fit with our wider group strategy. The margins on the core products appear intact, in the face of increased competition by competent Indian and Chinese suppliers, particularly in Africa where price sensitivity is higher and quality expectations of products are lower. African markets are currently in rapid evolution and we are taking proactive steps to adapt our strategy there.

Balance sheet

As expected, the Group has returned to positive cash generation in the quarter, and this is expected to continue in the coming trading periods. We have reduced overheads, completed the factory extensions a year ago, and as the new heat treatment plant is commissioned in Australia, the last set of historic capital expenditure decisions has now been concluded. The quality of what is being produced in the new furnaces across the Group is improving to the new standards required, and now represents our brand consistently.

This will leave the Group in a strong production shape overall, and the exceptional gains we have made on non-core disposals have accommodated write-offs and provisioning so that assets in the balance sheet are of good quality, current, and realisable over time. We are now able to work on switching production around the factories for comparative manufacturing advantage.

For us, this does not necessarily mean that we will be the lowest-cost producer, but we can provide customers with production and service from a location that best assists their operations. In some cases, the cost of production might be higher where we choose to make product, but the cost of transport is lower, and the speed to market and flexibility of design modification is higher.

We have worked hard over recent years to minimise the volatility of our foreign exchange exposure, and where we have acquired machinery, we have leased much of it in the region in which the manufacturing is occurring, and where the local profitability supports the lending. That means our free cash will reside at Group for acquisitions, should we see valuable opportunity, for dividends, and for other investment. Cash flow is positive and is expected to remain that way for the foreseeable future.

Market comment and position

The Regional leadership structure has been put in place with experienced well-qualified managers, and we are winning significant contracts for mining, mining services, and in the GeoTech space, which we have entered in the last two years. We continue to build out our capability in that GeoTech sub-sector with the intention of driving growth and profitability. Our experience is that the profitability there should, when we have established our market position, support the same margins as we have seen in the mining sector. Much of our GeoTech sales are being manufactured outside the Group, but we can manufacture ourselves over time, and we are considering our options in that regard.

At present we manufacture most of what we sell in the mining consumables space, hammers, bits, pipes, subs and so on, and in GeoTech much of what we buy-in, fits inside our capability today, with the added advantage that we do most of our own heat treatment for items at the upper end of value add. Capital expenditure at present, after some years of build out, has fallen to half the depreciation rate, and is likely to remain there for a couple of years outside of decisions and opportunities in the GeoTech side.

Our factories are well equipped with modern kit and overall throughput is running at about 80% of the capacity we installed. As the larger contracts spool up to their full potential and exiting supplier inventory is run-off, we expect to be able to absorb the increased throughput efficiently. We are also now geared up for increased sales and revenue from the new hammer and bit ranges for 2020.

The response of every competitor in the mining consumables sector has been to increase production in response to market growth, and this has led on to price competition with any market set-back, or where routes to market are blocked, such as the ongoing issues between the USA and China, and supply is redirected. We offer a value

proposition, better production for cost expended, and to work through this model to take market share means we aim to constantly improve our offering. Fuel efficiency has been a direction of the Group for years, and the next generation hammers and systems have this at the core.

With zero net debt, free cash balances, positive cash flow, new ranges of hammers and a management group that is playing as a team, we continue to see contract wins and success in the sectors we address. The core products remain sound, well positioned and represent value for money in the eyes of our customers. The GeoTech and mining consumables and services wins in Chile, Indonesia, Chesapeake, USA, and Europe give us an indication that the way we are deploying our investments in time and resource will continue to develop and pay off for the Group. The next generation products coming through in down the hole mining, and in piling, give us a great platform for the coming years.

Forward looking statements

Any forward-looking statements made in this document represent the Board's best judgment as to what may occur in the future. However, the Group's actual results for the current and future financial periods and corporate developments will depend on a number of economic, competitive and other factors, some of which will be outside the control of the Group. Such factors could cause the Group's actual results for future periods to differ materially from those expressed in any forward-looking statements included in this announcement.

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