



The Australia/New Zealand Specialist

AUSTRALIA

GNG AU Neutral

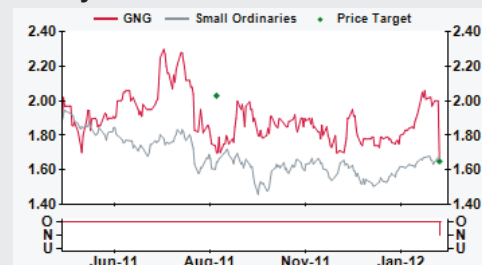
Close Price* 21 Feb 12 A\$1.67

Volatility index	Medium
12-month target	A\$ 1.65
12-month TSR	% +3.6
Valuation	A\$ 1.49-1.65
- EV/EBITA	
GICS sector	Capital Goods
Market cap	A\$m 250
30-day avg turnover	A\$m 0.2
Number shares on issue	m 150.0

Investment fundamentals

Year end 30 Jun		2011A	2012E	2013E	2014E
Revenue	m	142.5	159.6	191.5	210.7
EBIT	m	28.3	24.5	29.4	32.3
Reported profit	m	21.1	18.2	21.8	24.0
Adjusted profit	m	21.1	18.2	21.8	24.0
Gross cashflow	m	21.6	18.8	22.5	24.9
CFPS	¢	17.0	12.5	15.0	16.5
CFPS growth	%	nfmf	-26.6	19.7	10.5
PGCFPS	x	9.8	13.4	11.2	10.1
PGCFPS rel	x	0.95	1.53	1.63	1.58
EPS adj	¢	16.6	12.1	14.4	15.9
EPS adj growth	%	nfmf	-27.4	19.8	10.2
PER adj	x	10.1	13.9	11.6	10.5
PER rel	x	0.56	0.99	1.16	1.14
Total DPS	¢	4.0	8.0	8.0	8.0
Total div yield	%	2.4	4.8	4.8	4.8
Franking	%	100	100	100	100
ROA	%	41.2	33.7	35.3	33.4
ROE	%	51.7	41.4	41.9	38.3
EV/EBITDA	x	6.9	7.9	6.6	6.0
Net debt/equity	%	-85.9	-84.1	-81.5	-81.8
P/BV	x	6.1	5.3	4.4	3.6

GNG AU vs Small Ordinaries, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
Source: FactSet, Macquarie Research, February 2012
(all figures in AUD unless noted)

Analyst(s)

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21 February 2012
Macquarie Securities (Australia) Limited

GR Engineering Result below expectations

Event

- GR has reported a H1 FY12 NPAT of \$6.7m (Macquarie \$11.9m), down on pcp of \$10.6m. H1 FY12 EBIT of \$9.6m (Macquarie \$16.3 m) was down 44%.

Impact

- Conservative profit recognition and increased overheads.** Sales revenue of \$79.3m was in line with expectations and operating cash flow was over double our expectation at \$22.4m. GR also made a comment that "all construction projects advanced on time and on budget".
- Overheads doubled to \$5.0m as offices were expanded in anticipation of new work. Project delays meant these were not recovered in H1.
- We expect a much higher H2 result as profits are booked on large projects expected to finish in H2. However, this is not expected to make up for the shortfall in H1 earnings, leading to a large downgrade in FY12 earnings.
- \$150m in hand for FY12.** H2 revenue is expected to match H1 revenue. With recent contract wins, GNG now has virtually all of our FY12 revenue in hand. The company is confident of strong growth in FY13 and is working on 21 studies. We estimate the current and recently completed studies could eventually convert into \$1.75bn in EPC work not counting the \$360m Moly Mines project. GR has a typical conversion rate of 50% of studies into projects.
- Unique business model.** GNG is a Perth based engineering, project management, design and construction company. What makes it unusual for an engineering company is that it is predominantly an EPC (lump sum) rather than an EPCM (cost plus) company.
- The self perform model means GNG has limited direct competition and gives the company unique insights into costs, schedule and design issues.
- Strong balance sheet.** GNG has net cash of \$51.2m (Macquarie \$39.1m) on its balance sheet. We expect net cash to fall to \$39.5m by year end as contract pre-payments are reduced in H2.

Earnings and target price revision

- FY12E eps down 23.8% to 12.1cps. FY13E eps down 17.5% to 14.4cps.
- Price target changed from \$2.03 to \$1.65.

Price catalyst

- 12-month price target: A\$1.65 based on an EV/EBITA methodology.
- Catalyst: Further conversion of studies into construction contracts.

Action and recommendation

- We have reduced our recommendation to Neutral. While we continue to believe GR has a strong medium term outlook, this result represents a blow to confidence in the stock in our view.

GR Engineering Services (GNG:\$1.67)

21-Feb-12

Interim results		1H11(a)	2H11(a)	1H12(a)	2H12(e)	Profit & Loss		2011A	2012E	2013E	2014E	
Revenue		70.7	71.8	79.3	80.3	Revenue		\$m	142.5	159.6	191.5	210.7
EBITDA	\$m	17.3	11.5	9.9	15.3	EBITDA	\$m	28.9	25.2	30.2	33.2	
Depreciation	\$m	0.3	0.3	0.3	0.4	Depreciation	\$m	0.5	0.7	0.8	0.9	
Amortisation of goodwill	\$m	0.0	0.0	0.0	0.0	Amortisation of goodwill	\$m	0.0	0.0	0.0	0.0	
EBIT	\$m	17.1	11.3	9.6	14.9	EBIT	\$m	28.3	24.5	29.4	32.3	
Net Interest expense	\$m	-0.4	-0.5	-1.0	-0.4	Net interest expense	\$m	-0.9	-1.5	-1.7	-2.0	
Pre-Tax Profit	\$m	17.4	11.8	10.6	15.3	Pre-Tax Profit	\$m	29.2	26.0	31.1	34.3	
Tax Expense	\$m	6.8	1.3	3.9	3.9	Tax Expense	\$m	8.2	7.8	9.3	10.3	
Net Profit	\$m	10.6	10.5	6.7	11.4	Net Profit	\$m	21.1	18.2	21.8	24.0	
Outside equity interests	\$m	0.0	0.0	0.0	0.0	Outside equity interests	\$m	0.0	0.0	0.0	0.0	
Net Abn/Extra	\$m	0.0	0.0	0.0	0.0	Net Abnormals/Extra.	\$m	0.0	0.0	0.0	0.0	
Reported Earnings	\$m	10.6	10.5	6.7	11.4	Reported Earnings	\$m	21.1	18.2	21.8	24.0	
Adjusted Earnings	\$m	10.6	10.5	6.7	11.4	Adjusted Earnings	\$m	21.1	18.2	21.8	24.0	
Gross Cashflow	\$m	11.5	12.8	7.1	11.4	Gross Cashflow	\$m	24.3	18.5	24.1	25.9	
EPS (Adj/dil)	c	8.7	7.8	4.5	7.6	EPS (adj/diluted)	c	16.5	12.0	14.4	15.9	
EPS growth	%	nmf	-46.5	-48.9	-3.3	EPS growth	%	0.1	-0.3	0.2	0.1	
CFPS	c	19.2	-5.9	14.7	-3.2	PE (adj)	x	10.1	13.9	11.6	10.5	
CFPS Growth	%	nmf	nmf	-23.4	-44.7	CFPS	c	12.1	11.4	13.1	15.3	
EBITDA/Sales	%	24.5	16.1	12.5	19.0	CFPS Growth	%	-5.8	-5.5	14.3	17.2	
EBIT/Sales	%	24.2	15.7	12.1	18.5	PGCFPS	x	13.8	14.6	12.8	10.9	
Earnings Split	%	50.4	49.6	37.0	63.0	DPS	c	16.5	8.0	8.0	8.0	
Revenue Growth	%	nmf	-44.0	12.2	11.8	Yield	%	9.9	4.8	4.8	4.8	
EBIT Growth	%	nmf	-52.5	-43.7	32.2	Franking	%					
								100.0	100.0	100.0	100.0	
Profit and Loss ratios		2011A	2012E	2013E	2014E	Cashflow Analysis		2011A	2012E	2013E	2014E	
Revenue Growth	%	11.1	12.0	20.0	10.0	Pre-tax Profit	\$m	29.2	26.0	31.1	34.3	
EBIT Growth	%	19.4	-13.5	20.1	9.8	Depreciation & Amortisation	\$m	0.5	0.7	0.8	0.9	
EBITDA/Sales	%	20.3	15.8	15.8	15.8	Tax Paid	\$m	-5.5	-8.2	-7.8	-9.3	
EBIT/Sales	%	19.9	15.3	15.4	15.3	Gross cashflow	\$m	24.3	18.5	24.1	25.9	
Effective tax rate	%	27.9	30.0	30.0	30.0	Changes in working capital	\$m	4.0	-1.4	-2.6	-1.6	
Payout ratio	%	99.7	66.5	55.6	50.4	Other	\$m	-12.7	0.4	-1.5	-1.0	
EV/EBITA	x	6.2	8.6	6.9	6.0	Operating Cashflow	\$m	15.6	17.4	19.9	23.4	
EV/EBITDA	x	6.1	8.4	6.8	5.8	Acquisitions	\$m	0.0	0.0	0.0	0.0	
EV/Sales	x	1.2	1.3	1.1	0.9	Capex - Plant & Equip.	\$m	-1.1	-1.0	-1.2	-1.3	
Balance sheet ratios						Asset Sales	\$m	0.0	0.0	0.0	0.0	
ROE	%	82.7	41.4	41.9	38.3	Other	\$m	0.0	0.0	0.0	0.0	
ROA	%	48.1	33.7	35.3	33.4	Investing cashflow	\$m	-1.1	-1.0	-1.2	-1.3	
ROFE	%	1353.8	370.2	326.8	280.8	Dividend (ordinary)	\$m	-19.0	-12.0	-12.0	-12.0	
Net Debt	\$m	-35.1	-39.5	-46.3	-56.3	Equity raised	\$m	27.9	0.0	0.0	0.0	
Net Debt/Equity	%	< 0	< 0	< 0	< 0	Other	\$m	0.0	0.0	0.0	0.0	
Interest Cover	x	nmf	nmf	nmf	nmf	Financing cashflow	\$m	8.9	-12.0	-12.0	-12.0	
Price/NTA	x	5.6	5.0	4.2	3.5	Net Change in cash/debt	\$m	23.3	4.4	6.7	10.0	
NTA per share	\$	0.30	0.34	0.40	0.48							
FFPOWA	m	128.7	152.5	152.5	152.5							
Historical performance		2008A	2009A	2010A	2011A	Balance Sheet		2011A	2012E	2013E	2014E	
Revenue	\$m	106.2	79.1	128.2	142.5	Cash	\$m	36.0	40.4	47.2	57.2	
EBITDA	\$m	13.0	21.6	24.2	28.9	Receivables	\$m	24.7	27.7	33.2	36.6	
Depreciation/Amortisation	\$m	0.4	0.5	0.5	0.5	Inventories	\$m	1.7	1.9	2.2	2.5	
EBIT	\$m	12.6	21.1	23.7	28.3	Investments	\$m	0.0	0.0	0.0	0.0	
Net interest expense	\$m	-0.6	-1.0	-0.7	-0.9	Property, plant & equipment	\$m	2.0	2.3	2.7	3.1	
Pre-Tax Profit	\$m	13.3	22.1	24.4	29.2	Intangibles	\$m	0.0	0.0	0.0	0.0	
Tax Expense	\$m	3.9	6.6	6.6	8.2	Other Assets	\$m	4.4	4.4	4.4	4.4	
Net Profit	\$m	9.4	15.5	17.8	21.1	Total Assets	\$m	68.8	76.8	89.8	103.8	
Net Abn/Extra	\$m	0.0	0.0	0.0	0.0	Payables	\$m	14.8	16.5	19.8	21.8	
EPS (adj/dil)	c	7.8	12.8	14.7	16.5	Short Term Debt	\$m	0.5	0.5	0.5	0.5	
EPS growth	%	1207.5	0.6	0.2	0.1	Long Term Debt	\$m	0.4	0.4	0.4	0.4	
Ordinary DPS	c	5.4	9.2	12.5	16.5	Other Liabilities	\$m	12.3	12.3	12.3	12.3	
EBITDA/Sales	%	12.2	27.3	18.9	20.3	Total Liabilities	\$m	28.0	29.8	33.1	35.1	
EBIT/Sales	%	11.9	26.7	18.5	19.9	Shareholders Funds	\$m	40.8	47.0	56.8	68.8	
ROE	%	654.5	302.5	203.4	82.7	Minority Interests	\$m	0.0	0.0	0.0	0.0	
ROFE	%	-223.7	-238.9	-836.1	1353.8	Total Shareholders Equity	\$m	40.8	47.0	56.8	68.8	
FFPOWA	m	122.5	122.5	122.5	128.7	Total Funds employed	\$m	68.8	76.8	89.8	103.8	
						Divisional Information		2011A	2012E	2013E	2014E	
						Sales		142.5	159.6	191.5	210.7	
						Gross profit		36.8	35.6	42.7	47.0	
						Margin		25.8%	22.3%	22.3%	22.3%	
						Overheads		8.4	11.1	13.3	14.7	
						EBITA		28.3	24.5	29.4	32.3	
						Margin		19.9%	15.3%	15.4%	15.3%	

Source: Company data, Macquarie Research, February 2012