AUSTRALIA

GNG AU	Outperform
Price 14 Apr 11	A$1.00
Volatility index	**Low**

12-month target	**A$**	**1.94**
12-month TSR	**%**	**+100.9**
Valuation - EV/EBITA	**A$**	**1.76-1.94**
GICS sector		**Capital Goods**
Market cap	**A$m**	**150**
30-day avg turnover	**A$m**	**0.0**
Number shares on issue	**m**	**150.0**

Investment fundamentals

Year end 30 Jun		2011E	2012E	2013E	2014E
Revenue	m	138.3	152.2	167.4	175.7
EBIT	m	25.8	28.5	31.4	33.0
Reported profit	m	18.8	21.2	23.5	24.9
Adjusted profit	m	18.8	21.2	23.5	24.9
Gross cashflow	m	19.3	21.7	24.0	25.3
CFPS	¢	15.3	14.4	15.9	16.8
CFPS growth	%	nmf	-5.7	10.2	5.7
EPS adj	¢	14.9	14.1	15.6	16.5
EPS adj growth	%	nmf	-5.3	10.6	5.8
PER adj	x	6.7	7.1	6.4	6.1
Total DPS	¢	13.3	8.0	8.0	8.0
Total div yield	%	13.3	8.0	8.0	8.0
Franking	%	100	100	100	100
ROA	%	35.3	36.4	35.0	32.2
ROE	%	50.0	50.3	44.7	38.4
EV/EBITDA	x	4.9	4.5	4.1	3.9
Net debt/equity	%	-145.4	-136.6	-129.4	-124.0

Source: FactSet, Macquarie Research, April 2011
(all figures in AUD unless noted)

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15 April 2011
Macquarie Securities (Australia) Limited

GR Engineering

Unique business model

Event

- We commence coverage on GR Engineering (GNG) with an Outperform rating and A$1.94 target price.

Impact

- **Unique business model.** GNG is a Perth-based engineering, project management, design and construction company. What makes it unusual for a listed 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 history, bright outlook.** GNG can trace its origins back to 1986 when the current management team founded a business called JR Engineering. This business was sold to Downer in 2001. The same management team then founded GR Engineering in October 2006.
- The outlook for capital spending in the gold, base metals and nickel sector remains strong given current commodity prices. In addition, there are substantial geographic growth opportunities available to the company.
- **Outstanding financial growth and returns.** From a zero base in 2006, GNG is forecast to generate revenue of A$138.3m and EBIT of A$25.8m in FY11. EBIT has grown each year, including during the GFC.
- The EPC delivery model generates EBIT margins of 18.7% and ROE of nearly 50%. GNG will start its listed life with net cash of over A$40m on its balance sheet. This and the capex light business model will allow a future dividend payout ratio of 50-60%.
- **Key risks:** The key risks of an investment in GNG include: A downturn in commodity prices impacting demand for new processing plants; risks associated with fixed price contracting; and risks associated with dealing with smaller mining companies.

Earnings and target price revision

- No change.

Price catalyst

- 12-month price target: A$1.94 based on a EV/EBITA methodology.
- Catalyst: Conversion of studies into construction contracts.

Action and recommendation

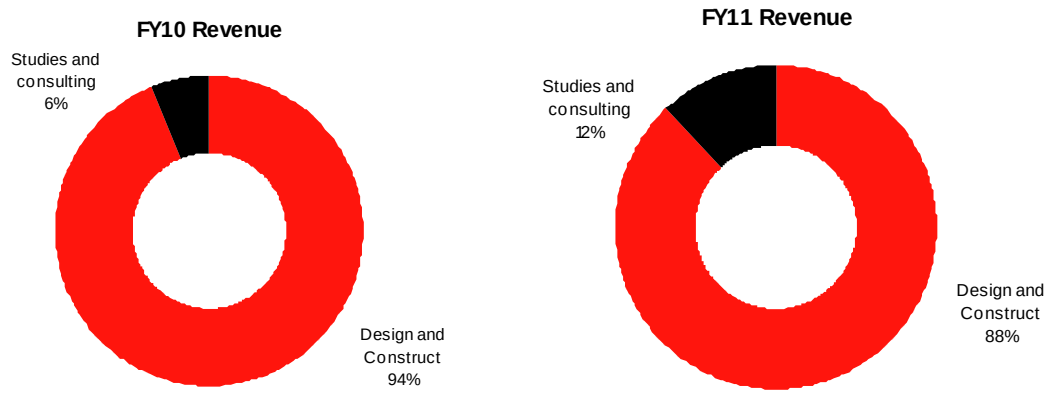
- We commence coverage with an Outperform recommendation and A$1.94 price target. We believe GNG has strong medium-term growth potential.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/disclosures.

Unique business model

- GNG is a Perth-based engineering, project management, design and construction company. What makes it unusual for a listed company is that it is predominantly an EPC (lump sum) rather than an EPCM (cost plus) company. We have detailed GNG's revenue by contract type in the charts below.

Fig 1 Revenue by service



Source: GNG, Macquarie Research, April 2011

- Whilst investors generally associate lump sum with increased risk levels, many of the best performing contractors on the ASX undertake predominantly fixed prices contracts. This includes companies like Monadelphous and Forge.
- GNG will typically be engaged by a client to perform the early stage feasibility then the FEED (front end engineering and design) phase of a project, followed by the detailed design and feasibility. All design is done in-house.
- GNG will then fix a price to build the plant on a lump sum EPC (engineer, procure and construct) basis. Given GNG is building to its own design the risks are lower than would otherwise be the case if it was building someone else's design. It is important to note that GNG only builds its own designs.
- The fabrication is sub contracted out as is the civil site works (earth and concrete) to a network of pre-qualified specialist sub contractors. The SMP (structural, mechanical and piping) and E&I (electrical and instrumentation) phases are self performed with GNG's own construction workforce.
- The commissioning and testing is performed in-house by the project designers which creates a valuable feedback and knowledge loop.
- The ability to fix a price and time and guarantee plant performance has significant appeal to GNG's clients as it provides a level of certainty appealing to project funders.
- The self-perform model means GNG has limited direct competition and gives the company unique insights into costs, schedule and design issues.
- GNG has successfully delivered 18 major projects on time, on budget and to guaranteed design performance. We have detailed some of these recent projects completed by GNG below:

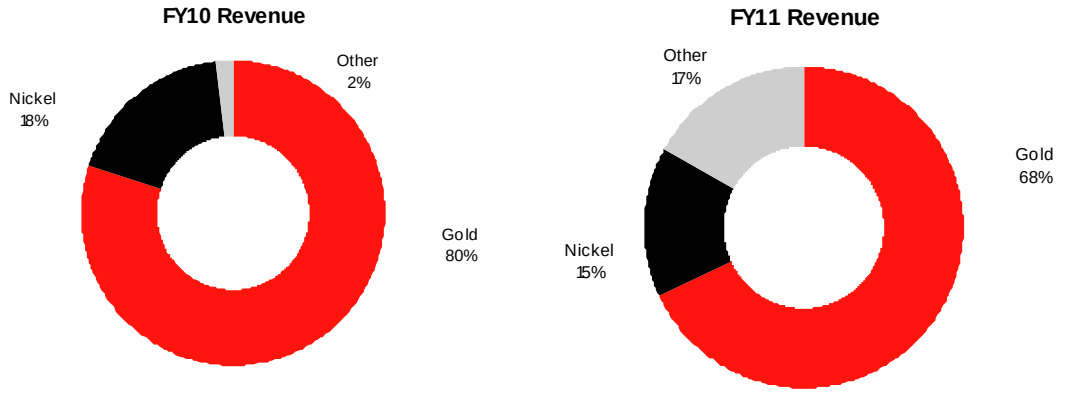
Fig 2 Project completions – specialist in gold and nickel plants

Customer	Project Name	State	Commodity	Description
Avoca	Higginsville	WA	Gold	Processing plant
Xstrata Nickel	Sinclair	WA	Nickel	Processing plant
Western Areas	Cosmic Boy	WA	Nickel	Concentrator upgrade
Barrick	Porgera	PNG	Gold	Paste fill plant
Catalpa	Edna May	WA	Gold	Processing plant
Integra	Randalls	WA	Gold	Processing plant
Newmont	Boddington	WA	Gold	Processing plant upgrade

Source: GNG, Macquarie Research, April 2011

- The key to success using this business model is to stick to core competencies and to retain control of the total process.
- We have detailed GNG's revenue by commodity in the chart below.

Fig 3 Revenue by commodity

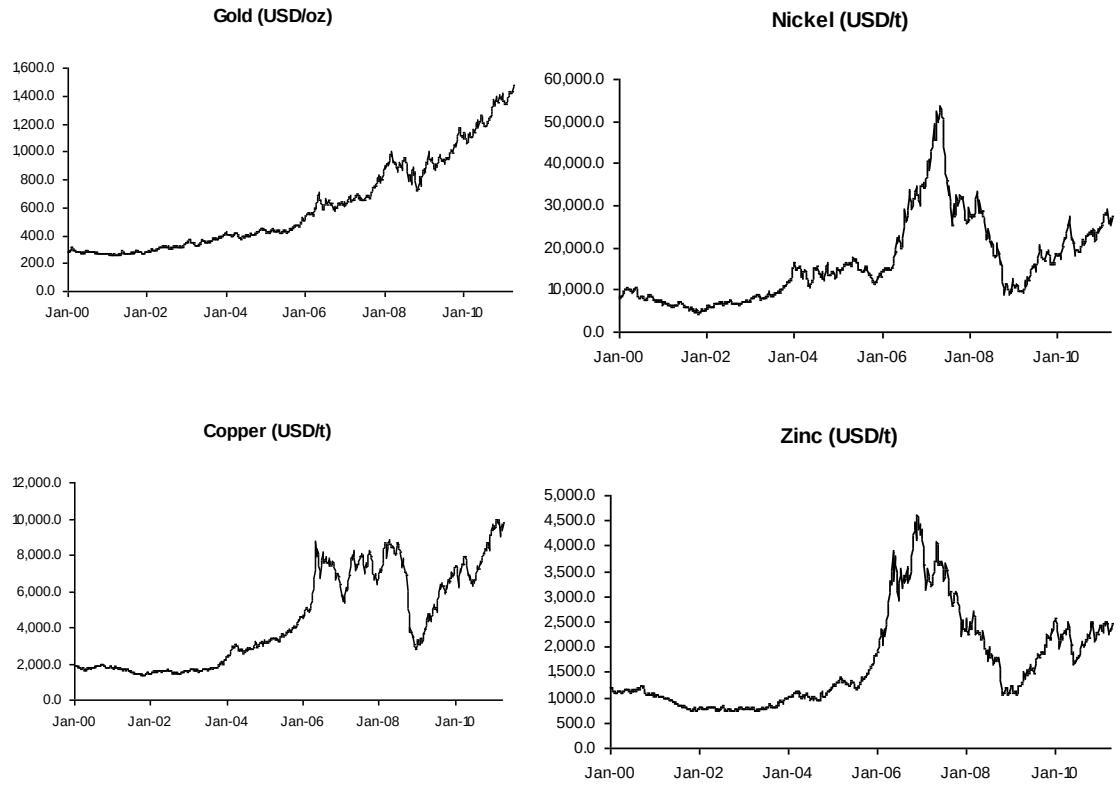


Source: GNG, Macquarie Research, April 2011

Strong history, bright outlook

- GNG can trace its origins back to 1986 when the current management team founded a business called JR Engineering. This business was sold to Downer in 2001. The same management team then founded GR Engineering in October 2006.
- GNG currently employs over 160 professional and support staff in three offices in Perth, Kalgoorlie and Brisbane. This excludes directly employed site construction personnel and sub contractors.
- Key board members and management are detailed below.
  - ⇒ Barry Patterson. Chairman. Mining engineer. Co-founder of GNG, Eltin, Australian Mine Management, National Mine Management and JR Engineering. Former Chairman of Sonic Healthcare.
  - ⇒ Joe Ricciardo. Managing Director. Mechanical Engineer. Co-founder of GNG and JR Engineering. Non executive director of Mineral Resources since IPO in 2006.
  - ⇒ Joe Totaro. Chief Financial Officer. Co-founder of GNG.
  - ⇒ Tony Patrizi. Executive Director. Co-founder of GNG and JR Engineering operations manager.
  - ⇒ Geoff Jones. Chief Operating Officer. Civil Engineer. Former GM of Sedgeman's metals engineering business.
  - ⇒ David Sala Tenna. General Manager. Mechanical Engineer. Co-founder of GNG.
- The outlook for capital spending in the gold, base metals and nickel sector remains strong given current commodity prices.

Fig 4 Key commodity prices strong



Source: IRESS, April 2011

- GNG is aiming to grow its business over time by further diversifying into commodities other than gold and nickel. This includes copper, lead, zinc and iron ore. GNG is also aiming to increase the scale of projects undertaken over time.
- In addition, there are substantial geographic growth opportunities available to the company. This is likely to be incremental and by initially taking on studies and EPCM contracts. GNG has already performed studies in South America and in January 2011 formed an alliance with MDM Engineering.
- MDM is a South African based engineering group and the aim of the alliance is to extend GNG's reach into Africa to take advantage of the large number of Australian companies with projects in Africa.

Outstanding financial growth and returns

- From a zero base in 2006, GNG is forecast to generate revenue of A$138.3m and EBIT of A$25.8m in FY11. EBIT has grown each year, including during the GFC. This is detailed in the table below.

Fig 5 Strong earnings history despite the GFC ($m)

Summary P&L	FY07(a)	FY08(a)	FY09(a)	FY10(a)	1H11(a)	2H11(e)	FY11(e)	FY12(e)
Sales	13.9	106.2	79.1	128.2	70.7	67.7	138.3	152.2
Growth		661.1%	-25.5%	62.1%		-47.2%	7.9%	10.0%
Gross profit	1.7	16.9	26.1	28.6	19.7	12.6	32.4	35.6
Margin	12.0%	15.9%	33.0%	22.3%	27.9%	18.7%	23.4%	23.4%
Overheads	1.8	4.3	5.0	4.8	2.6	3.9	6.5	7.1
OH/Sales	13.1%	4.0%	6.3%	3.8%	3.7%	5.8%	4.7%	4.7%
Growth		134.9%	16.9%	-3.6%			35.3%	8.5%
EBIT	-0.1	12.6	21.1	23.7	17.1	8.8	25.8	28.5
Margin	-1.1%	11.9%	26.7%	18.5%	24.2%	12.9%	18.7%	18.7%
Growth		n/a	67.0%	12.5%			8.8%	10.4%

Source: GNG, Macquarie Research, April 2011

- The EPC delivery model generates EBIT margins of 18.7% and ROE of nearly 50%.
- A typical EPC contract will see GNG begin to book some earnings when the job is 10-15% complete albeit with a margin for contingency. This will begin to be released when the job is around 75% complete.
- This profit recognition profile is responsible for the unusually strong margins in FY09 when some large jobs were in their final stages. Strong revenue growth was booked in FY10 as projects came back following the GFC.
- 1H11 was supported by projects such as Gold Ridge for Allied Gold and we expect 2H to be supported by the RASP project for CBH. Approximately 96% of FY11 revenue is in hand and we estimate GNG has approximately 60% of our FY12 revenue forecast in hand.
- Overheads to increase in FY11 due to both revenue growth and the opening of the new Brisbane office. Listed company costs will also contribute to an increase in overheads.
- The 1H11 tax rate of 39% was due to the tax treatment of the Gold Ridge project, which we expect to reverse in 2H to give an annual tax rate close to 30%.
- GNG will start its listed life with net cash of over A$40m on its balance sheet and has consistently maintained net cash over its life to date. GNG is an excellent cash converter as demonstrated in the table below.

Fig 6 A strong cash converter ($m)

	FY08(a)	FY09(a)	FY10(a)	1H11(a)	2H11(e)	FY11(e)
EBITDA	13.0	21.6	24.2	17.3	9.0	26.4
Operating Cashflow	26.2	6.2	15.7	23.5	11.2	34.7
+ Tax Paid	0.0	7.3	16.1	6.2	0.4	6.6
+ Net Interest Paid	-0.6	-1.0	-0.7	-0.4	-0.6	-1.0
Ungeared Pre tax Cashflow	25.6	12.5	31.1	29.3	11.0	40.3
Profit to cash Conversion	197.2%	57.8%	128.6%	169.0%	121.6%	152.8%

Source: GNG, Macquarie Research, April 2011

- An advantage of EPC contracts is the ability to match cash receipts with expenditure. GNG typically runs with no net working capital.
- This and the capex light business model will allow a future dividend payout ratio of 50-60%. We estimate a FY12 dividend of 8cps.

Key risks

- The key risks of an investment in GNG include:
  - ⇒ A downturn in commodity prices impacting demand for new processing plants.
  - ⇒ Risks associated with fixed price contracting.
  - ⇒ Risks associated with dealing with smaller mining companies.

Valuation A$1.76 to A$1.94, price target A$1.94

- We have detailed the valuation of GNG's key peers in the table below.

Fig 7 Comparables rated highly by the market

FY12	EV/EBITA	PER	Yield
AAX	8.7x	12.4x	4.4%
CDD	7.2x	10.7x	6.0%
LYL	9.9x	15.2x	3.3%
MND	11.7x	17.8x	4.7%
WOR	13.4x	18.7x	3.0%
DCG.AU	7.8x	13.5x	2.2%
SDM.AU	8.1x	12.2x	4.2%
Total/Average	12.2x	17.4x	3.5%

Source: Macquarie Research, April 2011

- GNG's key ASX listed comparables generally trade at premium multiples reflecting the premium nature of its businesses. We have begun our valuation of GNG at 7–8x FY12E EBIT. However, there is scope for this rating to rise as GNG develops its track record.
- This is detailed in the table below.

Fig 8 EV/EBITA valuation ($m)

Valuation	FY12	Multiple- Low	Multiple - High	Value - Low	Value - High
EBITA	28.5	7.0	8.0	199.5	228.1
Total	28.5			199.5	228.1
Less Net Debt				-63.9	-63.9
Plus option Cash				4.3	4.3
Value				267.8	296.3
Diluted Shares on Issue				152.5	152.5
Value per share				$1.76	$1.94

Source: Macquarie Research, April 2011

GR Engineering Services(GNG:$1.00)

14-Apr-11

Interim results		1H10(a)	2H10(a)	1H11(a)	2H11(e)
Revenue		**0.0**	**128.2**	**70.7**	**67.7**
EBITDA	**$m**	**0.0**	**24.2**	**17.3**	**9.0**
Depreciation	$m	0.0	0.5	0.3	0.3
Amortisation of goodwill	$m	0.0	0.0	0.0	0.0
EBIT	**$m**	**0.0**	**23.7**	**17.1**	**8.8**
Net Interest expense	$m	0.0	-0.7	-0.4	-0.6
Pre-Tax Profit	**$m**	**0.0**	**24.4**	**17.4**	**9.4**
Tax Expense	$m	0.0	6.6	6.8	1.2
Net Profit	**$m**	**0.0**	**17.8**	**10.6**	**8.1**
Outside equity interests	$m	0.0	0.0	0.0	0.0
Net Abn/Extra	$m	0.0	0.0	0.0	0.0
Reported Earnings	**$m**	**0.0**	**17.8**	**10.6**	**8.1**
Adjusted Earnings	**$m**	**0.0**	**17.8**	**10.6**	**8.1**
Gross Cashflow	**$m**	**0.0**	**8.8**	**11.5**	**9.3**
EPS (Adj/dil)	c	#DIV/0!	14.7	8.7	6.1
EPS growth	%	nmf	15.2	nmf	-58.2
CFPS	c	0.0	12.8	19.2	8.3
CFPS Growth	%	nmf	153.2	nmf	-35.2
EBITDA/Sales	%	nmf	18.9	24.5	13.4
EBIT/Sales	%	nmf	18.5	24.2	12.9
Earnings Split	%	0.0	100.0	56.6	43.4
Revenue Growth	%	nmf	62.1	nmf	-47.2
EBIT Growth	%	nmf	12.5	nmf	-63.1

Profit and Loss ratios		2010A	2011E	2012E	2013E
Revenue Growth	%	62.1	7.9	10.0	10.0
EBIT Growth	%	12.5	8.8	10.4	10.3
EBITDA/Sales	%	18.9	19.1	19.1	19.1
EBIT/Sales	%	18.5	18.7	18.7	18.8
Effective tax rate	%	27.0	30.0	30.0	30.0
Payout ratio	%	85.0	89.9	57.0	51.5
EV/EBITA	x	4.6	2.8	3.0	2.4
EV/EBITDA	x	4.5	2.7	3.0	2.3
EV/Sales	x	0.8	0.5	0.6	0.4
Balance sheet ratios					
ROE	%	203.4	78.6	50.3	44.7
ROA	%	62.9	42.3	36.4	35.0
ROFE	%	-836.1	-277.2	-166.7	-183.5
Net Debt	$m	-11.7	-54.7	-63.9	-75.4
Net Debt/Equity	%	< 0	< 0	< 0	< 0
Interest Cover	x	nmf	nmf	nmf	nmf
Price/NTA	x	8.5	3.6	3.0	2.4
NTA per share	$	0.12	0.27	0.34	0.41
EFPOWA	m	122.5	128.7	152.5	152.5

Historical performance		2007A	2008A	2009A	2010A
Revenue	**$m**	**13.9**	**106.2**	**79.1**	**128.2**
EBITDA	**$m**	**-0.1**	**13.0**	**21.6**	**24.2**
Depreciation/Amortisation	$m	0.1	0.4	0.5	0.5
EBIT	**$m**	**-0.1**	**12.6**	**21.1**	**23.7**
Net interest expense	$m	0.0	-0.6	-1.0	-0.7
Pre-Tax Profit	**$m**	**-0.2**	**13.3**	**22.1**	**24.4**
Tax Expense	$m	-0.1	3.9	6.6	6.6
Net Profit	**$m**	**0.0**	**9.4**	**15.5**	**17.8**
Net Abn/Extra	$m	0.0	0.0	0.0	0.0
EPS (adj/dil)	c	0.0	7.8	12.8	14.7
EPS growth	%	nmf	1207.5	0.6	0.2
Ordinary DPS	c	0.0	5.4	9.2	12.5
EBITDA/Sales	%	-0.5	12.2	27.3	18.9
EBIT/Sales	%	-1.1	11.9	26.7	18.5
ROE	%	220.0	654.5	302.5	203.4
ROFE	%	-13.0	-223.7	-238.9	-836.1
EFPOWA	m	122.5	122.5	122.5	122.5

Profit & Loss		2010A	2011E	2012E	2013E
Revenue	**$m**	**128.2**	**138.3**	**152.2**	**167.4**
EBITDA	**$m**	**24.2**	**26.4**	**29.0**	**31.9**
Depreciation	$m	0.5	0.5	0.5	0.5
Amortisation of goodwill	$m	0.0	0.0	0.0	0.0
EBIT	**$m**	**23.7**	**25.8**	**28.5**	**31.4**
Net interest expense	$m	-0.7	-1.0	-1.8	-2.1
Pre-Tax Profit	**$m**	**24.4**	**26.8**	**30.3**	**33.6**
Tax Expense	$m	6.6	8.0	9.1	10.1
Net Profit	**$m**	**17.8**	**18.8**	**21.2**	**23.5**
Outside equity interests	$m	0.0	0.0	0.0	0.0
Net Abnormals/Extra.	$m	0.0	0.0	0.0	0.0
Reported Earnings	**$m**	**17.8**	**18.8**	**21.2**	**23.5**
Adjusted Earnings	**$m**	**17.8**	**18.8**	**21.2**	**23.5**
Gross Cashflow	**$m**	**8.8**	**20.8**	**22.8**	**24.9**
EPS (adj/diluted)	c	14.7	14.7	14.0	15.5
EPS growth	%	0.2	0.0	0.0	0.1
PE (adj)	x	6.8	6.8	7.1	6.4
CFPS	c	12.8	27.0	14.2	15.7
CFPS Growth	%	153.2	109.9	-47.2	10.4
PGCFPS	x	7.8	3.7	7.0	6.4
DPS	c	12.5	13.3	8.0	8.0
Yield	%	12.5	13.3	8.0	8.0
Franking	%	100.0	100.0	100.0	100.0

Cashflow Analysis		2010A	2011E	2012E	2013E
Pre-tax Profit	**$m**	**24.4**	**26.8**	**30.3**	**33.6**
Depreciation & Amortisation	$m	0.5	0.5	0.5	0.5
Tax Paid	$m	-16.1	-6.6	-8.0	-9.1
Gross cashflow	**$m**	**8.8**	**20.8**	**22.8**	**24.9**
Changes in working capital	$m	-8.1	15.4	0.0	0.0
Other	$m	15.0	-1.5	-1.0	-1.0
Operating Cashflow	**$m**	**15.7**	**34.7**	**21.7**	**23.9**
Acquisitions	$m	0.0	0.0	0.0	0.0
Capex - Plant & Equip.	$m	-0.4	-0.4	-0.4	-0.4
Asset Sales	$m	0.0	0.0	0.0	0.0
Other	$m	0.0	0.0	0.0	0.0
Investing cashflow	**$m**	**-0.4**	**-0.4**	**-0.4**	**-0.4**
Dividend (ordinary)	$m	-15.0	-19.9	-12.0	-12.0
Equity raised	$m	0.0	28.5	0.0	0.0
Other	$m	0.0	0.0	0.0	0.0
Financing cashflow	**$m**	**-15.0**	**8.6**	**-12.0**	**-12.0**
Net Change in cash/debt	**$m**	**0.3**	**42.9**	**9.3**	**11.5**

Balance Sheet		2010A	2011E	2012E	2013E
Cash	$m	12.4	55.3	64.6	76.1
Receivables	$m	25.8	8.5	9.4	10.3
Inventories	$m	2.8	1.7	1.8	2.0
Investments	$m	0.0	0.0	0.0	0.0
Property, plant & equipment	$m	1.4	1.3	1.2	1.2
Intangibles	$m	0.0	0.0	0.0	0.0
Other Assets	$m	6.4	6.4	6.4	6.4
Total Assets	**$m**	**48.9**	**73.2**	**83.4**	**96.0**
Payables	$m	13.0	9.9	10.9	11.9
Short Term Debt	$m	0.3	0.3	0.3	0.3
Long Term Debt	$m	0.4	0.4	0.4	0.4
Other Liabilities	$m	25.1	25.1	25.1	25.1
Total Liabilities	**$m**	**38.7**	**35.6**	**36.6**	**37.7**
Shareholders Funds	$m	10.2	37.6	46.8	58.3
Minority Interests	$m	0.0	0.0	0.0	0.0
Total Shareholders Equity	$m	10.2	37.6	46.8	58.3
Total Funds employed	**$m**	**48.9**	**73.2**	**83.4**	**96.0**

Divisional Information	2010A	2011E	2012E	2013E
Sales	128.2	138.3	152.2	167.4
Gross profit	28.6	32.4	35.6	39.1
Margin	0.2	0.2	0.2	0.2
Overheads	4.8	6.5	7.1	7.7
EBITA	23.7	25.8	28.5	31.4
Margin	18.5%	18.7%	18.7%	18.8%

Source: Company data, Macquarie Research, April 2011

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 March 2011

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	45.65%	65.72%	59.70%	43.02%	68.91%	51.16%	(for US coverage by MCUSA, 14.36% of stocks covered are investment banking clients)
Neutral	39.49%	19.00%	29.85%	53.09%	26.43%	35.73%	(for US coverage by MCUSA, 17.55% of stocks covered are investment banking clients)
Underperform	14.86%	15.28%	10.45%	3.89%	4.66%	13.11%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

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