

Diploma Group Ltd

(DGX \$0.48) Buy

3 March 2010

▶ **Price Target:** \$0.76/sh

▶ **Reason For Update:** Half year result

▶ **What we know:**

DGX has posted a solid half year result with NPAT of \$5.3m up from \$0.9m pcp.

\$110m in new contracts was added to the orderbook.

Total forward order book is \$610m.

DGX is tendering or negotiating on a further \$300m in new work.

A 1c interim dividend has been declared.

We have no reason to change our full year expectations at this stage, and on that basis, DGX trades very cheaply at 4.6x forecast 2010 earnings.

▶ **What we think:**

The DGX result was up significantly on the pcp (up 462%) and the stock traded from around 30c to 50c on the back of the improved performance.

▶ **Property Development:**

That said, we continue to believe the second half can be stronger still as 2 further projects (Gateway South Joondalup and Rise Apartments) settle. In the half just gone, it was primarily the settlement of the Sky apartments that drove property development earnings.

In 2011 the property development pipeline includes the Zenith project (75% presold) and Joondalup stages 2 and 3 (marketing to commence shortly).

In 2012, Eleven 78 (94% presold) and Allure in Rockingham contributes.

In general the development pipeline is solid and demand for the product strong, particularly in the mid priced product typically offered by Diploma.

Financing remains tight, however Diploma have managed to finance developments all the way through the GFC and conditions are improving.

As always, the timing of settlements means development earnings will be lumpy, however the pipeline is sufficient to suggest strong earnings for a number of years.

Indicatively, property development is currently contributing 35% of total revenues; we would expect this to increase to 50% over the next few years.

▶ **Construction:**

The construction business targets \$20m to \$150m size construction projects and has a current orderbook of \$300m and opportunities identified of a further \$300m.

This is a solid position to be in given revenue generated for the first half of \$75m.

In addition, the construction division also performs work internally for the property development division. The margin is generated by the construction division, however often is not recognised until settlement and this will also tend to skew earnings somewhat.

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► **Investment Case:**

DGX is trading on a PE of 4.6x our 2010 forecast NPAT.

Our forecasts in 2011 and 2012 call for similar levels of income based on the property development opportunities we are aware of.

Growth is possible (and this is certainly management's expectation) and in general, we don't see the next few years being as lumpy as perhaps a PE of 4.6x would otherwise suggest.

Peers such as Finbar are comfortably trading at 7x guided earnings and we believe this is also where DGX will get to as it gains relevancy.

In short, we believe DGX are currently trading on the expectation the second half will be similar to the first, in our view however the second half will be stronger and this should see DGX trade up.

We retain our price target at \$0.76, or 7 x our 2010 expectations achieved by the full year result.

Diploma Group Ltd

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SECURITIES LIMITED

AUSTRALIAN EQUITIES RESEARCH

Sector: Property
Recommendation: Buy

Price (\$A): 0.48
Target Price (\$A): 0.76

Market Cap (\$A): 60.0m
Enterprise Value (\$A): 162.4m

| DIPLOMA GROUP LTD (DGX) | YEAR END 30 JUNE | | | |
|--------------------------------|------------------|---------------|--------------|--------------|
| | 09A | 10F | 11F | 12F |
| Income Statement | | | | |
| Sales | 143.5 | 219.0 | 227.7 | 236.0 |
| Other | 0.8 | 0.0 | 0.0 | 0.0 |
| Revenue | 144.4 | 219.0 | 227.7 | 236.0 |
| Operating costs | -140.8 | -200.0 | -208.7 | -217.5 |
| EBITDA | 3.6 | 19.0 | 19.0 | 18.5 |
| Depreciation | -0.3 | -0.3 | -0.4 | -0.5 |
| Other non cash | 0.0 | 0.0 | 0.0 | 0.0 |
| EBIT | 3.3 | 18.7 | 18.6 | 18.0 |
| Net Interest income/(expense) | -0.1 | -0.1 | 0.0 | 0.0 |
| Associates | 0.0 | 0.0 | 0.0 | 0.0 |
| Other income/(expense) | 0.0 | 0.0 | 0.0 | 0.0 |
| Abnormal items (pretax) | 0.0 | 0.0 | 0.0 | 0.0 |
| EBT | 3.2 | 18.6 | 18.6 | 18.0 |
| Tax expense | -1.2 | -5.6 | -5.6 | -5.4 |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 |
| Minority interest | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported Earnings | 2.0 | 13.0 | 13.0 | 12.6 |
| Dividends | -1.2 | -3.6 | -3.6 | -3.6 |
| Adjustments (one off) | 0.0 | 0.0 | 0.0 | 0.0 |
| Retained earnings | 0.8 | 9.4 | 9.4 | 9.0 |
| Normalized Net Profit | 2.3 | 13.0 | 13.0 | 12.6 |
| Cash Flow (A\$m) | 09A | 10F | 11F | 12F |
| Pretax Profit | 3.2 | 18.6 | 18.6 | 18.0 |
| + Depreciation | 0.3 | 0.3 | 0.4 | 0.5 |
| - Tax Paid | -4.0 | -5.6 | -5.6 | -5.4 |
| + inc (- dec) in provisions | 0.4 | 0.1 | 0.0 | 0.0 |
| - Profit/+ loss on disposal | 0.0 | 0.0 | 0.0 | 0.0 |
| +/- Other | -69.0 | 0.0 | 0.0 | 0.0 |
| Gross Cashflow | -69.1 | 13.4 | 13.4 | 13.1 |
| - Capital expenditure | -0.8 | -0.8 | -0.8 | -0.8 |
| +/- Changes in working capital | -115.3 | 47.9 | 10.7 | -1.7 |
| Operating Free Cashflow | -185.2 | 60.5 | 23.2 | 10.5 |
| +/- Investments | -0.3 | 0.0 | 0.0 | 0.0 |
| - Dividends | -0.4 | -3.6 | -3.6 | -3.6 |
| + Proceeds from equity raised | 0.0 | 0.0 | 0.0 | 0.0 |
| + Acquisition | -2.0 | 0.0 | 0.0 | 0.0 |
| +/- Minority interests | 0.0 | 0.0 | 0.0 | 0.0 |
| +/- Other | 65.0 | 0.0 | 0.0 | 0.0 |
| Net cashflow | -122.8 | 56.9 | 19.6 | 6.9 |
| Cash at beginning of period | 20.1 | -102.7 | -45.8 | -26.2 |
| Net debt at end of period | -102.7 | -45.8 | -26.2 | -19.2 |
| Balance Sheet (\$m) | 09A | 10F | 11F | 12F |
| Cash | 5.9 | 14.2 | 13.8 | 20.8 |
| Receivables | 45.4 | 38.3 | 45.3 | 48.6 |
| Inventories | 99.5 | 43.1 | 31.8 | 31.8 |
| Other | 0.2 | 0.2 | 0.2 | 0.2 |
| Current Assets | 150.9 | 95.8 | 91.1 | 101.3 |
| Receivables | 2.1 | 1.7 | 2.1 | 2.2 |
| Inventories | 19.8 | 18.5 | 13.6 | 13.6 |
| Property/Plant/Equipment | 1.9 | 2.5 | 2.9 | 3.3 |
| Equity Accounted Investments | 0.9 | 0.9 | 0.9 | 0.9 |
| Intangibles | 2.0 | 2.0 | 2.0 | 2.0 |
| Deferred tax assets | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.9 | 0.9 | 0.9 | 0.9 |
| Non Current Assets | 27.5 | 26.4 | 22.3 | 22.8 |
| Total Assets | 178.4 | 122.2 | 113.4 | 124.2 |
| Payables | -56.1 | -39.3 | -41.0 | -42.7 |
| Interest bearing liabilities | -108.3 | -20.0 | -20.0 | -20.0 |
| Current tax payable | -1.1 | -1.1 | -1.1 | -1.1 |
| Provisions | -2.5 | -2.5 | -2.5 | -2.5 |
| Current Liabilities | -167.9 | -62.9 | -64.6 | -66.3 |
| Payables | -1.0 | -0.7 | -0.7 | -0.8 |
| Interest bearing liabilities | -0.3 | -40.0 | -20.0 | -20.0 |
| Tax liabilities | 0.0 | 0.0 | 0.0 | 0.0 |
| Provisions | -0.1 | -0.1 | -0.1 | -0.1 |
| Non Current Liabilities | -1.4 | -40.8 | -20.8 | -20.8 |
| Total Liabilities | -169.3 | -103.7 | -85.4 | -87.2 |
| Net Assets | 9.1 | 18.6 | 28.0 | 37.0 |
| Contributed equity | 1.1 | 1.1 | 1.1 | 1.1 |
| Reserves | 0.8 | 0.8 | 0.8 | 0.8 |
| Retained profits | 7.2 | 16.6 | 26.0 | 35.1 |
| Minority Interests | 0.0 | 0.0 | 0.0 | 0.0 |
| Total equity | 9.1 | 18.6 | 28.0 | 37.0 |

| PERFORMANCE RATIOS | 09A | 10F | 11F | 12F |
|--|------------|------------|------------|-----------------------|
| Growth and Margins | | | | |
| Revenue Growth | n/a | 53% | 4% | 4% |
| EBITDA Growth | n/a | 433% | 0% | -3% |
| EBIT Growth | n/a | 465% | 0% | -3% |
| Normalized Net Profit Growth | n/a | 475.3% | -0.2% | -3.2% |
| EBITDA margin | 2.5% | 8.7% | 8.4% | 7.8% |
| EBIT margin | 2.3% | 8.5% | 8.2% | 7.6% |
| Normalized net profit margin | 1.6% | 6.0% | 5.7% | 5.3% |
| Effective tax rate | 37% | 30% | 30% | 30% |
| Liquidity | | | | |
| Capex/depreciation (x) | 3.3 | 2.8 | 2.2 | 1.8 |
| Current ratio (x) | 0.9 | 1.5 | 1.4 | 1.5 |
| Quick ratio (x) | 0.9 | 1.3 | 1.4 | 1.6 |
| Receivable days | 18 | 25 | 26 | 30 |
| Payable days | 22 | 26 | 23 | 25 |
| Risk Measures | | | | |
| Dividend Cover (x) | n/a | n/a | n/a | n/a |
| Payout ratio (%) | 59% | 27% | 27% | 28% |
| Net interest cover (x) | 40.9 | 223.7 | 530.5 | 950.3 |
| Net debt/equity (%) | 1126% | 213% | 71% | 35% |
| Returns | | | | |
| Return on average capital employed (%) | 35% | 134% | 80% | 580% |
| WACC (%) | | 10% | | |
| Return on assets (%) | 2% | 12% | 16% | 15% |
| Return on average equity (%) | 22% | 94% | 56% | 39% |
| Company cost of equity (%) | | 14% | | |
| SHARE DATA/VALUATION | 09A | 10F | 11F | 12F |
| Share Data | | | | |
| Issued shares (m) | 120.0 | 120.0 | 120.0 | 120.0 |
| Weighted ave shares (m) | 120.0 | 120.0 | 120.0 | 120.0 |
| Fully diluted shares (m) | 120.0 | 120.0 | 120.0 | 120.0 |
| Basic EPS (A\$) | 0.02 | 0.11 | 0.11 | 0.11 |
| YoY change (%) | n/a | 542% | 0% | -3% |
| Fully diluted EPS (A\$) | 0.02 | 0.11 | 0.11 | 0.11 |
| YoY change (%) | n/a | 475% | 0% | -3% |
| Fully diluted normalised EPS (A\$) | 0.02 | 0.11 | 0.11 | 0.105 |
| YoY change (%) | n/a | 475% | 0% | -3% |
| Dividend/share (A\$) | 0.01 | 0.03 | 0.03 | 0.03 |
| Franking (%) | 100% | 100% | 100% | 100% |
| Gross cashflow/share (A\$) | -0.58 | 0.11 | 0.11 | 0.11 |
| NBV/share (A\$) | 0.08 | 0.15 | 0.23 | 0.31 |
| NTA/Share (A\$) | 0.06 | 0.14 | 0.22 | 0.29 |
| Valuation | | | | |
| PER (Basic) (x) | n/a | 4.6 | 4.6 | 4.8 |
| PER (Fully diluted) (x) | n/a | 4.6 | 4.6 | 4.8 |
| PER (Fully diluted, normalized) (x) | n/a | 4.6 | 4.6 | 4.8 |
| P/CFPS (x) | n/a | 4.5 | 4.5 | 4.6 |
| Price/NBV (x) | n/a | 3.2 | 2.1 | 1.6 |
| Price/NTA (x) | n/a | 3.6 | 2.3 | 1.7 |
| Dividend Yield (%) | 2.0% | 6.0% | 6.0% | 6.0% |
| Fully diluted normalized 3 yr EPS Cagr (%) | n/a | n/a | n/a | n/a |
| PEG ratio (x) | n/a | n/a | n/a | n/a |
| EV | 162.7 | 105.8 | 86.2 | 79.2 |
| EV/EBITDA (x) | 45.6 | 8.5 | 8.5 | 8.8 |
| EV/EBIT (x) | 49.1 | 8.7 | 8.7 | 9.0 |
| EV/Revenue (x) | 1.1 | 0.7 | 0.7 | 0.7 |
| NPV/SOP (A\$) | | 0.20 | | |
| OTHER INFORMATION | | | | |
| Estimated free float | | | | |
| 12-mth High/Low (A\$/sh) | | | | 0.44 / 0.10 |
| Average daily volume (A\$m) | | | | 0.0 |
| ASX Code | | | | DGX |
| Next result | | | | Feb 10 (HY10 results) |
| COMPANY DESCRIPTION | | | | |
| Diploma Group Limited (DGX) is a commercial construction and property development business which offers a complete vertically integrated model by managing the entire design process of a project, from initial concept through to final delivery of the end product. The company has two divisions, Diploma Construction and Diploma Properties which are responsible for carrying out the business activities. | | | | |

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