

# Diploma Group Ltd

## (DGX \$0.40) Buy, Initiation of Coverage

12 February 2010

### Western Australia

Sector: Property Development and Construction  
DGX.ASX

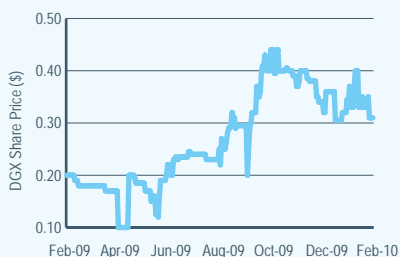
### Reason For Research

Initiation of Coverage

### Key Metrics

12M price target	\$0.76
+/- up/downside	90%
Methodology	PER
Market Cap	\$48m
Shares on issue	120m
Free float (est.)	15%
12M avg daily volume	\$0.01m
12M high/low	\$0.44 - \$0.10

### Share Price Performance



**Diploma Group Ltd listed in December 2007 as a long standing construction business and more recently property developer with a focus in Western Australia. DGX is particularly well placed to benefit from improvements in the WA economy driven by an increasingly strong resources sector, and in particular LNG expenditure themes, that are driving employment and population growth in the state. While DGX was not without challenges in 2009, in 2010 there are a number of developments completing (that have predominately presold) and as a consequence 2010 is shaping up as a solid year. While property development is inherently lumpy, we also have good visibility into 2011 and the construction business has also been winning work. DGX trades cheaply compared to peers, has travelled under the radar somewhat in its commencement of public life and we commence coverage with a Buy recommendation and PT of \$0.76.**

**Management, History, Earnings and Risks.** DGX commenced life as a construction business in 1976, founded by Dominic Di Latte. The business, now run by his son Nick (since 2005), has evolved into a vertically integrated commercial construction and property development business. This is explored further below. Diploma produced a 2009 NPAT result of \$2m on revenues of \$142m, down on expectations and primarily reflecting \$5m in write downs on certain construction contracts and slippage on settlement of the Sky apartments. In 2010 DGX is tracking towards a much improved result and we are forecasting NPAT of \$13.1m, driven by improved construction margin and the commencement of settlement on a number of property developments. Key risks, explored below, include continuing demand for product, and the ability of DGX to successfully execute on mandates.

**Property Development.** Diploma primarily develops apartment buildings in WA. DGX has a significant number of projects completing and settling in 2010, with an estimated settled value of circa \$100m (DGX's Share) in our view, versus approx \$9m in 2009. In 2011 we see a further \$84m in projects settling. Overall the order book in 2010 and 2011 is strong. Each project is separately project financed (banked based on presales that cover total debt) and construction is generally performed "in house" by the DGX construction division. The initial land purchase is often funded out of operating cash flows. The nature of property development means that at any given point in time debt levels can spike, as the development nears completion, however will reduce shortly thereafter as settlements occur. Other than project specific financing Diploma has no other debt.

**Construction Business.** In addition to property development, DGX has operated a construction business since 1976. This business performs construction on an arms length basis for the property development group (approx one third of revenues), however is also engaged in a meaningful way on WA based construction projects for external clients. The orderbook currently stands at \$300m with a further \$100m identified as short term opportunities. There is perhaps more work available than many might realise. The business is competitive however steady and provides a base load of work perhaps not quite as lumpy as property development.

**WA Macro Encouraging.** In our view prospects for 2010 and 2011 are bright based on existing projects, for which much of the product is presold. Longer term the question is what demand for apartments and commercial buildings will exist in the future, as this is the ultimate driver of both aspects of the Diploma business. Our analysis of various drivers (namely forecast economic growth, median house prices, affordability, dwelling approvals, population growth and unemployment), points to an encouraging macro environment generally for WA, driven by the significant resources expansion plans we are aware of, both committed and contemplated, and we have explored this in further detail below.

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**Sector:** Property Developer  
**Recommendation:** Buy

**Price (\$A):** 0.40  
**Target Price (\$A):** 0.76

**Market Cap (\$A):** \$48m  
**Enterprise Value (\$A):** \$150.4m

DIPLOMA GROUP LTD (DGX)	YEAR END 30 JUNE			
	09A	10F	11F	12F
<b>Income Statement</b>				
Sales	143.5	172.2	181.5	191.8
Other	0.8	0.0	0.0	0.0
<b>Revenue</b>	<b>144.4</b>	<b>172.2</b>	<b>181.5</b>	<b>191.8</b>
Operating costs	-140.8	-153.0	-162.4	-172.7
<b>EBITDA</b>	<b>3.6</b>	<b>19.2</b>	<b>19.1</b>	<b>19.1</b>
Depreciation	-0.3	-0.3	-0.4	-0.5
Other non cash	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>3.3</b>	<b>18.9</b>	<b>18.8</b>	<b>18.6</b>
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
<b>EBT</b>	<b>3.2</b>	<b>18.8</b>	<b>18.7</b>	<b>18.6</b>
Tax expense	-1.2	-5.6	-5.6	-5.6
Discontinued operations	0.0	0.0	0.0	0.0
Minority interest	0.0	0.0	0.0	0.0
<b>Reported Earnings</b>	<b>2.0</b>	<b>13.1</b>	<b>13.1</b>	<b>13.0</b>
Dividends	-1.2	-3.6	-3.6	-3.6
Adjustments (one off)	0.0	0.0	0.0	0.0
Retained earnings	0.8	9.5	9.5	9.4
<b>Normalized Net Profit</b>	<b>2.3</b>	<b>13.1</b>	<b>13.1</b>	<b>13.0</b>
<b>Cash Flow (\$m)</b>	<b>09A</b>	<b>10F</b>	<b>11F</b>	<b>12F</b>
<b>Pretax Profit</b>	<b>3.2</b>	<b>18.8</b>	<b>18.7</b>	<b>18.6</b>
+ Depreciation	0.3	0.3	0.4	0.5
- Tax Paid	-4.0	-5.6	-5.6	-5.6
+ 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
<b>Gross Cashflow</b>	<b>-69.1</b>	<b>13.5</b>	<b>13.5</b>	<b>13.5</b>
- Capital expenditure	-0.8	-0.8	-0.8	-0.8
+/- Changes in working capital	-115.3	53.9	10.6	-2.1
<b>Operating Free Cashflow</b>	<b>-185.2</b>	<b>66.6</b>	<b>23.3</b>	<b>10.6</b>
+/- 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	63.0	19.7	7.0
Cash at beginning of period	20.1	-102.7	-39.7	-20.1
<b>Net debt at end of period</b>	<b>-102.7</b>	<b>-39.7</b>	<b>-20.1</b>	<b>-13.1</b>
<b>Balance Sheet (\$m)</b>	<b>09A</b>	<b>10F</b>	<b>11F</b>	<b>12F</b>
Cash	5.9	20.3	19.9	26.9
Receivables	45.4	23.6	30.8	34.7
Inventories	99.5	43.1	31.8	31.8
Other	0.2	0.2	0.2	0.2
<b>Current Assets</b>	<b>150.9</b>	<b>87.2</b>	<b>82.7</b>	<b>93.6</b>
Receivables	2.1	1.1	1.4	1.6
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
<b>Non Current Assets</b>	<b>27.5</b>	<b>25.7</b>	<b>21.6</b>	<b>22.2</b>
<b>Total Assets</b>	<b>178.4</b>	<b>112.9</b>	<b>104.3</b>	<b>115.8</b>
Payables	-56.1	-30.1	-31.9	-33.9
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
<b>Current Liabilities</b>	<b>-167.9</b>	<b>-53.7</b>	<b>-55.5</b>	<b>-57.5</b>
Payables	-1.0	-0.5	-0.6	-0.6
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
<b>Non Current Liabilities</b>	<b>-1.4</b>	<b>-40.6</b>	<b>-20.6</b>	<b>-20.7</b>
<b>Total Liabilities</b>	<b>-169.3</b>	<b>-94.3</b>	<b>-76.2</b>	<b>-78.2</b>
<b>Net Assets</b>	<b>9.1</b>	<b>18.7</b>	<b>28.2</b>	<b>37.6</b>
Contributed equity	1.1	1.1	1.1	1.1
Reserves	0.8	0.8	0.8	0.8
Retained profits	7.2	16.7	26.2	35.7
Minority Interests	0.0	0.0	0.0	0.0
<b>Total equity</b>	<b>9.1</b>	<b>18.7</b>	<b>28.2</b>	<b>37.6</b>

PERFORMANCE RATIOS	09A	10F	11F	12F
<b>Growth and Margins</b>				
Revenue Growth	n/a	20%	5%	6%
EBITDA Growth	n/a	437%	0%	0%
EBIT Growth	n/a	469%	0%	-1%
Normalized Net Profit Growth	n/a	479.6%	-0.2%	-0.7%
EBITDA margin	2.5%	11.1%	10.5%	10.0%
EBIT margin	2.3%	11.0%	10.3%	9.7%
Normalized net profit margin	1.6%	7.6%	7.2%	6.8%
Effective tax rate	37%	30%	30%	30%
<b>Liquidity</b>				
Capex/depreciation (x)	3.3	2.8	2.2	1.8
Current ratio (x)	0.9	1.6	1.5	1.6
Quick ratio (x)	0.9	1.5	1.6	1.8
Receivable days	18	16	14	17
Payable days	22	18	14	16
<b>Risk Measures</b>				
Return on average capital employed (%)	35%	134%	80%	599%
WACC (%)		10%		
Return on assets (%)	2%	13%	17%	17%
Return on average equity (%)	22%	95%	56%	40%
Company cost of equity (%)		14%		
<b>Returns</b>				
Return on average capital employed (%)	35%	131%	79%	433%
WACC (%)		10%		
Return on assets (%)	2%	12%	15%	12%
Return on average equity (%)	22%	92%	55%	32%
Company cost of equity (%)		14%		
<b>SHARE DATA/VALUATION</b>	<b>09A</b>	<b>10F</b>	<b>11F</b>	<b>12F</b>
<b>Share Data</b>				
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	546%	0%	-1%
Fully diluted EPS (A\$)	0.02	0.11	0.11	0.11
YoY change (%)	n/a	480%	0%	-1%
Fully diluted normalised EPS (A\$)	0.02	0.11	0.11	0.109
YoY change (%)	n/a	480%	0%	-1%
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	0.16	0.23	0.31
NTA/Share (A\$)	0.06	0.14	0.22	0.30
<b>Valuation</b>				
PER (Basic) (x)	n/a	3.7	3.7	3.7
PER (Fully diluted) (x)	n/a	3.7	3.7	3.7
PER (Fully diluted, normalized) (x)	n/a	3.7	3.7	3.7
P/CFPS (x)	n/a	3.6	3.6	3.6
Price/NBV (x)	n/a	2.6	1.7	1.3
Price/NTA (x)	n/a	2.9	1.8	1.3
Dividend Yield (%)	2.5%	7.5%	7.5%	7.5%
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	150.7	87.7	68.1	61.1
EV/EBITDA (x)	42.3	7.9	7.9	7.9
EV/EBIT (x)	45.5	8.0	8.0	8.1
EV/Revenue (x)	1.0	0.9	0.8	0.8
NPV/SOP (A\$)		0.08		
<b>OTHER INFORMATION</b>				
Estimated free float				15%
12-mth High/Low (A\$/sh)				0.44 / 0.10
Average daily volume (A\$m)				0.1
ASX Code				DGX
Next result				Feb 10 (HY10 results)
<b>COMPANY DESCRIPTION</b>				
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.				

## Investment case

Diploma trades on a 2010 PE of approx 3.7x and yields approx 7.5% based on our forecasts.

The earnings are inherently lumpy, however DGX trade at an unwarranted discount to peers in our view, perhaps a consequence of trading under the radar.

A selection of peers are provided below:

Company	ASX Code	PER		Yield	
		2010	2011	2010	2011
Stockland	SGP	13.3x	12.4x	5.7%	5.9%
Lend Lease Corporation Limited	LLC	14.0x	13.0x	3.9%	4.4%
Mirvac Group	MGR	16.1x	14.0x	5.6%	6.1%
FKP Property Group	FKP	7.6x	7.0x	1.5%	3.0%
Peet Limited	PPC	16.0x	13.8x	3.8%	4.4%
Cedar Woods Properties Limited	CWP	13.8x	10.0x	3.6%	5.0%
Australand Property Group	ALZ	10.1x	9.3x	9.0%	9.1%
Watpac	WTP	6.9x	6.2x	7.6%	9.0%
Finbar Group Limited	FRI	6.8x	6.8x	6.9%	6.9%
<b>Average</b>		<b>12.2x</b>	<b>10.8x</b>	<b>5.0%</b>	<b>5.6%</b>

Of the peers, the most comparable are Finbar and Watpac. Finbar is a purely WA based apartment property developer and Watpac, a Qld construction and property development company. Both are comfortably trading at around 7 x 2010 forecast earnings.

We set our 12 month price target at 7 x our EPS forecasts for 2011 of 11c, which translates to \$0.76.

This is under peers, however assumes a discount for the possible lumpiness of earnings. This discount can trade away if DGX can demonstrate consistency of property development earnings over the next number of years and this provides upside.

Indicatively, were DGX able to consistently generate NPAT in the region of \$12 to \$13m (as we are forecasting in 2010 and 2011), the market may eventually be inclined to capitalise these earnings at current peer metrics of around 10x (which are approx historical averages), and this suggests a PT in the region of \$1.00.

To achieve this, DGX will need to identify, market, sell and construct further projects to settle in 2013 and beyond.

Catalysts for this stock are really about results and successful marketing of potential projects and we expect good newsflow on both these fronts in the short and medium term.

## Management, History, Earnings and Risks

Diploma listed in December 2007 to provide a mechanism to free up some of founder Dominic Di Latte interests in a business he commenced some 35 years ago, together with providing a platform to assist grow the business.

The company listed at 50c with a market capitalisation of \$60m and achieved prospectus forecasts of \$10m EBT. In the following year, 2009, DGX experienced a slump in earnings to \$2m, partially due to timing differences in the settlement of the Sky apartments (which subsequently have settled this year) and partially due to approx \$5m in write downs on certain constructions jobs (these issues are explored further below)

Since then conditions have improved and prospects for 2010 and 2011 look bright.

### Board and Management

The board consists of Dominic Di Latte (Chairman and founder), Nick Di Latte (Managing Director), John Norup (executive director and head of construction activities), Ian Olson (non executive director and chartered accountant), Carl Lancaster (non executive with significant property development experience) and Simon Oaten (CFO).

In our view, the board looks more than capable, however primarily represents the management talent of the business and could probably look to more independence over time.

### Shareholders

Directors own approx half (61m) of the 120m shares on issue. A further 40m is owned by management and interested parties and only 18m is available for public trade in our view.

Liquidity will be an issue for investors.

### Earnings

We are looking for 2010 NPAT in the region of \$13.1m for both 2010 and 2011.

Our forecasts are based on our analysis of the development and construction divisions included elsewhere in this report.

The following provides a summary of our forecast expectations:

	2009	2010	2011	2012
<b>Revenue</b>				
Çonstruction (external only)	134.5	75.0	98.0	110.5
Property development	9.1	97.2	83.5	81.3
Other	0.8	0.0	0.0	0.0
<b>Total Revenue</b>	<b>144.4</b>	<b>172.2</b>	<b>181.5</b>	<b>191.8</b>
Cost of Sales	-131.4	-143.7	-152.5	-162.2
Administration	-6.6	-6.0	-6.4	-6.7
Marketing and advertising	-1.0	-1.2	-1.2	-1.3
Occupancy	-0.5	-0.6	-0.6	-0.7
Other	-1.3	-1.6	-1.6	-1.7
<b>Operating costs</b>	<b>-140.8</b>	<b>-153.0</b>	<b>-162.4</b>	<b>-172.7</b>
<b>EBITDA</b>	<b>3.6</b>	<b>19.2</b>	<b>19.1</b>	<b>19.1</b>
Depreciation & amortisation	-0.3	-0.3	-0.4	-0.5
<b>EBIT</b>	<b>3.3</b>	<b>18.9</b>	<b>18.8</b>	<b>18.6</b>
Net borrowing costs	-0.1	-0.1	-0.0	-0.0
<b>Net profit before tax</b>	<b>3.2</b>	<b>18.8</b>	<b>18.7</b>	<b>18.6</b>
Tax expense	-1.2	-5.6	-5.6	-5.6
<b>Net profit / (loss)</b>	<b>2.0</b>	<b>13.1</b>	<b>13.1</b>	<b>13.0</b>

Detailed investigation of each division is provided below however in general we note:

- We anticipate property development income to increase significantly in 2010 based on known projects and associated settlements.
- We anticipate this level of development to be maintained in 2011 and a good part of 2012.
- Construction revenues are also well up; a key assumption here is around ability to deliver margin, which proved difficult in 2009. This was due to “lenient” pricing on some internal work. We understand this has since been rectified and margin is on track in 2010.
- We assume all interest cost is capitalised and included in relevant COGS.

## Balance Sheet

At the end of 2009 DGX carried significant levels of project finance debt associated with development of the Rise and Sky Apartments. These levels have unwound during the course of 2010, however have partially increased as construction at Eleven 78 and Zenith ramps up.

In the absence of the project financing the balance sheet is very lean, with earnings typically paid out as dividends and insurance bonds providing necessary construction guarantees.

The business model is working for the moment, and there is no particular working capital risk in our view, although DGX may well look to raise money at some point to strengthen ability to opportunistically acquire future development sites.

Each project is financed individually with the opportunity put to tender. To date developments have been well supported by the banks.

## Risks

The Key construction risk is execution.

Good execution requires not just robust procedures and systems but the discipline to follow them. To this end good project management is key. DGX mitigate this risk some what by 35 years experience and by engaging on a series of large jobs rather than many small ones, meaning the “top” construction teams are achieving more bang for the buck. “Poor” construction contracts are however inevitable from time to time.

On the development side the primary risk is a demand. A lack of demand means no presales and ultimately no projects, which would obviously impact future earnings. Once the project is banked, costs need to be managed per the construction contract.

## Property Development

We provide below our view of the orderbook of current property development opportunities.

<b>Development (EZL estimates)</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>Joondalup (South)</b>				
Units Settled	42.0	20.0	-	-
Price ('000's)	450.0	450.0	450	450
Total sales (\$m)	18.9	9.0	-	-
share of sales	100.0%	100.0%	100.0%	100.0%
DGX sales	18.9	9.0	-	-
Anticipated Margin	20.0%	20.0%	20.0%	20.0%
Gross Profit	3.8	1.8	-	-
% of profits	100.0%	100.0%	100.0%	100.0%
DGX share of profit	3.8	1.8	-	-
<b>Joondalup (North)</b>				
Units Settled	7.0	-	-	-
Price ('000's)	450.0	450.0	450	450
Total sales (\$m)	3.2	-	-	-
Anticipated Margin	20.0%	20.0%	20.0%	20.0%
Gross Profit	0.6	-	-	-
% of profits	100.0%	80.0%	80.0%	80.0%
DGX share of profit	0.6	-	-	-
<b>Joondalup (Cove and Edge)</b>				
Units Settled	-	64.0	21	-
Price ('000's)	450.0	450.0	450	450
Total sales (\$m)	-	28.8	9.5	-
Anticipated Margin	20.0%	20.0%	20.0%	20.0%
Gross Profit	-	5.8	1.9	-
% of profits	100.0%	100.0%	100.0%	100.0%
DGX share of profit	-	5.8	1.9	-
<b>Sky</b>				
Units Settled	115.0	4.0	-	-
Price	500.0	540	540	540
Total sales	57.5	2.2	-	-
share of sales	80.0%	80.0%	80.0%	80.0%
DGX share of sales	46.0	1.7	-	-
Anticipated margin	17.0%	17.0%	17.0%	17.0%
Gross Profit	7.8	0.3	-	-
% of profits	100.0%	100.0%	100.0%	100.0%
DGX share	7.8	0.3	-	-
<b>Rise</b>				
Units Settled	52	20	-	-
Price	700	750	750	750
Total sales	36.4	15.0	-	-
share of sales	80.0%	80.0%	80.0%	80.0%
DGX share of sales	29.1	12.0	-	-
Anticipated margin	20.0%	20.0%	20.0%	20.0%
Gross Profit	7.28	3	-	-
% of profits	100.0%	100.0%	100.0%	100.0%
DGX share	7.28	3	-	-

Table continues on the following page.

	2010	2011	2012	2013
<b>Zenith</b>				
Units Settled	-	100	25	-
Price	640	640	640	640
Total sales	-	64	16	-
Share of revenues	50	50.0%	50.0%	50.0%
DGX Sales	-	32	8	0
Anticipated margin	20.0%	20.0%	20.0%	20.0%
Gross profit	-	6.4	1.6	-
<b>Eleven78</b>				
Units Settled	-	0	126.0	-
Price	600	600	600	600
Total sales	-	0	75.6	-
Share of revenues	50.0%	50.0%	50.0%	50.0%
DGX sales	-	0	37.8	-
Anticipated margin	20.0%	20.0%	20.0%	20.0%
Gross profit	-	0	7.6	-
% of profits	100.0%	100.0%	100.0%	100.0%
DGX share	-	0	7.6	-
<b>Allure (Rockingham)</b>				
Units Settled	-	-	50	64
Price	-	-	520	520
Total sales	-	-	26	33.28
Anticipated margin	-	-	20.0%	20.0%
Gross profit	-	-	5.2	6.656
<b>Pier Street</b>				
Units Settled	-	-	-	140
Price	-	-	425	425
Total sales	-	-	-	59.5
Share of revenues	-	-	0.5	0.5
DGX sales	-	-	-	29.75
Anticipated margin	-	-	20.0%	20.0%
Gross profit	-	-	-	5.95
% of profits	-	-	100.0%	100.0%
DGX share	-	-	-	5.95
<b>Summary</b>				
Total revenues	97.2	83.5	81.3	63.0
Gross Profit	19.5	17.3	16.3	12.6
Gross profit margin	20.1%	20.7%	20.0%	20.0%

The property development pipeline supports a good level of earnings from these activities for 2010 and 2011.

A significant amount of the earnings we are forecasting above are locked in. We note the following:

#### Joondalup South

This is a 62 apartment project which has achieved practical completion. 30 of the apartments have sold and 12 are on hold. Appetite has been solid. We are conservatively assuming the remaining apartments settle in 2011. The project was completed on time and budget.

#### Joondalup Cove

This is a 64 apartment project which has been approved. DGX will commence marketing once Joondalup South is primarily sold. Once banked the project will take a year to complete. Provided apartment demand holds up, these apartments should settle late fiscal 2011 or early fiscal 2012.

## **Sky**

Construction of this project is complete. 105 of this projects 119 apartments settled in the first half of 2010, with the remainder expected to settle in the second half.

## **Rise**

As with Sky, this project is complete with 55 of 72 apartments sold. Title has not yet been achieved and the 55 apartments will settle once this has happened. We are conservatively assuming the remaining 18 apartments settle in 2011.

## **Zenith**

This is a 125 apartment project that is part way through construction. The project is a 50% JV with the land owner. Practical completion is expected December 2010. 94 of the apartments are presold and consequently strong settlements in 2011 are likely.

## **Eleven 78**

This is a 126 apartment project in JV with the land owner. 118 apartments have been presold and funding is approved. Construction will commence shortly. DGX will be pushing hard for title by end of fiscal 2011. We are assuming settlement in 2012.

## **Allure**

This project is identified as a contributor to 2012. Approvals are in place and marketing will commence in March 2010. The project offers a significant number of apartments under \$500k. Once sufficient presales are achieved, DGX will bank, and then develop, the project.

## **Pier Street**

This is a 140 apartment project in JV with the state Government. The Government has agreed to take up 30% of the product. We are conservatively assuming this project settles in 2013. Although marketing has not yet commenced the strong take up by the Government is a very good start.

## Construction Business

We present below the order book as at Dec 2009 as we see it for the construction business.

<b>Construction</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Total</b>
Queens River	25.0	45.0	40.0	110.0
Zenith	20.0	25.0	-	45.0
Eleven 78	5.0	16.0	16.0	37.0
Other	30.0	60.0	20.0	110.0
Orderbook as at Dec 2009	80.0	146.0	76.0	302.0
Revenues first half	70.0	-	-	-
Work to be won	-	50.0	145.0	-
Forecast	150.0	196.0	221.0	-
50% External	75.0	98.0	110.5	
50% Internal	75.0	98.0	110.5	
Margin	6.0%	6.0%	6.0%	
Gross Profit	9.0	11.8	13.3	

We note the following:

- Queens Riverside is a third party construction project at 36 Adelaide Terrace in Perth. The project is worth \$110m over 3 years, with subsequent stages possible.
- Other projects identified include "internal" projects Zenith and Eleven 78.
- We understand there is a further \$100m in short term construction possibilities to be awarded in the short term.
- In addition, not included in the above, is possible UAE construction work, which represents a significant but not valued opportunity. DGX have a team in place and opportunities have been tendered.
- A key risk to DGX earnings is contract execution. To this end we rely on business systems and procedures of sufficient robustness to capture and seek variation on any changes to scope on a project, together with adequate pricing of the project in the first place.
- From an analytical point of view the ability of DGX to execute is difficult to determine, other than to look at previous results.
- We provide the following table identifying previous construction performance.

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010 F</b>
Revenue external	23.2	53.5	90.0	134.0	75.0
Revenue internal	-	-	22.8	60.0	75.0
Total construction revenue	23.2	53.5	112.8	194.0	150.0
EBIT	1.1	2.8	10.8	1.4	9.0
EBIT margin	4.90%	5.17%	9.57%	0.72%	6.00%

We note the following:

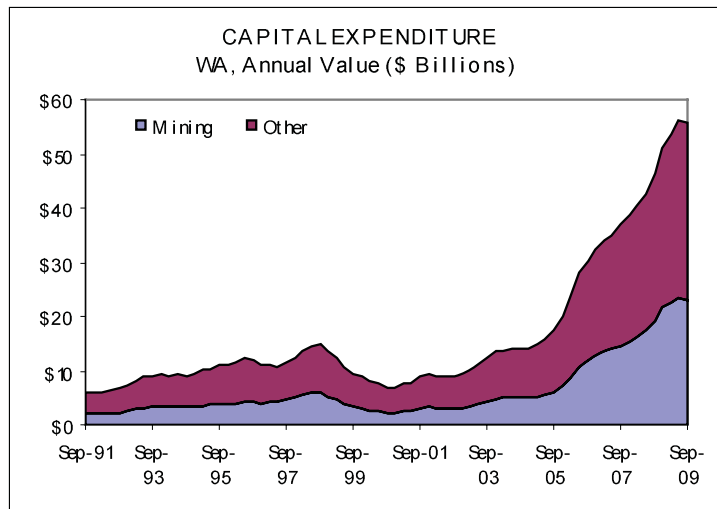
- Margins have consistently ranged between 5% + 10% since 2006 except for 2009.
- 2009 was impacted by the GFC generally but also by "lenient" pricing on certain internal property development projects.
- We understand processes in relation to pricing internally have been tightened, however this will require watching.

## WA Macro Encouraging

The primary driver of overall opportunity for DGX is appetite for apartments in Western Australia. While DGX is also making inroads in NSW and the UAE, WA is the primary driver and the focus of our macro environment work.

We provide the following charts and note the following:

Capital expenditure levels remains at historical highs, driving the WA economy.



Source: ABS, Cat. 5625

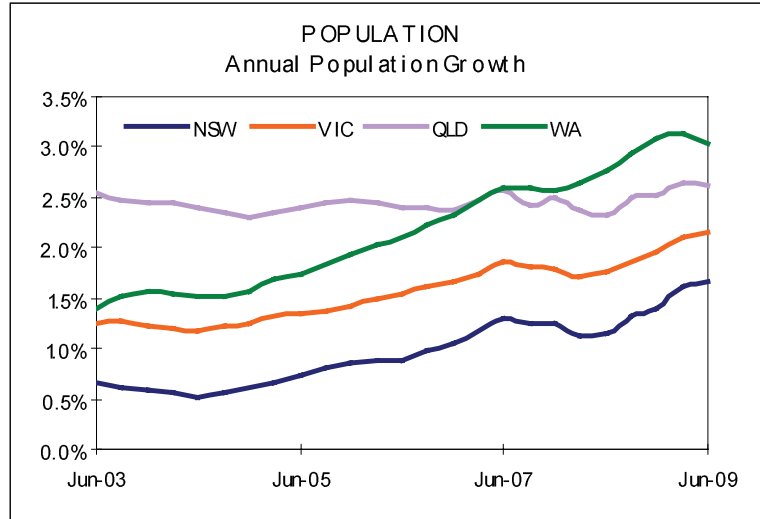
The strong economy has seen a recovery in Perth median house prices and importantly for DGX, a recovery in unit prices

Composition Adjusted Median House Prices (Quarterly)						
HOUSES	Dec-09	Sep-09	Jun-09	Dec-08	QOQ%Δ	YOY%Δ
Sydney	\$595,745	\$565,581	\$553,583	\$531,560	5.3%	12.1%
Melbourne	\$517,756	\$486,708	\$451,783	\$436,765	6.4%	18.5%
Brisbane	\$445,562	\$432,530	\$426,324	\$413,767	3.0%	7.7%
Adelaide	\$427,109	\$420,624	\$406,936	\$416,949	1.5%	2.4%
Canberra	\$535,941	\$513,854	\$488,608	\$484,757	4.3%	10.6%
Perth	\$512,178	\$497,011	\$484,120	\$471,104	3.1%	8.7%
Hobart	\$321,798	\$303,067	\$292,074	\$281,176	6.2%	14.4%
Darwin	\$556,295	\$533,116	\$530,058	\$490,146	4.3%	13.5%
National	\$525,524	\$501,660	\$483,635	\$468,946	4.8%	12.1%

Composition Adjusted Median Unit Prices (Quarterly)						
UNITS	Dec-09	Sep-09	Jun-09	Dec-08	QOQ%Δ	YOY%Δ
Sydney	\$405,795	\$397,679	\$389,071	\$369,607	2.0%	9.8%
Melbourne	\$375,663	\$368,833	\$354,817	\$337,015	1.9%	11.5%
Brisbane	\$358,289	\$363,407	\$357,186	\$352,010	-1.4%	1.8%
Adelaide	\$281,451	\$276,801	\$273,519	\$266,975	1.7%	5.4%
Canberra	\$387,788	\$384,004	\$377,857	\$352,494	1.0%	10.0%
Perth	\$385,001	\$361,102	\$341,786	\$332,492	6.6%	15.8%
Hobart	\$246,854	\$234,431	\$230,412	\$215,353	5.3%	14.6%
Darwin	\$428,448	\$415,906	\$363,513	\$348,861	3.0%	22.8%
National	\$377,079	\$369,106	\$358,066	\$343,282	2.2%	9.8%

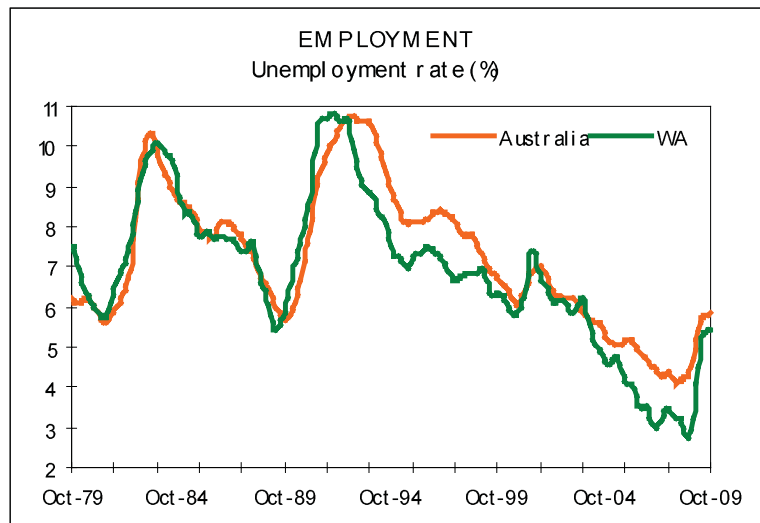
Source: Australian Property Managers

The strong economy is also resulting in population growth



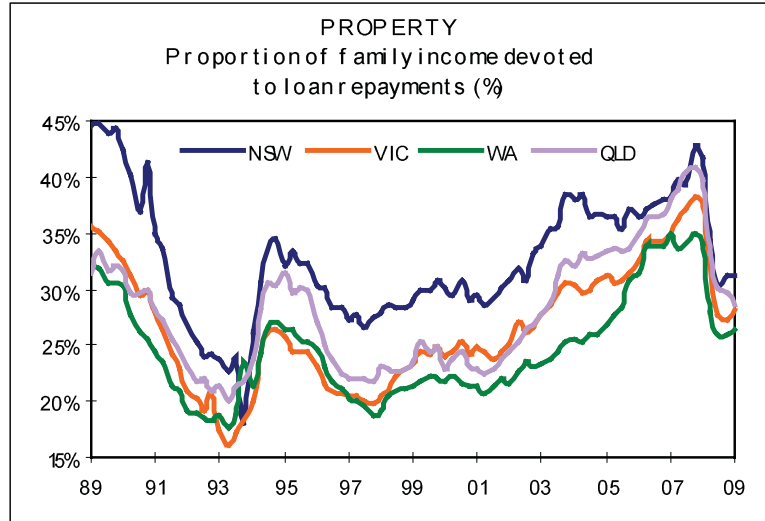
Source: ABS, Cat. 3101

And low unemployment



Source: ABS, Cat. 6202

That said, while affordability has improved from peaks, it is still historically high.



Source: REIA

**And in our view, demand for relatively affordable, however new and well appointed apartment dwellings can expect strong demand, particularly around the \$500 to \$600k mark, both in terms of affordability for owner occupiers and yield for investors.**

Importantly for the DGX investment case, the WA market place trend saw a significant number of apartments completed during 2009 and 2010 industry wide, many of which are presold, however scheduled completions for 2011 and 2012 taper off significantly. This supports the assertion that demand will exist to support further development activity longer term.

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