

MITA No. 010/06/2008

AusGroup Ltd

8 May 2009

Stronger but external risks remain

Maintain

HOLD

Previous Rating: HOLD

S\$0.60

Fair Value: S\$0.55

Stock Code: AUSG.SI
 Reuters: 5GJ
 ISIN Code: AUSG SP
 Bloomberg:

Event: Results

General Data

Issued Capital (m)	394
Mkt Cap (S\$m/US\$m)	236/161
Major Shareholder	
Carson Barry Alfred	5.24%
Free Float (%)	86.7
NAV per share (A cents)	27.7
Daily Vol 3-mth ('000)	16,000
52Wk High (S\$)	0.950
52Wk Low (S\$)	0.100

Revenue down 23.5% QoQ. AusGroup Ltd posted a 23.5% QoQ decline in 3Q09 revenue to A\$99.6m. Despite a higher gross margin of 15.2% (11.8% in 2Q09) due to timing effects, net profit fell 17.1% QoQ to A\$4.1m. On a YoY basis, both net profit and revenue (up 28.3% YoY) compared favorably with a net loss of A\$3.4m recorded a year ago. The company's results were better than expected as our estimates had provided for revenue drop through additional contract cancellations.

Tough external environment. Financing difficulties and a steep decline in commodity prices have impacted the mineral resources sector's capital expenditure programs. This is also true, to a lesser extent, in the oil & gas sector. The size and availability of future projects is a question mark. Our view is that select blue chips like BHP Billiton will continue to spend and replacement capex should pick up slowly. But the size of the pie appears to have shrunk compared to last year's levels. Additionally, AusGroup's margins may be at risk due to 1) increased competitive pressure and 2) negative operating leverage - a fixed cost/falling volume effect.

But reaping rewards from overhaul of execution capabilities. Over the past year, management has been working on improving AusGroup's tendering process in facets such as selection of opportunities, costing, and ensuring tighter terms and conditions. It has also been focused on improving management oversight on projects and implementing a more robust risk management process. This overhaul is clearly a long-term work in progress but is already producing visible results. We see three key indicators: 1) a more realistic revenue booking process; 2) an impressive decline in receivable days from 103 days to about 50 days over 9M09 (our estimate); and 3) the pay down of A\$24.3m in debt in 9M09, taking the company to a net cash position.

Valuation. AusGroup's current order book stands at A\$230m, up 37% QoQ. We have adjusted our earnings estimates upwards and now estimate revenues of A\$80m in 4Q09F (down 20% QoQ) and A\$380m in FY10F (down 13.6% YoY). This implies AusGroup winning another A\$230m of orders over the next 14 months. 4Q09 will be a better benchmark of both operating conditions and AusGroup's ability to sustain this improvement in internal processes, in our opinion. AusGroup is up 186% YTD. Recommend **HOLD** with S\$0.55 fair value (previously under review). This pegs AusGroup at 13x FY10F earnings - at a slight discount to ASX-listed competitor Monadelphous.

Year to 30 Jun	Revenue (A\$m)	Gross Profit (A\$m)	Net Profit (A\$m)	EPS (A cents)	EPS Growth (%)	PER (x)	Div Yield (%)
FY 07	281.1	50.0	20.7	5.3	58.0	10.4	0.9
FY 08	379.0	48.2	14.4	3.6	-30.5	15.0	0.9
FY 09F	440.0	58.3	18.7	4.7	30.0	11.5	0.9
FY 10F	380.0	49.4	15.0	3.8	-19.4	14.3	0.7

Price ratios based on 1.1 SGD/AUD exchange rate

Please refer to the important disclosures at the back of this document.

More on gross margin. AusGroup Ltd posted a 23.5% QoQ decline in 3Q09 revenue to A\$99.6m. Gross margin of 15.2% was higher than the 11.8% achieved in 2Q09. We understand that this was largely because of the impact of timing due to delays in finalizing variations around certain construction projects (the company recognizes costs as they are incurred but revenue from variations have to be negotiated). As such, it is more useful to examine gross margin over a broader period - it stands at 13.1% for 9M09. AusGroup's 3Q net profit of A\$4.1m represents a 17.1% QoQ decline, mainly due to the fall in revenue.

Order book trends. AusGroup's earnings have already been impacted by the 'rationalization' of capex plans with two projects suspended/terminated in December. A tough environment notwithstanding, AusGroup secured a A\$120m LNG contract in April. This is a strategic milestone for the company, in our opinion.

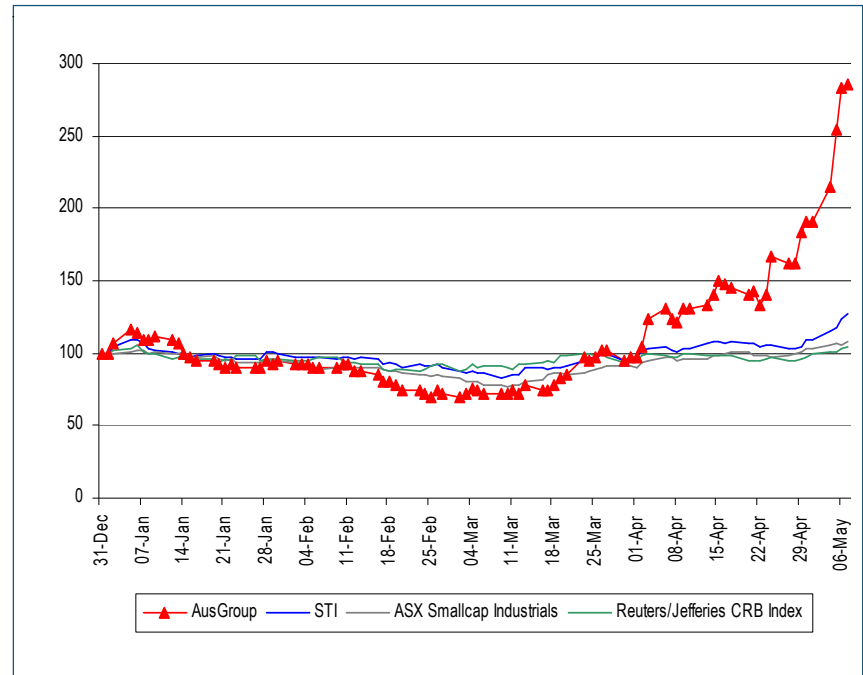
Exhibit 1: Order book trends

Historic order book (AUDm)									
Announced	Event	Orderbook	Change	Customer	Project	Further details	Sector	Start	End
10-Jun-08	Contract win	200.0	21.0	Not disclosed	Iron ore export facility, Pilbara, WA	Fabrication of a twin cell car dumper and iron ore wagon (Repeat customer)	Mineral resources	immediate	Jun-09
10-Jul-08	Contract win	223.0	42.8	Apache Energy	Reindeer Gas Field (WA)	Fabrication of wellhead platform	Oil & gas	immediate	End 2009
08-Aug-08	Contract win	295.0	60.0	Minara Resources	Murrin Murrin Nickel Operation (WA)	Maintenance support contract	Mineral resources	Over three years	
25-Aug-08	Results	296.0							
10-Sep-08	Contract win	282.0	30.0	Not disclosed	Blacktip offshore gas field project	Labor supply contract	Oil & gas	immediate	Jan-09
13-Nov-08	Results	286.0							
03-Dec-08	Project suspension	-	21.0	Not disclosed	Iron ore export facility, Pilbara, WA	Fabrication of a twin cell car dumper and iron ore wagon (Repeat customer)	Mineral resources	Completed 42% to date	
09-Dec-08	Contract termination	241.0	42.8	Apache Energy	Reindeer Gas Field (WA)	Fabrication of wellhead platform	Oil & Gas	14% invoiced & paid	
10-Feb-09	Results	168.0	<i>-Apache Energy's cancelled project now revived within 3 months. Coming out for re-tendering</i>						
03-Apr-09	Contract win	264.0	120.0	Woodside	Pluto LNG project	Construction support activities for process facility	Oil & Gas	immediate	Jun-10
06-May-09	Results	230.0							

Source: Company, OIR

AusGroup is up 186% YTD. The following exhibit pits AusGroup's share price performance year-to-date against the Straits Times Index and the ASX Smallcap Industrials index. AusGroup has significantly outperformed both.

Exhibit 2: Share price performance YTD



Source: Bloomberg

Exhibit 3: Peer comparison

Name	Price (LC)	Mkt Cap (LCm)	PER (x)	FY09F PER (x)	FY10F PER (x)	P/Book (x)	NPM (%)
Monadelphous Grp Ltd	A\$ 10.95	941.1	12.4	12.8	14.5	8.7	7.3
United Group Ltd	A\$ 9.83	1,622.9	10.9	11.0	11.1	1.4	3.8
Southern Cross Electrical	A\$ 0.85	102.0	8.4	7.7	12.1	3.1	13.4
VDM Group Ltd	A\$ 0.29	27.7	1.8	4.5	4.4	0.2	6.3
Paladio Group Ltd	A\$ 0.44	51.7	-	8.0	5.6	0.8	0.0
Transfield Services Ltd	A\$ 2.64	1,091.1	11.2	8.4	9.2	1.2	2.7
Bradken Ltd	A\$ 3.83	486.1	6.2	7.0	7.9	1.4	7.6
Macmahon Hldgs Ltd	A\$ 0.41	221.3	5.5	9.4	7.5	0.9	4.1
Lycopodium Ltd	A\$ 1.80	68.1	4.3	5.4	7.1	2.0	10.4
Leighton Hldgs Ltd	A\$ 24.50	7,300.3	14.8	11.3	11.4	3.1	5.9
Worley Parsons Ltd	A\$ 21.52	5,037.3	13.4	12.6	12.8	3.0	7.5
ASX Average			8.9	8.9	9.4	2.3	6.3
Rotary Engineering Ltd	S\$ 0.53	301.0	5.9	8.2	10.4	1.5	9.8
MTQ Corp Ltd	S\$ 0.56	53.5	16.1	-	-	1.0	13.5
SembCorp Marine Ltd	S\$ 2.70	5,592.8	12.9	11.4	12.3	4.2	8.5
Keppel Corp Ltd	S\$ 6.93	11,040.4	9.8	11.3	12.2	2.3	9.3
SGX Average ex AusGroup			11.2	10.3	11.6	2.2	10.3
Average ALL ex AusGroup			9.6	9.2	9.9	2.3	7.3
AusGroup Ltd	S\$ 0.60	236.4	15.0	11.5	14.3	2.4	3.8

Note: For FY09-10F PER, consensus estimates are used except for AUSG

Source: Bloomberg, consensus & OIR estimates

Exhibit 4: Selected management comments and OIR views

Topic	Management commentary	OIR comments
Minerals resources sector	<ul style="list-style-type: none"> - Activity [continues] to be impacted by the ongoing delays and deferrals to previous [projects] due to issues around commodity prices and project funding for some mineral resources clients. - These delays will result in reduced activity levels for natural resources service providers with a corresponding impact on margins over the next 12 month period. 	<ul style="list-style-type: none"> - Our view is that select blue chips will continue to spend and replacement capex should pick up slowly. - However, the overall capex pie is smaller - impacting the availability of future projects as well as margins.
Oil & gas sector	<ul style="list-style-type: none"> - [AusGroup] believes that over the next 12 months, demand for [its] Australian based services will remain satisfactory, driven largely by Western Australian LNG and oil and gas project developments. 	<ul style="list-style-type: none"> - AusGroup secured a A\$120m LNG contract in April, a strategic milestone for the company.
Cactus (Singapore)	<ul style="list-style-type: none"> - [AusGroup's] Singapore operations have observed a reduction in forward looking activity due to project deferrals, [impacted by the weakness in world oil prices]. - [AusGroup's] Singapore operations expect the activity levels to further reduce over the next 12 months on the back of weaker project activity from the upstream oil and gas sector. 	<ul style="list-style-type: none"> - AusGroup wrote down some plant and equipment at Cactus by A\$0.67m to A\$3.5m in 3Q09, and also earmarked the above for sale. - In our view, AusGroup is "cleaning house" on Cactus, perhaps taking a more realistic view of future expected utilization and capacity.
Guidance for 4Q09	<ul style="list-style-type: none"> - In the short term (next reporting period) [AusGroup] expects the overall impact of the market trend and operating conditions to result in lower revenues. - However, earnings are expected to benefit from the close out of several completed Australian projects where a number of claims and variations are being negotiated. 	<ul style="list-style-type: none"> - AusGroup's current order book stands at A\$230m. - We estimate revenues of A\$80m in 4Q09F (down 20% QoQ) and net profit of A\$3.7m (down 9.5% QoQ).
Guidance for FY10	<ul style="list-style-type: none"> - [In FY10, AusGroup] expects the market trends and operating conditions to result in lower revenues and earnings. - This expected contraction in revenues and earnings is primarily due to reduced levels of activities in [AusGroup's] markets caused by the global financial crisis and related flow on effects in to lower commodity prices. 	<ul style="list-style-type: none"> - We estimate A\$380m in FY10F revenue (down 13.6% YoY) and A\$15m in net profit (down 19.4% YoY).

Source: OIR, AusGroup's 3Q09 earnings release

Ausgroup's Key Financial Data

Ausgroup Results Year Ended 30 Jun (A\$ m)	3Q09 (A\$m)	3Q08 (A\$m)	% Chg (YoY)	2Q09 (A\$m)	% Chg (QoQ)
Revenue	99.6	77.6	28.3%	130.1	-23.5%
Cost of sales	-84.5	-64.5	31.0%	-114.8	-26.4%
Gross profit	15.1	13.1	15.1%	15.3	-1.4%
Other operating income	0.3	0.1	n.m.	1.5	-80.4%
Other operating expenses	-3.7	-13.3	-72.0%	-3.2	18.0%
Administrative expenses	-4.5	-3.8	16.8%	-5.2	-13.1%
Marketing & distribution expenses	-0.4	-0.3	7.3%	-1.0	-61.9%
Profit from operations	6.8	-4.3	n.m.	7.5	-9.5%
Finance costs	-0.6	-0.8	-21.3%	-0.4	37.0%
Profit before taxation	6.2	-5.1	n.m.	7.1	-12.4%
Income tax expense	-2.1	1.6	n.m.	-2.1	-0.9%
Profit after taxation	4.1	-3.4	n.m.	5.0	-17.1%
Units outstanding (m)	394.0	394.0		394.0	
EPS (A cents)	1.1	-0.9	n.m.	1.3	-17.1%
DPU (S cents)	0.0	0.0	-	0.0	-
Gross margin (%)	15.2	16.9	-1.7	11.8	3.4
Net profit margin (%)	4.2	-4.4	n.m.	3.8	31.7%

EARNINGS FORECAST

Year Ended 30 Jun (A\$ m)	FY07	FY08	FY09F	FY10F
Revenue	281.1	379.0	440.0	380.0
Cost of sales	-231.2	-330.8	-381.7	-330.6
Gross profit	50.0	48.2	58.3	49.4
Other operating income	2.3	2.0	2.7	1.9
Other operating expenses	-7.8	-11.3	-12.2	-9.5
Administrative expenses	-15.5	-15.7	-17.6	-17.1
Marketing & distribution expenses	-0.4	-1.5	-2.3	-1.9
Depreciation and amortization	-	-	-	-
Profit from operations	28.5	21.7	29.0	22.8
Finance costs	-1.5	-2.2	-2.2	-1.9
Profit before taxation	27.1	19.6	26.8	20.9
Income tax expense	-7.2	-5.2	-8.1	-5.9
Profit after taxation	19.9	14.4	18.7	15.0
Minority interests	-0.8	-	-	-
Net profit attributable to shareholders	20.7	14.4	18.7	15.0

BALANCE SHEET

As at 30 Jun (A\$ m)	FY07	FY08	FY09F	FY10F
Cash and bank balances	16.7	18.8	27.1	24.1
Other current assets	72.9	127.3	67.4	60.4
Property, plant, and equipment	31.6	61.5	77.7	93.7
Other long term assets	11.7	11.8	12.6	12.6
Total assets	132.9	219.3	184.9	190.8
Current liabilities less debt	43.3	86.5	46.2	44.0
Debt	9.6	39.5	19.0	14.0
Total liabilities	57.2	130.7	72.0	64.7
Shareholders equity	75.7	88.6	113.0	126.1
Total equity and liabilities	132.9	219.3	184.9	190.8

CASH FLOW

Year Ended 30 Jun (A\$ m)	FY07	FY08	FY09F	FY10F
Operating profit before working cap. changes	31.2	27.1	36.8	31.8
Working capital changes	-10.0	-3.9	24.9	4.8
Taxes and interest	-7.0	-13.8	-8.4	-7.8
Net cash from operations	14.2	9.4	53.4	28.8
Purchase of PP&E	-7.2	-36.3	-24.9	-25.0
Total investing cash flow	-10.3	-35.1	-19.9	-25.0
Total financing cash flow	-10.2	27.9	-26.7	-6.9
Net cash flow	-6.3	2.3	6.7	-3.0
Cash at beginning of year	26.4	16.7	18.8	27.1
Cash at end of year	16.7	18.8	27.1	24.1
Cash and overdraft	16.7	18.8	27.1	24.1

Per Share data

	FY07	FY08	FY09F	FY10F
Units outstanding (m)	394.0	394.0	394.0	394.0
EPS (A cents)	5.3	3.6	4.7	3.8
NAV (A cents)	19.2	22.5	28.7	32.0
DPU (A cents)	0.5	0.5	0.5	0.4

Key Rates & Ratios

	FY07	FY08	FY09F	FY10F
Revenue growth (%)	17.1	34.8	16.1	-13.6
Gross margin (%)	17.8	12.7	13.3	13.0
Net profit margin (%)	7.4	3.8	4.2	4.0
EPS growth (%)	58.0	-30.5	30.0	-19.4
PER (x)	10.4	15.0	11.5	14.3
Price/NAV (x)	2.8	2.4	1.9	1.7
Dividend yield (%)	0.9	0.9	0.9	0.7
ROE (%)	27.3	16.2	16.5	11.9

Source: Company data, OIR estimates

Price ratios based on 1.1 SGD/AUD exchange rate

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The analyst/analysts who wrote this report holds NIL shares in the above security.

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