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# GR Engineering (GNG)

## The work keeps rolling in

Recommendation
Buy (unchanged)
Price
$1.485
Target (12 months)
$1.70 (previously $1.60)

**GICS Sector**

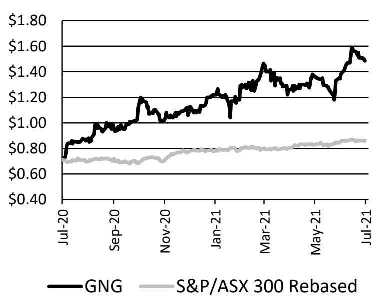
Construction and Engineering

| Expected Return | |
|---|---|
| Capital growth | 14.5% |
| Dividend yield | 6.7% |
| Total expected return | 21.2% |
| **Company Data & Ratios** | |
| Enterprise Value | $194.8m |
| Market cap | $238.5m |
| Issued capital | 160.6m |
| Free float | 39% |
| Avg. daily val. | $53,200 |
| 12 month price range | $0.71-$1.645 |

**Price Performance**

| | (1m) | (3m) | (12m) |
|---|---|---|---|
| Price (A$) | 1.38 | 1.26 | 0.71 |
| Absolute (%) | 7.61 | 17.86 | 109.15 |
| Rel market (%) | 6.94 | 10.70 | 87.82 |

**Absolute Price**




SOURCE: IRESS

## Order book continues to fill, further opportunities remain

GNG has announced a ~$68m contract award for works at Newmont Corporation's Tanami gold mine. Works have been subcontracted to GNG by RUC Cementation Mining Contractors Pty Ltd, and are expected to be completed by April 2023.

Additionally, we note positive project updates from ASX-listed Galena Mining on its Abra Base Metals Project, and Geopacific Resources on its Woodlark Gold Project. GNG was previously awarded a $74m conditional EPC contract in February 2020 for the Abra Base Metals Project, whilst GNG has previously valued the Woodlark opportunity at $92m. With these projects continuing to progress, formal contract confirmation and construction ramp up would further strengthen GNG's order book.

## Outlook remains strong, potential upside for UPS

GNG's workload continues to be supported by high commodity prices, which are increasing access to capital, and project activity amongst its key junior/mid-tier resources clients. In addition to the ~$68m Tanami contract, GNG has recently announced a $75.5m contract from Calidus Resources for its Warrawoona Gold project, and a $59.5m contract from Pantoro for its Norseman Gold project.

Additionally, we note that the Australian Government has opened expressions of interest for Phase 1 of the Northern Endeavour decommissioning works. Potential awards under this decommissioning process for GNG's UPS Oil & Gas subsidiary would represent upside to our forecasts.

## Buy rating maintained, price target increased to $1.70

Our FY22e and FY23e EPS forecasts are raised by 2.8% and 4.6% respectively. We have also increased our FY22e and FY23e dividend estimates by 8.3% and 11.1% respectively. Our FY21 estimates are unchanged. We continue to remain attracted to GNG's exposure to Australian resources projects, with a solid net cash position and forecast fully-franked dividend of 8.8% in FY22e, further supporting our Buy rating.

**Earnings Forecast**

| Year end 30 June | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|
| Total revenue ($m) | 222.4 | 385.7 | 422.2 | 340.3 |
| EBITDA (adjusted) ($m) | 10.2 | 28.9 | 38.8 | 31.2 |
| NPAT (adjusted) ($m) | 4.6 | 18.0 | 24.2 | 19.0 |
| EPS (cps) | 3.0 | 11.6 | 15.0 | 11.5 |
| EPS growth (%) | -37.9 | 285.4 | 29.6 | -23.0 |
| PER (x) | 49.5 | 12.8 | 9.9 | 12.9 |
| Price/CF (x) | 20.3 | 7.9 | 8.3 | 13.6 |
| EV/EBITDA (x) | 19.2 | 6.7 | 4.9 | 6.4 |
| Dividend (cps) | 6.0 | 10.0 | 13.0 | 10.0 |
| Franking (%) | 0 | 100 | 100 | 100 |
| Yield (%) | 4.0 | 6.7 | 8.8 | 6.7 |
| ROE (%) | 11.4 | 43.5 | 46.8 | 33.0 |

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Company overview

## Company history

GNG was founded in 2006, with the intention of providing engineering consulting and construction services to the mining and minerals processing industries. This remains the bulk of GNG's business today, with its focus being on the delivery of EPC contracts for minerals processing plants.

While GNG was created in 2006, and listed on the ASX in 2011, the team that founded GNG has a much longer history. This history dates back to 1986, when the co-founders of GNG created JR Engineering. JR Engineering was ultimately sold to ASX-listed Downer, in 2001.

While some of GNG's founders have retired, others remain in executive and non-executive positions at GNG. Directors, founders & senior management of GNG continue to hold 61% of the company.

GNG expanded its services in 2014, via the purchase of Upstream Production Solutions (UPS). UPS is an Oil & Gas services business focused on providing operations & maintenance support, and was acquired for $5.75m. This formed GNG's 2nd key operating division.

More recently, GNG acquired Arizona, USA based Hanlon Engineering for US$2.75m, which will aid GNG's geographic expansion aspirations.

GNG has also announced an agreement to acquire Mipac Holdings Pty Ltd for a purchase price of up to $21.4m.

## Valuation increased from $1.60 to $1.70

We continue to utilise a DCF for our valuation of GNG, with our key DCF inputs unchanged (9.9% discount rate, 2.5% terminal growth rate).

Following revisions to our EPS estimates (FY21: unchanged, FY22 +2.8%, FY23 +4.6%), our price target has increased to $1.70.

A price of $1.70 equates to an FY22e 7.6% fully-franked dividend yield, and P/E ratio of 14.7x, 11.3x, and 14.7x across FY21e-FY23e respectively. While a discount to the broader market, we believe this is appropriate given the cyclicality of GNG's end markets and the risks involved in EPC contracting.

# Key risks

**EPC/Construction risk: The construction industry is inherently risky, and particularly so when EPC contracts are involved. This is a result of EPC contracts being of a fixed-cost nature. Any unforeseen project costs and delays will thus be borne by the EPC contractor. EPC contracting, and construction contracting more generally, is fraught with examples of major contract disputes which can impact profitability, cash flow and ongoing viability. Recent examples of material cost overruns and/or contract disputes can be seen from RCR Tomlinson, Decmil, CIMIC, Primero and Monadelphous. While GNG has generally had a good track record of achieving profits, given that GNG is primarily an EPC contractor, there always remains a risk that a material negative cash outflow may occur. This may result in a need to raise additional equity, and in extreme circumstances, may impact GNG's ongoing viability. GNG's practically non-existent Minerals Processing profit in FY20 is a testament to the variable nature of margins on construction projects.**

**Contract completion risk:** There is always a risk that unforeseen issues prevent GNG from completing a contract as initially intended, or that a disagreement arises with the party that awarded the contract. This risk has grown as project developers have attempted to shift a greater proportion of risks onto contractors, and is particularly pertinent with EPC contracts, where contractors are responsible for project delivery. This is the predominate contracting method used by GNG. Contract completion risks created problems at RCR Tomlinson that led to its eventual collapse.

**Contract mispricing risk:** In addition to customer disputes, GNG could misprice projects for which it tenders. This could result in GNG winning work on uneconomic terms, which may result in GNG recording large losses on some projects that were not originally anticipated. Mispricing could occur as a result of not factoring into account for unforeseen costs, time constraints and project risks. A potential push into larger sized EPC projects increases this risk to GNG, as the potential for larger cost overruns and disputes is greater.

**Contract award/renewal risk:** In order to simply maintain revenue, GNG needs to continually win new projects from clients to replace revenue from other projects as they are completed. The amount of work available for tender varies significantly across periods of time as a result of the cyclical nature of the mining industry. During times of low mining project activity there is a heightened risk that GNG will not be able to replace completed projects with new work. In addition, during times of low mining project activity, margins are likely to come under significant pressure as E&C companies aggressively tender for a smaller supply of opportunities.

**Bad debt risk:** Given that GNG is not paid entirely upfront for its contracts, there is a risk that a customer(s) will not be able to fully pay GNG for its services in the event that they suffer cash flow issues. These issues are more likely to arise during downturns in the mining industry, which is also when contract award/renewal risk is greatest.

**Availability and cost of employees/subcontractors risk:** During times of an upturn in mining construction activity, there is a possibility that staff shortages can occur. This may impact GNG's ability to source adequate staff to tender for new projects and increase its revenue. Even if staff are able to be secured, it may require GNG to pay substantially higher rates to both current and newly hired employees/ subcontractors in order to secure their services. This is particularly relevant for GNG's EPC contracts, where it bears fixed price risk. This risk is enhanced in the current environment, whereby border restrictions may impact the ability to access/transfer labour from interstate/overseas.

**Occupational Health & Safety risk:** Construction activity carries with it significant health and safety risks. If not properly mitigated by sufficient safety procedures, there is a risk that employees may suffer serious harm. A lack of a proper safety culture would damage employee morale, impact the ability to hire and retain staff, potentially cause litigation risks, and impact a company's social licence.

**Commodity price/Macroeconomic risk:** Given that GNG primarily provides services to mining companies, any sustained fall in commodity prices is likely to lead to a reduction in mining projects, and the demand for GNG's services. A sustained economic downturn is likely to lead to the same result as prospective customers seek to shore up their balance sheets and/or are unable to access funding to expand their operations. These external impacts were seen at a sector level in FY09-FY10 (GFC) and FY14-FY16 (commodity price slump).

**Political risk:** In light of recent climate activism globally, political risk is becoming increasingly more prominent to the broader mining industry. If this activism was to lead to reductions in the number of new mining projects approved, it may have a significant impact on GNG's future pipeline of opportunities.

**Biological virus risk:** The potential quarantine/lockdown of wide parts of the world will likely impact GNG's ability to source and distribute employees to complete work. Any localised infection may result in the lockdown of worksites, leading to delays. This may result in substantial reductions in revenue, and impact near-term cash flow. Supply chains and end user demand may also be impacted, further impacting GNG's operations and the commodity prices received by its clients.

**Foreign currency risk:** Given that GNG conducts some projects in overseas jurisdictions, it is subject to fluctuations in the value of foreign currencies, which may impact on its profitability when converted back into AUD. This risk has grown following GNG's acquisition of Arizona, USA based Hanlon Engineering, which likely exposes GNG to a greater proportion of ongoing revenue generated in a foreign currency. GNG now also has a USD denominated bank loan of $2.75m, which could become more difficult to service in the event of an adverse movement in the AUD/USD exchange rate.

# GR Engineering
as at 2 July 2021

| | |
|---|---|
| Recommendation | Buy |
| Price | $1.485 |
| Target (12 months) | $1.70 |

**Table 1 - Financial Summary**

| | | | |
|---|---|---|---|
| **GR Engineering** | | **Share Price (A$)** | **$1.49** |
| **As at** | **2-Jul-21** | **Market Cap (A$m)** | **$238.5** |

| INCOME STATEMENT ($m) | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| **Revenue** | **182.3** | **222.4** | **385.7** | **422.2** | **340.3** |
| **Statutory EBITDA** | **9.9** | **-6.8** | **32.1** | **38.8** | **31.2** |
| Bad debts | -1.3 | -17.7 | 0.3 | 0.0 | 0.0 |
| Gain on sale of investments | 0.0 | 0.7 | 2.9 | 0.0 | 0.0 |
| **Adjusted EBITDA** | **11.2** | **10.2** | **28.9** | **38.8** | **31.2** |
| Depreciation | -1.4 | -2.7 | -2.8 | -3.8 | -3.7 |
| **Adjusted EBITA** | **9.7** | **7.5** | **26.1** | **35.0** | **27.4** |
| Amort. of acquired customer contracts | 0.0 | -0.1 | -0.2 | -0.2 | -0.2 |
| **Adjusted EBIT** | **9.7** | **7.4** | **25.9** | **34.8** | **27.2** |
| Net interest | 0.3 | -0.1 | -0.2 | -0.2 | -0.1 |
| **Adjusted pre-tax profit** | **10.0** | **7.3** | **25.7** | **34.6** | **27.1** |
| Tax | -2.2 | 2.4 | -8.7 | -10.4 | -8.1 |
| less adjustments tax impact | -0.4 | -5.1 | 0.9 | 0.0 | 0.0 |
| **Adjusted net profit** | **7.4** | **4.6** | **18.0** | **24.2** | **19.0** |
| add back adjustments (net of tax) | -0.9 | -11.9 | 2.2 | 0.0 | 0.0 |
| **Statutory net profit** | **6.5** | **-7.2** | **20.2** | **24.2** | **19.0** |

| VALUATION & GEARING RATIOS | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| EPS (adjusted) | 4.8c | 3.0c | 11.6c | 15.0c | 11.5c |
| Dividend Per Share (DPS) | 6.0c | 6.0c | 10.0c | 13.0c | 10.0c |
| Dividend Yield | 4.0% | 4.0% | 6.7% | 8.8% | 6.7% |
| Franking | 67% | 0% | 100% | 100% | 100% |
| Shares on issue (m) | 153.6 | 153.7 | 160.6 | 162.3 | 165.4 |
| Weighted average shares (m) | 153.5 | 153.7 | 155.4 | 161.7 | 164.3 |
| | | | | | |
| P/E ratio | 30.7x | 49.5x | 12.8x | 9.9x | 12.9x |
| EV/EBITDA (adjusted) | 17.6x | 19.2x | 6.7x | 4.9x | 6.4x |
| EV/EBIT (adjusted) | 20.2x | 26.3x | 7.5x | 5.5x | 7.3x |
| Price/OpCFPS | 9.2x | 20.3x | 7.9x | 8.3x | 13.6x |
| Price/NTA | 4.9x | 7.5x | 6.6x | 6.0x | 5.8x |
| Dividend Payout | 124% | 200% | 86% | 87% | 87% |
| Interest cover (EBIT / Net Interest) | n/a | n/a | n/a | n/a | n/a |
| Net Debt / EBITDA | Net cash | Net cash | Net cash | Net cash | Net cash |
| Net Debt / Equity | Net cash | Net cash | Net cash | Net cash | Net cash |

| CASHFLOW ($m) | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| Net Profit | 6.5 | -7.2 | 20.2 | 24.2 | 19.0 |
| Depreciation & amortisation | 1.4 | 2.7 | 3.0 | 4.0 | 3.9 |
| Change in working capital | 20.5 | 15.5 | 6.0 | 0.8 | -5.2 |
| Other | -3.7 | 0.2 | 0.0 | 0.0 | 0.0 |
| **Operating cashflow** | **24.7** | **11.2** | **29.2** | **29.0** | **17.7** |
| Capex | -1.0 | -1.0 | -2.2 | -2.8 | -2.5 |
| Payments for Businesses | 0.0 | 0.0 | -7.5 | -2.0 | 0.0 |
| Investments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.0 | 0.6 | 0.0 | 0.0 | 0.0 |
| **Investing cashflow** | **-1.0** | **-0.3** | **-9.7** | **-4.8** | **-2.5** |
| Issue of shares | 0.0 | 0.0 | 7.0 | 0.0 | 1.5 |
| Dividends paid | -13.8 | -6.1 | -13.8 | -18.2 | -18.6 |
| Change in borrowings | 0.0 | 3.4 | 0.0 | 0.0 | -1.2 |
| Other | -0.3 | -2.2 | -1.3 | -1.2 | -1.1 |
| **Financing cashflow** | **-14.1** | **-4.9** | **-8.1** | **-19.4** | **-19.5** |
| **Net change in cash** | **9.6** | **6.0** | **11.4** | **4.8** | **-4.3** |
| Op cash flow per share (excl abnormals) | 16.1c | 7.3c | 18.8c | 17.9c | 10.9c |

| GROWTH | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| Revenue | | 22.0% | 73.4% | 9.5% | -19.4% |
| EBITDA (adjusted) | | -9.1% | 184.7% | 34.0% | -19.6% |
| EBIT | | -23.8% | 249.7% | 34.3% | -21.7% |
| Net Profit (adjusted) | | -37.9% | 289.8% | 34.8% | -21.8% |
| EPS (adjusted) | | -37.9% | 285.4% | 29.6% | -23.0% |

| PROFITABILITY RATIOS | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| EBITDA/Sales | 6.1% | 4.6% | 7.5% | 9.2% | 9.2% |
| EBIT/Sales | 5.3% | 3.3% | 6.7% | 8.2% | 8.0% |
| Effective tax rate | 22.2% | -33.1% | 33.7% | 30.0% | 30.0% |
| Return on assets | 8.9% | 5.1% | 14.8% | 16.0% | 12.8% |
| Return on equity | 15.0% | 11.4% | 43.5% | 46.8% | 33.0% |

| SEGMENT REVENUE ($m) | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| Minerals Processing | 93.8 | 138.0 | 251.0 | 286.4 | 275.8 |
| Oil & Gas | 88.4 | 84.4 | 134.7 | 135.9 | 64.5 |
| Other / Eliminations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Total Revenue** | **182.3** | **222.4** | **385.7** | **422.2** | **340.3** |

| BALANCE SHEET ($m) | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| Cash | 31.4 | 37.5 | 48.9 | 53.7 | 49.4 |
| Receivables | 35.5 | 38.8 | 66.7 | 69.7 | 56.2 |
| Inventories | 0.3 | 0.0 | 0.3 | 0.4 | 0.3 |
| Plant and equipment | 3.4 | 6.4 | 6.7 | 6.6 | 6.4 |
| Identifiable Intangible Assets | 0.0 | 4.4 | 5.6 | 5.5 | 5.3 |
| Goodwill | 0.0 | 0.0 | 6.2 | 9.7 | 11.6 |
| Other | 11.0 | 10.8 | 11.4 | 12.0 | 10.7 |
| **Total assets** | **81.6** | **98.0** | **145.9** | **157.6** | **139.8** |
| Debt | 0.0 | 4.0 | 4.0 | 4.0 | 2.8 |
| Payables | 24.8 | 44.6 | 63.6 | 67.6 | 54.5 |
| Provisions and other | 10.4 | 14.7 | 30.2 | 30.4 | 23.2 |
| **Total liabilities** | **35.2** | **63.3** | **97.8** | **102.0** | **80.5** |
| Contributed equity | 30.6 | 30.6 | 37.6 | 39.1 | 42.5 |
| Reserves & outside equity | 0.9 | 2.2 | 2.2 | 2.2 | 2.2 |
| Retained earnings | 15.0 | 1.9 | 8.3 | 14.3 | 14.6 |
| **Total equity** | **46.4** | **34.7** | **48.1** | **55.6** | **59.3** |
| Net Debt (Cash) | -31.4 | -33.5 | -44.9 | -49.7 | -46.6 |
| NTA | $0.30 | $0.20 | $0.23 | $0.25 | $0.26 |

| SEGMENT STATUTORY PBT ($m) | 2019 | 2020 | 2021e | 2022e | 2023e |
|---|---|---|---|---|---|
| Minerals Processing | 3.6 | 0.0 | 16.0 | 22.9 | 23.2 |
| Oil & Gas | 5.1 | -10.4 | 12.8 | 11.8 | 3.9 |
| Other / Eliminations | 0.0 | 0.7 | 0.0 | 0.0 | 0.0 |
| **Total PBT** | **8.8** | **-9.7** | **28.9** | **34.6** | **27.1** |

| INTERIMS ($m) | 1H20 | 2H20 | 1H21 | 2H21e |
|---|---|---|---|---|
| **Revenue** | **95.3** | **127.1** | **176.3** | **207.3** |
| **Adjusted EBITDA** | **2.0** | **8.1** | **11.0** | **17.9** |
| Depreciation | -1.3 | -1.4 | -1.4 | -1.5 |
| **Adjusted EBITA** | **0.7** | **6.8** | **9.7** | **16.4** |
| Amort. of acquired contracts | 0.0 | -0.1 | -0.1 | -0.1 |
| **Adjusted EBIT** | **0.7** | **6.7** | **9.6** | **16.3** |
| Net interest | 0.0 | -0.1 | -0.1 | -0.1 |
| **Adjusted pre-tax profit** | **0.7** | **6.6** | **9.5** | **16.2** |
| Tax | 5.5 | -3.1 | -4.1 | -4.6 |
| less adjustments tax impact | -5.1 | 0.0 | 0.9 | 0.0 |
| **Adjusted net profit** | **1.1** | **3.5** | **6.3** | **11.7** |

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

*Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.*

*Such investments may carry an exceptionally high level of capital risk and volatility of returns.*

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