UBS

UBS Investment Research

GUD Holdings Limited

Global Equity Research
Australia
Auto Parts

Rating	Neutral 2
Price target	A$6.83/US$5.04
Price	A$6.25/US$4.60 (ADR)

RIC: GUD.AX BBG: GUD AU

11 December 2003

GUD powers on

Sales and margins running ahead of budget

GUD has confirmed that trading is ahead of budget and PCP, in line with our expectations. Margin enhancement has been driven by cost reductions, the rollout of new, higher-margin products and greater pricing power stemming from its increasingly valuable brand equity. GUD is a net beneficiary of a stronger A$ as it imports most of its Sunbeam range from suppliers in Asia in US$.

Good acceptance of new products

Sunbeam has launched 70 new products for the Christmas 2003 sales season. We understand that the take-up of many of these products has been ahead of expectations. Victa has launched its new Razor mower to its dealer network after two years in the pipeline. The demand for the Razor has been high.

The restructuring of filters

GUD will book $3.2m of before-tax costs in H1 04 relating to the restructuring of the filtration business. Ryco filters will now be manufactured by external suppliers offshore as well as by GUD itself in Australia and New Zealand.

Valuation: $6.83 per share

We value GUD on a DCF basis applying a WACC of 11.5%, a ße of 1.1 and a nominal long-run growth rate of 3.0%. Our valuation is $6.83 per share. Our price target is equal to our valuation. This implies an FY 04E PER of 12.4x.

Highlights (A$m)	06/02	06/03	06/04E	06/05E	06/06E
Revenues	398	376	423	439	455
EBITDA	25	47	61	63	65
EBIT	14	37	51	53	55
Net income (UBS)	6	22	32	34	36
EPS (UBS, A$)	0.12	0.38	0.55	0.60	0.62

Profitability & Valuation	5-yr hist. av.	06/03	06/04E	06/05E	06/06E
EBIT margin %	-	9.9	12.0	12.0	12.0
ROIC (EBIT) %	-	21.9	33.0	37.1	39.5
EV/revenues x	-	0.7	0.9	0.8	0.7
EV/EBITDA x	-	5.6	6.3	5.7	5.3
PE (UBS) x	-	10.2	11.4	10.5	10.1

Source: Company accounts, Thomson Financial, UBS estimates. UBS EPS is stated before goodwill, exceptionals and other special items.
Valuations: based on an average share price that year, (E): based on a share price of A$6.25 on 11 Dec 2003

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Forecast returns	
Forecast price appreciation	+9.3%
Forecast dividend yield	5.3%
Forecast stock return	+14.6%
Market return assumption	10.4%
Forecast excess return	+4.2%
Net DPS (04E)	A$0.33/US$0.24
Trend EPS growth rate	+17%

Trading data (local/US$)	
52-wk. range	A$6.44-3.55/US$4.73-2.01
Market cap.	A$0.38bn/US$0.28bn
Shares o/s	61m (ORD)/61m (ADR)
ADR Ratio	1 ADR:1 ORD
Free float	100%
Average volume ('000)	130/OTC
Convertible	No
Volatility	Low

Balance sheet data 06/04E	
Shareholders' equity	A$0.15bn
P/BV (UBS)	2.8x
Net cash (debt)	A$0.01bn

EPS (UBS, A$)	06/03	06/04E	Prior	Cons.
H1	0.23	0.28	-	-
H2	0.15	0.26	-	-
FY	0.38	0.55	-	0.53

Strong operational performance

Sales and margins running ahead of budget

In an open briefing released to the ASX, GUD has confirmed that trading so far this financial year has exceeded budget and the prior comparative period, in line with our expectations. Margin enhancement has been driven by cost reductions, the rollout of new, higher-margin products (such as its *Café Series* range of coffee machines) and increased pricing power stemming from its increasingly valuable brand equity.

The effect of a stronger A$

GUD has been a beneficiary of a stronger A$ in its Sunbeam business as it imports most of its product range from suppliers in Asia, under contracts denominated in US$. The lower A$ value of inputs has further reduced costs in this business and boosted operating margins. In the filtration division, the higher A$ has reduced the cost of imported Wesfil filters but affected the margins on the sale of domestically manufactured Ryco filters. While the stronger A$ has also impacted the price-competitiveness of exported Davey Pumps, the division also benefits from the reduced A$ cost of imported motors and components.

Good acceptance of new products

Sunbeam has launched 70 new products for the Christmas 2003 sales season. These include a number of non-staple appliances such as the rechargeable wine chiller and *Flossy* fairy floss maker, as well as new models of products such as coffee makers, electric shavers and hairdryers. We understand that the take-up of many of these products has been ahead of expectations. Victa has launched its new *Razor* mower to its dealer network after two years of research and development. The demand for *Razor* has been high, with strong acceptance of its aesthetics (Figure 1) and performance. We understand that *Razor* has contributed significantly to an improved performance of the Victa business in H1 04 after demand for mowers last year was badly affected by drought.

Figure 1: Victa ***Razor***: launched after two years in the pipeline

Source: GUD Holdings

The restructuring of filters

Australian manufacturing operations contracted

GUD will book $3.2m of before tax costs in H1 04 relating to the restructuring of the filtration business. EBIT margins improved to 18% (from 15%) in FY 03, brought about by rationalisation of the manufacturing base. Ryco margins have come under pressure from the stronger A$ during H1 04, as alternative imported products have become more price competitive. The decision has been taken to further rationalise domestic manufacturing, leading to the removal of 60 heads in the Australian operations over the past 5 months. The $3.2m restructuring charge relates to the costs of this headcount reduction.

The future for Ryco

Ryco filters will continue to be manufactured in Australia (at Sunshine), but with a lower output than before. In addition to its Australian operations, GUD runs a manufacturing facility at Avondale in New Zealand. Ryco products will now also be sourced from external manufacturers offshore. These will be made exclusively to GUD’s specifications and will allow the overall costs of manufacture to be reduced. We expect that the number of Ryco filters produced in Australia will now be balanced by the number made in New Zealand and by offshore suppliers. We consider this to be a positive move to continue to improve margins and supply chain efficiency.

Outlook and forecasts

We are forecasting 14% growth in H1 04

The strong operational performance of GUD’s businesses is the basis for our forecasts for significant earnings growth into H1 04 and the full year. Our H1 04e NPAT is $15.2m after one-off items. This is 14.3% higher than the comparative figure in H1 03 ($13.3m). The company has indicated that it expects H1 03 earnings to be ‘comfortably’ into double-digits.

We continue to upgrade earnings forecasts

We believe that GUD is building significant operational momentum, based on the successful rollout of new, higher margin products, the development of strong brand equity and well-judged enhancements to its supply chain. The company is also a net beneficiary of the stronger A$. We upgraded our FY 04 NPAT forecasts 8.7% in October from $28.7m to $31.2m. We have made an additional upward revision today; FY 04e NPAT rises by 1.3% to $31.6m.

Investment case

We value GUD on a DCF basis applying a WACC of 11.5%, a ße of 1.1 and a nominal long-run growth rate of 3.0%. Our valuation is $6.83 per share. Our price target is equal to our valuation. This implies an FY 04E PER of 12.4x. On our FY 04 forecasts, GUD is currently trading on a PER of 11.4x. The forecast excess return of the stock is 4.2% and accordingly, our rating remains Neutral 2. We view GUD as a very well managed company with a compelling strategy for growth, effective financial discipline and a strong balance sheet. We see this as a company to watch.

■ GUD Holdings Limited

GUD Holdings owns and manages a diverse group of businesses selling branded manufactured products in Australia and New Zealand. GUD operates several of Australia's most established and well-recognised consumer and industrial brands, including Sunbeam appliances, Victa lawnmowers, Ryco filters and Davey pumps. GUD was formed in 1940 and first listed in 1959.

■ Statement of Risk

Risks to our investment case include a loss of sales due to a downturn in consumer spending in Australia and New Zealand, greater competitive pressure from imported goods in a stronger A$ environment and a failure to manage any possible acquisitions effectively.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Required Disclosures

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Global ratings: Definitions and allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage[1]	IB services[2]
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	**Buy 2**	FSR is > 10% above the MRA, lower degree of predictability	**Buy**	35%	44%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	**Neutral 2**	FSR is between -10% and 10% of the MRA, lower degree of predictability	**Hold/Neutral**	56%	40%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	**Reduce 2**	FSR is > 10% below the MRA, lower degree of predictability	**Sell**	9%	37%

1: Percentage of companies under coverage globally within this rating category.
2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 30 September 2003.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.
Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).
Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.
Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.
UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

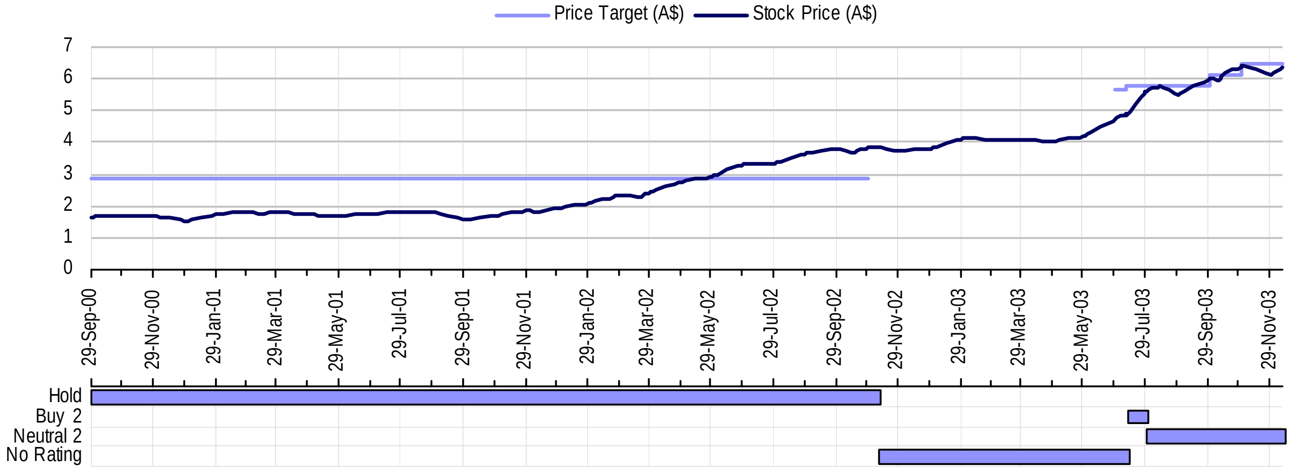
Companies mentioned

Company Name	Reuters	Rating	Price
GUD Holdings Limited	GUD.AX	Neutral 2	A$6.38

Price(s) as of Wednesday, 10 December 2003. Source: UBS.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

GUD Holdings Limited (A$)



Source: UBS; as of Wednesday, 10 December 2003.

Note: On October 13, 2003, UBS adopted new definition criteria for its rating system. (See 'Global ratings: Definitions and allocations' table for details.) Between January 11 and October 12, 2003, the UBS ratings and their definitions were: Buy 1: Excess return potential > 15%, smaller range around price target; Buy 2: Excess return potential > 15%, larger range around price target; Neutral 1: Excess return potential between -15% and 15%, smaller range around price target; Neutral 2: Excess return potential between -15% and 15%, larger range around price target; Reduce 1: Excess return potential < -15%, smaller range around price target; Reduce 2: Excess return potential < -15%, larger range around price target. Prior to January 11, 2003, the UBS ratings and definitions were: Strong Buy: Greater than 20% excess return potential, high degree of confidence; Buy: Positive excess return potential; Hold: Low excess return potential, low degree of confidence; Reduce: Negative excess return potential; Sell: Greater than 20% negative excess return potential, high degree of confidence. Under both ratings systems, excess return is defined as the difference between the FSR and the one-year local market interest rate.

Global Disclaimer

This report was produced by: UBS Securities Australia Ltd

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UBS

GUD Holdings Limited

Per share (A$)	6/02	6/03	6/04E	6/05E	6/06E
EPS	0.12	0.38	0.55	0.60	0.62
CEPS	0.27	0.52	0.69	0.73	0.76
Net DPS	0.17	0.26	0.33	0.36	0.36
BVPS	1.95	2.10	2.30	2.53	2.76
Profit & loss (A$ m)					
Sales	398	376	423	439	455
EBITDA	25	47	61	63	65
EBIT	14	37	51	53	55
PBT	9	34	49	53	56
Net Profit	6	22	32	34	36
Cash flow (A$ m)					
EBIT	14	37	51	53	55
Depreciation & amortisation	11	10	10	10	10
Change in NWC	12	8	14	(2)	(2)
Other (operating)	8	(1)	(0)	0	0
Operational cash flow	44	54	75	61	62
Tax paid	(3)	(9)	(17)	(19)	(20)
Capital expenditure	(8)	(8)	(7)	(7)	(7)
Net interest	(5)	(4)	(2)	0	1
Dividends paid	(10)	(12)	(19)	(21)	(22)
Net (acquisitions) / disposals	13	0	0	0	0
Other items	4	(4)	2	1	2
Change in net debt	35	17	32	16	17
Operating free cash flow (OpFCF) (A$ m)					
Core EBITDA	25	47	61	63	65
Less: Maintenance capex	(5)	(4)	(4)	(4)	(4)
Less: Maintenance NWC	20	7	14	(2)	(2)
OpFCF	40	50	71	56	58
Balance sheet (A$ m)					
Net tangible fixed assets	41	37	34	29	25
Net intangible fixed assets	51	51	49	48	46
Net working capital	84	76	61	63	66
Total invested capital (IC)	176	164	144	140	137
Financial & other fixed assets	6	7	7	7	7
Net cash / (debt)	(38)	(21)	11	29	47
Provisions	(20)	(19)	(19)	(19)	(19)
Minority interests	(0)	0	0	0	0
Shareholders' funds	122	127	148	162	176
Profitability					
EBITDA margin	6.2%	12.6%	14.3%	14.2%	14.2%
EBIT margin	3.6%	9.9%	12.0%	12.0%	12.0%
EBIT RoIC	7.4%	21.9%	33.0%	37.1%	39.5%
Net RoE	5.1%	17.5%	23.0%	22.2%	21.3%
Interest cover (EBIT)	2.7x	10.0x	24.9x	NM	NM
Dividend cover (net)	0.7x	1.5x	1.7x	1.7x	1.7x
Productivity					
Labour % sales					
Depreciation % sales	2.6%	2.7%	2.3%	2.3%	2.2%
Capex % sales	2.0%	2.0%	1.6%	1.5%	1.5%
Invested capital turnover	2.0x	2.2x	2.7x	3.1x	3.3x
Tax rate	29.5%	35.1%	35.1%	35.1%	35.1%
Net debt / total equity	31.2%	16.5%	Cash	Cash	Cash
Momentum					
Sales growth	+15.9%	-5.7%	+12.7%	+3.7%	+3.7%
EBIT growth	-39.4%	+160.0%	+36.3%	+3.7%	+3.7%
Net earnings growth	-40.0%	>+200%	+45.4%	+8.9%	+4.6%
Dividend growth	+10.0%	+57.6%	+26.9%	+9.1%	+0.0%
Value*					
Market capitalisation (A$ m)	136	237	378	378	378
Plus: Core net debt / (cash)	55	29	5	(20)	(38)
Plus: Pension provisions	-	-	-	-	-
Plus: Buy out of minorities	0	-	-	-	-
Less: Non-core assets	-	-	-	-	-
Enterprise value (EV, avg)	192	267	383	358	340
EV/Sales (core)	0.48x	0.71x	0.90x	0.81x	0.75x
EV/EBITDA (core)	7.7x	5.6x	6.3x	5.7x	5.3x
EV/EBIT (core)	13.4x	7.2x	7.5x	6.8x	6.2x
EV/OpFCF	4.8x	5.3x	5.4x	6.3x	5.8x
EV/Invested capital	1.0x	1.6x	2.5x	2.5x	2.5x
P/CE	8.1x	7.5x	9.1x	8.5x	8.2x
P/E	17.4x	10.2x	11.4x	10.5x	10.1x
Dividend yield (net)	7.69%	6.69%	5.28%	5.76%	5.76%
P/BV (average)	1.1x	1.9x	2.7x	2.5x	2.3x

Source: UBS estimates, * Historical valuations are based on an `average for the year' share price. Current & future valuations are based on a share price of A$6.25 on 11/12/2003

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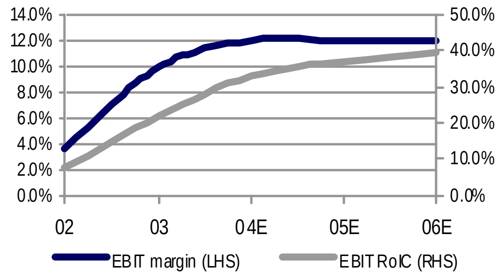
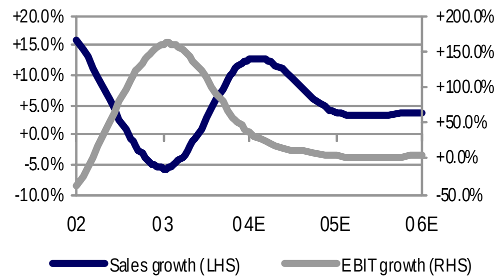
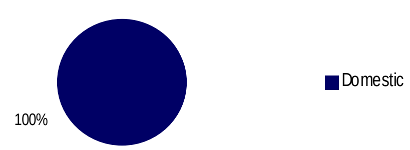
Profitability (EBIT margins & RoIC)



Momentum (Sales & EBIT growth)



Geographic exposure (Sales)



Value (EV/OpFCF & P/E)