Foresight Capital
Daily Research
Authorised Representative of Morrison Securities Pty Ltd

Morrison Securities Pty Limited
ABN: 50 001 430 342 AFS Licence: 241 737

G.U.D. Holdings | GUD | Hold | $8.03

1H05 result disappoints; higher yield key potential shareprice support

Adam Michell
02 9033 8306
asm@morrisonsecurities.com

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GUD reported 1H05 NPAT of $19.2m (pre one-off) which was considerably lower than we had expected following management's earnings outlook of 13 Dec 04. Whilst management expects 2H05 operating profit to be inline with pcp and a turnaround in operating cashflow, we have a more conservative outlook given the potential for further disappointment from the Victa operation. On our revised post-result earnings profile we see scope for a further PER derating given likely market caution until 2H05 earnings appear readily achievable. Nonetheless the increased payout ratio of 75% offers a +6% sustainable yield (fully franked), with potential for a higher dividend than forecast facilitated by a still-strong balance sheet offering a counterbalance to this potential derating.

⇒ **Sunbeam Victa margins the result disappointment;** Whilst the Sunbeam appliances division had a satisfactory 1H05 the Victa division's performance was severely impacted by continued weak industry conditions and import competition, with EBITA margins declining from 15.9% in 1H04 to 12.9% in 1H05. Whilst management is introducing new products to counter cheaper imports we still see turnaround prospects as difficult.

⇒ **A large scale acquisition unlikely, with buybacks & higher dividends likely capital initiatives**; Within a still competitive market we see GUD's prospects of a large scale acquisition as limited, leaving the company with still considerable balance sheet capacity. The current share buyback program still has up to 1.9m shares outstanding (we have assumed 1.5m are acquired over the next 18 months) and we see scope for a higher payout ratio than our forecast 75% that represents a yield of 6.4%.

6 mths ending Dec	1h05	1h04	%chg
Sales revenue	211	212	0%
EBITDA	34.9	38.8	-10%
Dep'n and amort'n	4.8	5.5	-12%
EBIT	**30.1**	**33.4**	**-10%**
Net interest expense	1.7	1.4	23%
Pre-tax profit	28.4	32.0	-11%
Tax expense	9.2	9.6	-5%
Net profit (pre abn's)	**19.2**	**22.4**	**-14%**
Abn's / extra's	-8.8	-2.1	321%
Reported profit	10.4	20.3	-49%
Tax rate (%)	32.3%	30.1%	
EBIT margin (%)	**14.2%**	**15.8%**	
EPS	**33.5**	**37.4**	**-11%**
DPS	23.0	17.0	35%

Company Information

Price			$8.03
Target Price (12 month)			$8.00
Difference			**- 0%**
Shares (diluted)	60.0M	Market cap.	$482M
High/low (12 month)	$7.25/$11.42	Monthly turnover	$30.3M

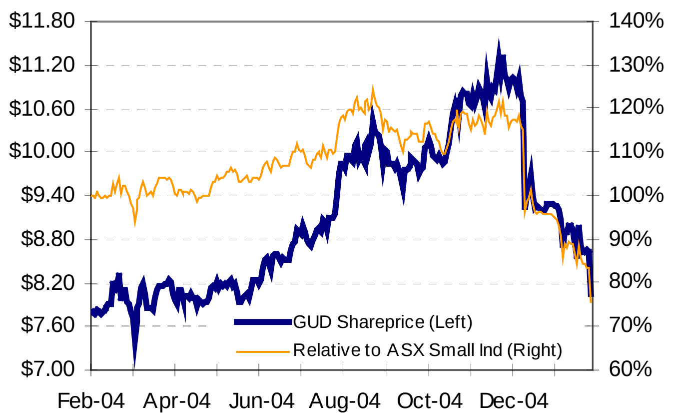
Earnings Summary

Year ending Jun	2003	2004	2005F	2006F
NPAT (reported) (A$M)	27.4	41.7	38.8	40.8
FST adj NPAT (A$M)	28.4	43.4	41.2	43.2
EPS (¢)	46.0	71.1	68.0	72.6
PER	17.4 x	11.3 x	11.8 x	11.1 x
EPS Growth	34%	54%	-4%	7%
EV / EBITDA	9.3 x	6.7 x	7.2 x	6.9 x
Operating CFPS (¢)	67.3	80.9	68.1	89.0
Price / CF	11.9 x	9.9 x	11.8 x	9.0 x
Dividend (¢)	26.0	40.0	51.0	55.0
Yield	3.2%	5.0%	6.4%	6.8%
Franking	100%	100%	100%	100%
Payout Ratio	56%	56%	75%	76%
NTA per share	$1.26	$1.39	$1.33	$1.43

Earnings Forecast Changes

		2005F	2006F
NPAT (FST adj)	Change (%)	-11%	-13%
EPS (FST adj)	Change (%)	-11%	-13%

GUD versus Small Industrials Index



1H05 result disappoints, with Victa the key division

GUD reported 1H05 NPAT of $28.4m (pre one-off) on revenue of $211m, which was lower than we had anticipated and also implies a weaker result than management's comments at the 13 Dec 04 company release (where ggt indicated a full-year EBIT growth range of 0% to 9%). Key points to the result were:

⇒ **Group revenue flat**; A decline in revenues from the Sunbeam/Victa and Ryco/Wesfil divisions was offset by an improved Davey operation (which also benefited from the Spa-Quip acquisition)

Margin decline impacts result

⇒ **Margin decline impacts EBIT**; However a decline in Sunbeam Victa margins impacted group EBIT which declined -10% on pcp.

Extended terms for Sunbeam impacts cashflow over Christmas period

⇒ **Operating cashflow negative**; A $32m increase in trade debtors resulted in negative operating cashflow of -$11.3m, a substantial turnaround from the $10.9m pcp (noting a $6.2m increase in taxed paid in 1H05)

⇒ **Payout ratio increases to 69%**; The 23c dividend (100% franked) represents a payout ratio of 69% (pre-goodwill), an increase from the 46% in 1H04.

⇒ **One-off cost for Ryco restructuring**; The restructure of the Ryco / Wesfil division resulted in a one-off expense of -$12.6m.

Sunbeam Victa margins the primary driver of EBIT decline

Table 1 below provides a segment summary of the GUD 1H05 result.

TABLE 1: GUD 1H05 SEGMENT RESULT SUMMARY

Disappointing Victa performance impacts division margins

Davey performance strong

		1H05	1H04	% Change
Sunbeam/Victa	Revenue	117	122	-4%
	EBITA	15.1	19.4	-22%
	EBITA Margin	12.9%	15.9%	
Ryco/Wesfil	Revenue	40	44	-9%
	EBITA	8.7	9.6	-9%
	EBITA Margin	21.6%	21.7%	
Davey	Revenue	47	39	21%
	EBITA	6.3	4.5	40%
	EBITA Margin	13.5%	11.7%	
Lock Focus	Revenue	7	7	1%
	EBITA	1.5	1.6	-6%
	EBITA Margin	20.8%	22.5%	
GROUP	Revenue	211	212	0%
	EBITA	31.9	35.1	-9%
	EBITA Margin	15.1%	16.6%	

Source: GUD, FST

⇒ **Sunbeam Victa**; Whilst Sunbeam's performance remained strong due to the operation's leading brand positioning within the Australia small appliances sector, Victa's performance was severely impacted by lower market volumes and import competition.

⇒ **Ryco / Wesfil**; A relatively soft automotive aftermarket impacted revenues, however management incremental cost cutting activity maintained margins at +20%

- ⇒ **Davey**; The acquisition of Spa-Quip provided a solid revenue boost to the division with integration savings and improved cost controls increasing margins. However, the strong $A/$US impacted export margins.
- ⇒ **Lock Focus**; saw margins decline due to competitive pressures in a market that management saw as "patchy", however sales remained consistent with pcp.

Management expect 2H05 EBITA consistent with pcp

Mgt expects 2H05 trading profit inline with pcp…

Following the 1H05 result management expects trading profit for 2H05 to be inline with last year, implying EBITA of ~$33m which represents an improvement on 1H05 EBITA of $31.9m.

…We still see prospects for further Victa disappointment

However, we have adopted a more conservative forecast given conditions for the underperforming Victa operation appear unlikely to improve over the next five months (and also that the company's traditional 1H/2H earnings split remains consistent), and have downgraded our EPS forecasts by 11% and 13% in FY05 and FY06 respectively whilst assuming a 75% dividend payout ratio.

We have also assumed GUD continues with the share buyback program over the next 1½ years with the purchase of 1.5m shares (noting the current buyback program still has a maximum of 1.9m shares).

2H05 operating cashflow improvement expected

Management also anticipates a turnaround in operating cashflow, with net debt at the end of FY05 likely to be below FY04 net debt of $17.6m, however whilst we assume a strong turnaround is achieved (with 2H05 operating cashflow of $52.6m on the basis that management is successful in reducing trade debtors) we expect higher net debt given a higher payout ratio and share buyback.

Domestic economic conditions are expected by management to remain reasonably supportive, although consumer activity is expected to slow, therefore although we do not see any substantial downside risks to the revenues of GUD's better-performing operations (i.e. Sunbeam, Ryco & Davey), the prospects for faster than expected growth appear unlikely.

Additionally, given the substantial improvements in group EBIT margins from 7.4% in FY01 to 15.8% achieved in FY04 there appears limited scope for further substantial cost savings, noting savings from the restructuring of Ryco are expected to materialise in FY06.

Large-scale acquisitions appear unlikely

Whilst acquisitions offer potential upside to our earnings forecasts, facilitated by GUD's strong balance sheet, prospects for a large-scale acquisition appear to remain somewhat limited. Indeed, in a smaller diversified industrials market that remain competitive we consider GUD is more limited in its ability to undertake larger-scale acquisitions than potential competitors (such as ALS) that can afford higher acquisitions multiples due to higher integration synergy benefits.

Scope for further PER derating given earnings disappointment…

Following the post-result earnings downgrade and shareprice fall GUD is trading at a 27% discount to the small industrials FY05 PER aggregate, and we consider there is scope for this discount to increase until the market becomes comfortable that 2H05 earnings expectations are realistic.

…however sustainable +6% yield and active buyback expected to support

However, the 6.3% yield (which we consider sustainable if not potentially higher) offers considerable shareprice support when combined with the likely continued share buyback program. Thus whilst we see few prospects for shareprice appreciation in light of negative market sentiment following the disappointing result, further substantial shareprice declines appear likely to be offset by the yield, thus we recommend GUD as a Hold.

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Valuation data

Year ending Jun	2002	2003	2004	2005F	2006F
EPS pre goodwill (¢)	**34.3**	**46.0**	**71.1**	**68.0**	**72.6**
P/E ratio	**23.4 x**	**17.4 x**	**11.3 x**	**11.8 x**	**11.1 x**
P/E relative *			59	72	79
EPS growth	**78%**	**34%**	**54%**	**-4%**	**7%**
EPS pre abn's (¢)	32.3	44.4	68.3	64.1	68.6
P/E ratio	24.9 x	18.1 x	11.8 x	12.5 x	11.7 x
P/E relative *			61	77	84
EPS growth	86%	38%	54%	-6%	7%
EV / EBIT	14.9 x	11.4 x	8.0 x	8.7 x	8.2 x
EV / EBITDA	**11.5 x**	**9.3 x**	**6.7 x**	**7.2 x**	**6.9 x**
Op CFPS (¢)	55.3	67.3	80.9	68.1	89.0
Price / Op CF	14.5 x	11.9 x	9.9 x	11.8 x	9.0 x
Free CFPS (¢)	60.0	61.9	67.3	58.2	78.9
Price / Free CF	13.4 x	13.0 x	11.9 x	13.8 x	10.2 x
DPS (¢)	16.5	26.0	40.0	51.0	55.0
Yield	**2.1%**	**3.2%**	**5.0%**	**6.4%**	**6.8%**
Franking	55%	100%	100%	100%	100%
NTA per share	$1.15	$1.26	$1.39	$1.33	$1.43
Pr / NTA	7.0 x	6.4 x	5.8 x	6.0 x	5.6 x

Profit and loss ($M)

Year ending Jun	2002	2003	2004	2005F	2006F
Sales revenue	365.9	372.4	395.8	394.2	404.8
growth over pcp	*7%*	*2%*	*6%*	*0%*	*3%*
EBITDA	45.4	54.3	74.4	70.0	73.0
Dep'n and amort'n	9.2	9.0	10.2	9.2	9.2
EBITAg	**36.2**	**45.3**	**64.3**	**60.8**	**63.8**
Goodwill amortisation	1.3	1.0	1.7	2.4	2.4
EBIT	**34.9**	**44.3**	**62.6**	**58.4**	**61.4**
growth over pcp	*39%*	*27%*	*41%*	*-7%*	*5%*
Net interest expense	5.3	3.7	2.4	2.1	2.2
Pre-tax profit	29.6	40.6	60.2	56.3	59.2
Tax	8.8	13.2	18.4	17.4	18.3
Effective tax rate	*29.9%*	*32.5%*	*30.6%*	*31.0%*	*31.0%*
Preference dividends	0.0	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0
FST adjustments	1.3	1.0	1.7	2.4	2.4
FST adj profit	**22.1**	**28.4**	**43.4**	**41.2**	**43.2**
Reported profit (pre abn)	20.8	27.4	41.7	38.8	40.8
One-off items (post tax)	(14.4)	(5.6)	(6.2)	(8.8)	0.0
Reported net profit	6.4	21.8	35.5	30.0	40.8

Ratio analysis

Year ending Jun	2002	2003	2004	2005F	2006F
EBITDA / sales	12.4%	14.6%	18.8%	17.8%	18.0%
EBITAg / sales	9.9%	12.2%	16.2%	15.4%	15.8%
EBIT / sales	**9.5%**	**11.9%**	**15.8%**	**14.8%**	**15.2%**
Return on assets	15%	21%	29%	25%	26%
Return on equity	**17%**	**23%**	**32%**	**29%**	**31%**
Net debt / (cash) ($M)	38.0	20.9	17.6	24.6	18.5
Debt / equity	40%	34%	33%	40%	35%
Net debt / equity	**31%**	**16%**	**12%**	**18%**	**13%**
Interest cover	6.6 x	11.8 x	25.8 x	27.7 x	27.8 x
Dividend payout ratio	48%	56%	56%	75%	76%
Capex (net) / dep'n	nmf	0.5 x	1.1 x	0.8 x	0.8 x
Working capital / sales	21%	19%	20%	21%	21%

Balance sheet ($M)

Year ending Jun	2002	2003	2004	2005F	2006F
Cash	11.1	21.8	29.7	29.7	29.7
Receivables	55.2	49.9	51.1	59.1	60.7
Inventories	57.4	60.0	66.5	67.0	68.8
Other	7.5	5.7	4.7	5.8	5.8
Current assets	**131.2**	**137.3**	**152.0**	**161.6**	**165.0**
Net PPE	40.9	37.5	36.8	34.8	32.7
Investments	0.0	0.0	0.0	0.0	0.0
Goodwill	11.2	10.2	18.2	15.8	13.4
Other intangibles	39.9	40.6	39.7	41.3	40.1
Other	6.1	6.7	8.1	11.8	11.8
Non-current assets	**98.1**	**95.1**	**102.8**	**103.7**	**98.1**
Total assets	**229.3**	**232.4**	**254.7**	**265.3**	**263.1**
Creditors	36.3	40.0	37.9	43.4	44.5
Debt	49.0	42.6	47.3	54.3	48.2
Provisions	22.3	22.9	26.9	30.6	32.4
Other	0.0	(0.0)	0.0	(0.0)	0.0
Total liabilities	**107.6**	**105.6**	**112.1**	**128.2**	**125.2**
Equity / reserves	111.9	108.0	107.7	99.5	91.2
Retained profits	9.8	18.8	34.9	37.6	46.8
Total s/h funds	**121.7**	**126.8**	**142.6**	**137.1**	**138.0**
Minorities	0.1	0.0	0.0	0.0	0.0
Total funds emp.	**229.3**	**232.4**	**254.7**	**265.3**	**263.1**

Cashflow ($M)

Year ending Jun	2002	2003	2004	2005F	2006F
EBIT	34.9	44.3	62.6	58.4	61.4
Net interest paid	(5.3)	(3.7)	(2.4)	(2.1)	(2.2)
Dep'n and amort'n	10.5	10.0	11.9	11.6	11.6
Tax paid	(3.4)	(9.0)	(11.3)	(18.4)	(17.4)
Gross cash from op'ns	**36.7**	**41.5**	**60.8**	**49.5**	**53.3**
(Inc) / dec in wk'g cap	11.3	6.5	(9.9)	(3.0)	(2.2)
Other	(12.3)	(6.5)	(1.5)	(5.2)	1.8
Operating cashflow	**35.7**	**41.5**	**49.4**	**41.3**	**53.0**
growth over pcp	*170%*	*16%*	*19%*	*-17%*	*28%*
Investing cashflows					
Capital expenditure	(7.9)	(7.6)	(9.2)	(7.0)	(6.5)
Asset sales	10.9	4.3	0.9	1.0	0.5
Free cashflow	**38.8**	**38.2**	**41.1**	**35.3**	**47.0**
growth over pcp	*261%*	*-1%*	*8%*	*-14%*	*33%*
Investments	0.0	0.0	(9.3)	0.0	0.0
Divestments	12.5	0.0	0.0	0.0	0.0
Financing cashflows					
Equity raised	(6.9)	(4.7)	(0.7)	(8.3)	(8.3)
Dividends paid	(9.5)	(12.2)	(19.4)	(26.3)	(32.6)
Chg in loans	**(38.7)**	**(6.4)**	**(1.4)**	**7.0**	**(6.1)**
Other non-op flows	0.0	(4.0)	(2.5)	(7.7)	0.0
Net chg in cash	**(3.8)**	**10.9**	**7.8**	**0.0**	**0.0**

Interims ($M)

Half yearly	1h03	2h03	1h04	2h04	1h05
Sales revenue	198.0	174.4	211.7	184.1	211.1
EBITDA	28.0	26.3	38.8	35.6	34.9
EBIT	**23.2**	**21.1**	**33.4**	**29.2**	**30.1**
FST adj profit	**15.2**	**13.1**	**22.9**	**20.6**	**20.4**
Reported profit	14.7	12.6	22.4	19.4	19.2
Operating cashflow	**(4.1)**	**45.6**	**10.9**	**38.5**	**(11.3)**
EBIT / sales	11.7%	12.1%	15.8%	15.9%	14.2%
EPS (¢)	**24.6**	**21.5**	**37.4**	**33.7**	**33.5**
DPS (¢)	11.0	15.0	17.0	23.0	23.0
% of FY sales	53%	47%	53%	47%	54%
% of FY EBIT	52%	48%	53%	47%	51%

* Relative to FST growth companies universe

31-Jan-05