

GUD Holdings Limited

Turning up the heat on Breville



Wilson HTM
INVESTMENT GROUP

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\$9.50

HOLD

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Price Performance



Security/Capital Details

ASX Code	GUD
Market Cap	\$575 M
Issued Shares	61.5 M
Avg Mth T'over	5.07 M
12 Mth High – Low	\$9.35 - \$3.58

Key Data/Ratios – FY 2010

EBITDA / Sales	15.6%
EBIT / Sales	13.5%
Net Debt / Equity	50.7%
Interest Cover	9.1 x
ROE	30.0%
EPS Growth	5.5%
N/A / Share	\$ 0.93
12 Mth Price Target	\$ 9.10

Recommendation

We retain a HOLD. Our 12 month target is \$9.10 p/share on a stand-alone basis, with upside under Breville takeover scenarios to \$9.70 - \$10.50.

GUD held its 2009 AGM in Melbourne and has confirmed a good start to FY10, and generally positive comments with respect to the outlook for FY10 earnings, and beyond. GUD did not make any new revelations with respect to its current takeover offer for Breville. We value GUD on a stand-alone basis at \$9.10 p/share taking a 12 month view. This increases to \$9.70 - \$10.50 p/share under various takeover scenarios. HOLD.

Key Points

- **AGM update.** GUD has confirmed its expectation of a positive outlook for FY10, providing us with confidence in our forecast for EBIT of ~\$65M (+7%).
- **Takeover offer for Breville.** GUD's current takeover offer for Breville is on the basis of 1 GUD share for every 4 Breville shares. The offer is for 100% of Breville, but is only conditional on securing a minimum of 50.1% of all Breville shares. The offer is also subject to ACCC clearance.
- **WHTM view.** We retain the view that GUD's current offer for Breville is fair and reasonable, with the offer valuing Breville at \$2.38 p/share (FY11 PER 14.5x) based on GUD's current share price of \$9.50. Given GUD has already secured support from 47.4% of Breville's shareholder base, provided ACCC clearance is achieved, we expect the minimum acceptance condition of 50.1% to be satisfied, and that the current offer will be successful.
- The optimum value for GUD shareholders is that GUD becomes entitled to +90% of Breville shares, and subsequently moves to compulsory acquisition, thereby enabling full access to an estimated +\$15M of merger cost synergies. This outcome remains far from certain, particularly in light of the 25% shareholding held by Premier Investments and 5.5% by the Lew Family. We view it as most likely that GUD would need to 'sweeten' its current offer to secure these shareholdings, if they are for sale at all.
- We assess GUD's current offer as FY11 EPS positive by 3.9% - 6.8% (pre-synergies), and 20% positive (including full synergies). Our initial analysis suggests that GUD could increase its current offer to ~2 GUD shares for each 7 Breville share (ie. assumes EPS neutrality for GUD (pre-synergies)).
- **Earnings outlook.** Our stand-alone GUD earnings forecasts remain unchanged, and include trading EBIT of \$65.2M (+7%) and EPS of \$0.69 for FY10. Any future changes are increasingly biased toward upside (ie. +5%-10%), but remain conditional on the critical Christmas trading period.
- **Valuation assessment.** Our revised 12 month target for GUD on a stand-alone basis is \$9.10 p/share (FY11 EV/EBITDA 9.0x, implied PER 12.5x). Under various scenarios, we assess the upside from a merger with Breville as being within the \$9.70 - \$10.50 p/share range (refer overleaf for details).
- **Recommendation.** Based on a current share price of \$9.50, and the uncertain end result from GUD's current takeover play for Breville, we view a HOLD rating as being appropriate at this point in time.

BUY: Total return +10% or more over a 12 month period. HOLD: Total return expected to be between +10% to -10% over a 12-month period
SELL: Total return expected to be -10% or more over a 12 month period. TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

June	NPAT (Rep) \$M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2009a	34.8	65.4	-7.9	14.5	11.9	9.3	60.0	6.3	100
2010e	41.5	68.9	5.5	13.8	11.1	8.7	62.0	6.5	100
2011e	44.6	73.2	6.2	13.0	10.7	8.2	64.0	6.7	100
2012e	46.8	76.1	3.9	12.5	10.7	8.1	66.0	7.0	0



Takeover offer for Breville Group

(a) Key offer details:

Having acquired a 19.4% shareholding in Breville in May 2009, GUD recently made a takeover offer for all the shares in Breville that it does not already own.

GUD's current 1-for-4 scrip takeover offer for Breville provides a market valuation for Breville of \$308M, or \$2.38 p/share (note: assumes GUD share price of \$9.50).

The offer provides Breville PER multiples of 16.5x for FY10 and 14.5x for FY11.

(b) Offer considerations:

- Our **initial view** is that GUD's offer is within the range of 'fair and reasonable' value for Breville. We base our assessment on FY11 earnings (ie. year of more 'normal' cyclical earnings), and believe a PER range of 13x – 14x as appropriate. This implies an FY11 EV/EBITA range of 10.0x - 10.6x.
- Given GUD's offer is conditional on a **minimum 50.1% acceptance level**, and it already has support from 47.4% of Breville's shareholding base, we view the risk of meeting this condition as close to nil.
- Receiving **ACCC clearance**, without excessive conditions/undertakings, is higher risk, but is modest in our view. If the ACCC condition is cleared, we rate GUD's current offer as highly likely of achieving its minimum 50.1% acceptance level, and thereby being successful.
- The full value in GUD's offer is in the event of it securing +90% (and proceeding to a full merger) of Breville, and extracting +\$15M of merger cost synergies.
- The prospect of moving to a +90% acceptance level is far from certain, and would specifically require acceptance by Breville's largest shareholder, Premier Investments (25%), and potentially the acceptance of the Lew Family's 5.5% shareholding. If GUD could be assured of securing these shareholdings (and a +90% shareholding), then we believe there are good prospects that its current offer could be 'sweetened'. If GUD was assured it could achieve a full takeover, we believe it could validate an offer of 2 GUD shares for every 7 Breville share (implied value of \$2.71 p/share). This analysis assumes: (a) the maximum GUD could pay on the basis of a full scrip offer, if (b) GUD could be guaranteed of a full takeover of Breville (ie. achieve +90% acceptance of the offer), and (c) the offer consideration would be FY11 EPS neutral pre merger synergies, with the value of merger synergies to then be shared proportionately by respective shareholder bases.
- **Valuation assessment.** Our stand-alone 12 month target for GUD is \$9.10 p/share (FY11 EV/EBITA 9.0x, implied PER 12.5x). The valuation assessment under a range of takeover scenarios is less certain, however we assess these as being within a range of \$9.70 (ie. 50.1% acceptance level, under the current offer) up to \$10.50 p/share (assume succeeds with a full takeover under a revised offer of 2 GUD shares for every 7 Breville share (ie. \$2.71 p/share)).
- With a current share price of \$9.50, we view a HOLD rating as being appropriate for GUD under the current position.
- A summary of our initial appraisal of the financials under various scenarios is summarised overleaf.

Financial outlook

A summary of our initial appraisal of the financial impact of the current takeover offer under various acceptance scenarios is summarised below.

Merger appraisal - GUD and Breville

GUD shareholding in Breville ... Y/e: FY11e		GUD stand only	Majority 50.1%	Majority 89.9%	Merged 100%	Merged 100%
Revenue:						
- GUD	\$M	504.4	504.4	504.4	504.4	504.4
- Breville	\$M	n/a	480.8	480.8	480.8	480.8
Revenue (combined)	\$M	504.4	985.2	480.8	985.2	985.2
EBITA:						
- GUD	\$M	69.7	69.7	69.7	69.7	69.7
- Breville	\$M	n/a	33.4	33.4	33.4	33.4
- Merger synergies (WHTM est:)	\$M	n/a	0.0	0.0	0.0	15.0
EBITA (combined)	\$M	69.7	103.1	103.1	103.1	118.1
NPAT (pre minorities)	\$M	44.6	66.0	66.0	66.0	76.5
- Minorities	\$M	n/a	-10.6	-2.2	0.0	0.0
NPAT (GUD)	\$M	44.6	55.4	63.8	66.0	76.5
Shares (GUD)	M	61.5	71.5	84.4	87.6	87.6
EPS (GUD)	cents	72.5	77.5	75.7	75.3	87.3
- EPS accretion	%	n/a	6.8%	4.4%	3.9%	20.4%

Note: initial analysis assumes proportional consolidation of Breville earnings.

A summary of our stand-alone earnings forecasts for GUD are summarised below.

Financial summary

Y/e: 30 June		FY07	FY08	FY08	FY09	% Chg	FY10e	FY11e	FY12e
			Reported	Ex-Victa		Ex-Victa			
Sales revenue	\$M	518.7	534.9	469.0	468.3	0%	484.3	504.3	525.5
- growth	%	12%	3%	n/a	-12%	n/a	3%	4%	4%
Divisional EBIT:									
- Consumer	\$M	25.6	38.4	33.0	29.9	-9%	32.4	34.5	36.3
- Automotive	\$M	16.9	19.4	19.4	19.3	-1%	19.8	20.5	21.3
- Water	\$M	19.1	13.5	13.5	15.0	11%	16.1	17.2	18.6
- Security	\$M	2.3	2.5	2.5	1.3	-49%	1.8	1.8	1.9
- Unallocated	\$M	-3.7	-5.4	-5.4	-4.7	-12%	-4.8	-4.8	-5.0
Trading EBIT	\$M	60.2	68.4	63.0	60.8	-4%	65.2	69.2	73.1
- growth	%	-5%	14%	n/a	-11%	n/a	7%	6%	6%
NPAT (normalised)	\$M	36.2	41.6	37.9	37.4	-1%	41.5	44.6	46.8
- growth	%	-10%	15%	n/a	-10%	n/a	11%	8%	5%
Significant items	\$M	-2.5	-4.2	-4.2	-2.6	-38%	0.0	0.0	0.0
NPAT (reported)		33.6	37.4	33.7	34.8	3%	41.5	44.6	46.8
EPS (normalised)	cps	60.3	69.7	63.5	64.5	2%	68.1	72.5	76.1
- growth	%	-10%	15%	n/a	-7%	n/a	6%	6%	5%
DPS	cps	61.0	68.0	68.0	60.0	-12%	62.0	64.0	66.0
Earnings multiples:									
- EV / EBITA	x	11.0	9.3	10.1	10.9	n/a	10.1	9.4	8.8
- PER (Cash EPS)	x	15.7	13.6	15.0	14.7	n/a	13.9	13.1	12.5
- Yield	%	6.4	7.2	7.2	6.3	n/a	6.5	6.7	6.9

Source: GUD & WHTM. Note: assume DRP applies to 2H FY09 and 1H FY10 DPS. Victa was sold 30/06/08.

GUD Holdings Limited (GUD : \$9.50)

INVESTMENT FUNDAMENTALS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EPS Reported (c)	62.8	60.0	68.1	72.5	76.1
EPS Normalised (c)	70.9	65.4	68.9	73.2	76.1
EPS Growth (%)	N/A	-7.9%	5.5%	6.2%	3.9%
PER Normalised (x)	13.4	14.5	13.8	13.0	12.5
DPS (c)	68.0	60.0	62.0	64.0	66.0
Payout (%)	108.2%	100.1%	91.0%	88.3%	86.7%
Yield (%)	7.2%	6.3%	6.5%	6.7%	7.0%
Franking (%)	100%	100%	100%	100%	0%

VALUATION DATA

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EV / EBITA (x)	9.2	10.8	10.0	9.3	8.8
EV / EBITDA (x)	7.9	9.3	8.7	8.2	8.1
CFPS (c)	97.8	79.9	86.0	89.2	88.5
Price / CF	9.7	11.9	11.1	10.7	10.7
Book Value / Share (\$)	2.1	2.2	2.4	2.4	2.6
Price / Book (x)	4.6	4.4	4.0	3.9	3.7

PROFIT & LOSS (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Sales Revenue	534.9	468.3	484.3	504.3	525.5
EBITDA	80.9	71.4	75.5	79.1	79.6
Depreciation	12.0	10.1	9.7	9.4	6.5
EBITA	68.9	61.3	65.7	69.7	73.1
Amortisation	0.6	0.5	0.5	0.5	0.0
EBIT	68.3	60.8	65.2	69.2	73.1
Net Interest Expense	9.3	7.7	7.2	6.6	6.2
Pre-tax Profit	59.0	53.1	58.1	62.6	66.9
Tax	17.3	15.7	16.6	18.0	20.1
Tax rate (%)	29.4%	29.5%	28.6%	28.8%	30.0%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net Profit	41.6	37.4	41.5	44.6	46.8
Abn's / Extraord's	-4.2	-2.6	0.0	0.0	0.0
Reported Net Profit	37.4	34.8	41.5	44.6	46.8
Revenue Growth (%)	N/A	-12.5%	3.4%	4.1%	4.2%
EBIT Growth (%)	N/A	-11.0%	7.3%	6.1%	5.6%
NPAT Growth (%)	N/A	-10.1%	10.8%	7.6%	5.0%

PROFITABILITY RATIOS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EBIT / Sales (%)	12.8%	13.0%	13.5%	13.7%	13.9%
ROA (%)	N/A	21.8%	22.7%	24.1%	25.1%
ROE (%)	N/A	29.7%	30.0%	30.2%	30.4%
ROFE (%)	N/A	28.6%	29.9%	32.1%	33.9%

BALANCE SHEET (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Cash	33.1	16.2	21.4	20.0	18.9
Receivables	65.9	62.3	64.4	67.1	69.9
Inventories	81.4	82.7	85.5	89.0	92.8
Other	4.2	6.6	4.7	4.9	5.0
Current Assets	184.7	167.8	176.0	181.0	186.6
Net PPE	20.2	19.6	21.2	22.5	23.5
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	92.2	91.6	87.3	79.8	79.8
Other	5.2	24.5	24.5	24.5	24.5
Non-current Assets	117.6	135.7	132.9	126.8	127.8
Total Assets	302.3	303.4	308.9	307.8	314.4
Current Payables	45.1	44.3	45.8	47.7	49.7
Current Debt	0.5	0.5	0.5	0.5	0.5
Non-Current Debt	118.8	106.4	94.4	84.4	76.4
Provisions	0.0	0.0	0.0	0.0	0.0
Other	17.8	21.2	23.4	24.6	30.4
Total Liabilities	182.2	172.3	164.0	157.1	156.9
Equity	80.7	94.5	103.7	103.7	103.7
Reserves	-0.8	-0.9	-0.9	-0.9	-0.9
Retained Profits	40.3	37.5	42.0	47.9	54.7
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	120.1	131.1	144.9	150.7	157.6
Total Funds Employed	206.3	221.7	218.4	215.6	215.4

LIQUIDITY & LEVERAGE RATIOS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Net Debt (Cash) (\$m)	86.2	90.6	73.5	64.8	57.9
Net Debt / Equity (%)	71.8%	69.1%	50.7%	43.0%	36.7%
Interest Cover (x)	7.3	7.9	9.1	10.5	11.9
Debt / CashFlow (x)	2.1	2.3	1.8	1.5	1.4

CASHFLOW (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EBIT	68.3	60.8	65.2	69.2	73.1
Dep'n and Amort'n	12.6	10.6	10.2	9.9	6.5
Net Int Rec'd (Paid)	-9.3	-7.7	-7.2	-6.6	-6.2
Tax Paid	-13.3	-10.8	-12.5	-13.3	-14.4
Dec / (Inc) W'kg Cap	5.8	1.5	-3.4	-4.3	-4.6
Other	-5.9	-8.1	0.0	0.0	0.0
Operating Cash Flow	58.2	46.4	52.3	54.9	54.5
Capital Expenditure	-6.4	-9.5	-7.5	-7.5	-7.5
Asset Sales	0.0	0.0	0.0	0.0	0.0
Investments	12.1	-18.2	0.0	0.0	0.0
Other Inv. Flows	0.0	0.0	0.0	0.0	0.0
Investing Cash Flow	5.6	-27.7	-7.5	-7.5	-7.5
Equity Raised	-17.8	13.9	9.2	0.0	0.0
Inc / (Dec) in Loans	8.0	-11.9	-12.0	-10.0	-8.0
Dividends Paid	-38.3	-37.6	-36.9	-38.8	-40.0
Other Fin. Flows	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	-48.1	-35.6	-39.7	-48.8	-48.0
Net Cash Flow	15.7	-16.9	5.2	-1.4	-1.0

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