ShawandPartners
an EFG company

SRG Global (SRG)

Rating: Buy | Risk: High | Price Target: $0.70

Relativity

Key Information

Current Price ($ps)	0.47
12m Target Price ($ps)	0.70
52 Week Range ($ps)	0.18 - 0.51
Target Price Upside (%)	48.9%
TSR (%)	53.2%
Reporting Currency	AUD
Market Cap ($m)	209.5
Sector	Industrials
Avg Daily Volume (m)	0.2
ASX 200 Weight (%)	0.01%

Fundamentals

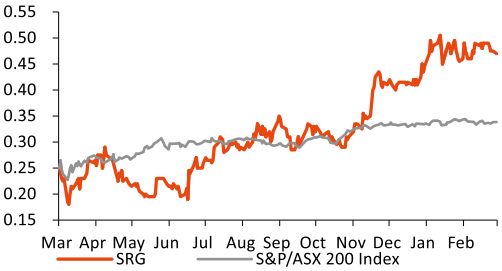
YE 30 Jun (AUD)	FY20A	FY21E	FY22E	FY23E
Sales ($m)	520.0	599.6	675.8	730.7
NPAT ($m)	1.4	13.8	18.0	21.8
EPS (cps)	0.3	3.1	4.0	4.9
EPS Growth (%)	(86.1%)	873.4%	30.8%	21.0%
DPS (cps) (AUD)	1.0	2.0	2.5	3.0
Franking (%)	100%	100%	100%	100%

Ratios

YE 30 Jun	FY20A	FY21E	FY22E	FY23E
P/E (x)	66.2	15.2	11.6	9.6
EV/EBITDA (x)	7.5	4.7	4.0	3.6
Div Yield (%)	4.8%	4.3%	5.3%	6.4%
Payout Ratio (%)	315.5%	64.8%	61.9%	61.4%

Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	3.6%	4.7%	12.5%	65.7%
Absolute (%)	2.2%	5.6%	14.6%	88.0%
Benchmark (%)	(1.4%)	0.9%	2.1%	22.3%



Price performance indexed to 100 *Source:*

Major Shareholders

Perennial Value Management	11.6%
Mitsubishi UFG	8.5%

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Event

Post a good half year result, we recently upgraded our target price on SRG Global ('SRG' or the 'Company'), see our research note "$750mn Not Out" (26th February 2021). We outlined how our valuation was still been held back by the recent weakness in some peer group companies and hence this had negatively impacted our relative multiple valuation for SRG. This weakness in the peer group has generally continued and we feel this is unwarranted given the positive outlook for both mining and asset services in Australia. In valuing SRG, we now believe it is fairer to derive our target price based upon the target multiples for its peer group, rather than their current share prices. As such our 12-month target price has increased to $0.70ps (from $0.60). We maintain our Buy Recommendation.

Highlights

- SRGs asset service peer group now has on average 31% upside to consensus target prices; the mining construction names 46%. As such, we believe it is treating SRG unfairly to value it based on the current (share price) multiples of these peer stocks, rather than the projected multiples using the consensus target prices for these names.
- We believe that our 12-month forward valuation for SRG should be based on these target multiples, and we now incorporate this into our relative expected PE multiple and Sum of the Parts valuations. This moves the target price estimated from both these valuations much closer to our DCF valuation, which as we outlined in "$750mn Not Out" was considerably higher than that implied by our relative multiple analysis (using current share prices). If sell side consensus for these peers is correct, both the mining and asset service sectors are cheap, with SRG even cheaper (49% upside).
- We value SRG on a relative basis to peers and the market (PE Relative 16.2x (from 13.6x due to 30% upside to consensus price target of close peers) = $0.65ps (from $0.55ps)) as well as sense checking the relative valuation using a DCF ($0.78ps, unchanged) and Sum of the Parts (break up) valuation ($0.69ps from $0.50ps, due to 46% upside to consensus target price for construction peers and 31% for SRG's asset service peers).
- From this, our 12 month forward composite valuation and price target is now $0.70 per share, up from $0.60 previously. Based on our target price the stock would be trading on 6.8x, 5.9x and 5.3x our FY21-23 EBITDA forecasts respectively.

Recommendation

The recovery in SRG's operational performance is gathering pace as the Company continues to win contracts and WIH stands at record levels. We additionally expect the macro outlook to remain strong, across infrastructure, asset services, mining and select construction.

We believe the outlook for SRG remains very positive due to;

- FY21-22 revenue underpinned by high quality WIH. Large pipeline of work identified and hence likely news flow catalysts as more contracts are secured.
- Lower risk profile due to annuity earnings, alliance style contracts, breadth of clients and geographies etc.
- Improving competitive landscape and exit from the underperforming businesses.
- Solid balance sheet and forecast strong earnings momentum in the next few years.
- M&A potential.

As such we would expect SRG to continue to re-rate, along with a recovery in reported financial performance, towards a valuation closer to its lower risk maintenance focused peers (FY22 6.0x EBITDA). Given the upside in relative valuation, current WIH and likely positive catalysts from the tendering pipeline, we continue to rate SRG a Buy.

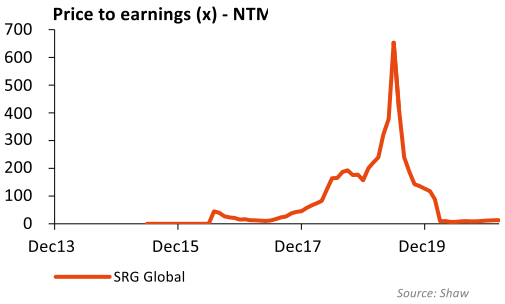
SRG Global
Industrials
Capital Goods
FactSet: SRG-AU / Bloomberg: SRG AU

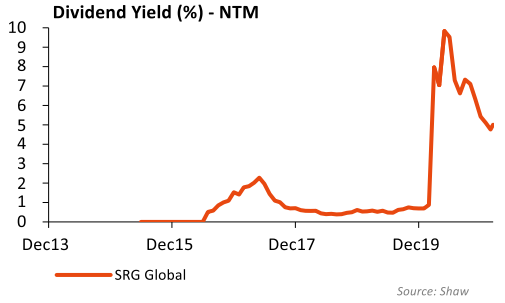
Key Items	Data
Recommendation	BUY
Risk	HIGH
Price ($ps)	0.47
Target Price ($ps)	0.70
52 Week Range ($ps)	0.18 - 0.51
Shares on Issue (m)	445.8
Market Cap ($m)	209.5
Enterprise Value ($m)	219.1
TSR (%)	53.2%

Valuation NPV	Data
Beta	1.30
Cost of Equity (%)	10.8%
Cost of Debt (net) (%)	6.0%
Risk Free Rate (%)	3.0%
Terminal Growth (%)	2.5%
WACC (%)	9.9%

Company Description

SRG Global Ltd. is an engineering-led global specialist asset services, mining services and construction group operating across the entire asset lifecycle of engineer, construct and sustain. It operates through the following segments: Asset Services, Mining Services and Construction. The Asset Services segment supplies integrated services to customers across the entire asset life cycle. The Mining Services segment provides services to mining clients and ground solutions including production drilling, ground and slope stabilization, design engineering and monitoring services. The Construction segment supplies integrated products and services to customers involved in the construction of complex infrastructure. The company was founded in 1961 and is headquartered in Subiaco, Australia.





Financial Year End: 30 June

Investment Summary (AUD)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS (Reported) (cps)	**2.1**	**(6.7)**	**3.1**	**4.0**	**4.9**
EPS (Underlying) (cps)	**2.3**	**0.3**	**3.1**	**4.0**	**4.9**
EPS (Underlying) Growth (%)	(73.6%)	(86.1%)	873.4%	30.8%	21.0%
PE (Underlying) (x)	**90.6**	**66.2**	**15.2**	**11.6**	**9.6**
EV / EBIT (x)	**12.4**	**43.8**	**9.1**	**7.6**	**6.3**
EV / EBITDA (x)	**6.2**	**7.5**	**4.7**	**4.0**	**3.6**
DPS (cps) (AUD)	1.5	1.0	2.0	2.5	3.0
Dividend Yield (%)	0.7%	4.8%	4.3%	5.3%	6.4%
Franking (%)	100%	100%	100%	100%	100%
Payout Ratio (%)	65.7%	315.5%	64.8%	61.9%	61.4%
Free Cash Flow Yield (%)	(15.7%)	(53.0%)	3.7%	6.4%	7.4%

Profit and Loss (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
Sales	486.4	520.0	599.6	675.8	730.7
Sales Growth (%)	*12.7%*	*6.9%*	*15.3%*	*12.7%*	*8.1%*
EBITDA	**32.0**	**29.2**	**47.0**	**54.5**	**59.4**
EBITDA Margin (%)	*6.6%*	*5.6%*	*7.8%*	*8.1%*	*8.1%*
Depreciation & Amortisation	(16.1)	(24.2)	(23.0)	(25.9)	(25.4)
EBIT	**15.9**	**5.0**	**24.0**	**28.6**	**34.0**
EBIT Margin (%)	*3.3%*	*1.0%*	*4.0%*	*4.2%*	*4.6%*
Net Interest	(1.3)	(3.0)	(2.9)	(2.9)	(2.9)
Pretax Profit	14.5	2.0	21.2	25.7	31.1
Tax	(4.4)	(0.6)	(7.4)	(7.7)	(9.3)
Tax Rate (%)	*(30.0%)*	*(30.0%)*	*(35.0%)*	*(30.0%)*	*(30.0%)*
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	**10.2**	**1.4**	**13.8**	**18.0**	**21.8**
Significant Items	(0.8)	(31.1)	0.0	0.0	0.0
NPAT Reported	**9.4**	**(29.7)**	**13.8**	**18.0**	**21.8**

Cashflow (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
EBIT	15.9	5.0	24.0	28.6	34.0
Tax Paid	(4.4)	(0.6)	(7.4)	(7.7)	(9.3)
Net Interest	(1.3)	(3.0)	(2.9)	(2.9)	(2.9)
Change in Working Capital	(8.6)	3.9	8.9	5.5	6.8
Depreciation & Amortisation	16.1	24.2	23.0	25.9	25.4
Other	(14.0)	(22.1)	(17.8)	(10.9)	(13.6)
Operating Cashflow	**3.7**	**7.5**	**27.8**	**38.5**	**40.4**
Capex	(45.9)	(57.1)	(20.0)	(25.0)	(25.0)
Acquisitions and Investments	0.0	0.0	0.0	0.0	0.0
Disposal of Fixed Assets/Investments	0.7	(25.2)	0.0	0.0	0.0
Other	64.6	64.1	0.0	0.0	0.0
Investing Cashflow	**19.3**	**(18.2)**	**(20.0)**	**(25.0)**	**(25.0)**
Free Cashflow	**(145.0)**	**(49.6)**	**7.8**	**13.5**	**15.4**
Equity Raised / Bought Back	0.8	0.0	0.0	0.0	0.0
Dividends Paid	(8.1)	(2.2)	(8.9)	(11.1)	(13.4)
Change in Debt	16.5	(9.5)	0.0	0.0	0.0
Other	(3.9)	(7.7)	0.0	0.0	0.0
Financing Cashflow	**5.3**	**(19.5)**	**(8.9)**	**(11.1)**	**(13.4)**
Exchange Rate Effect	0.3	0.0	0.0	0.0	0.0
Net Change in Cash	**28.6**	**(30.2)**	**(1.1)**	**2.3**	**2.0**

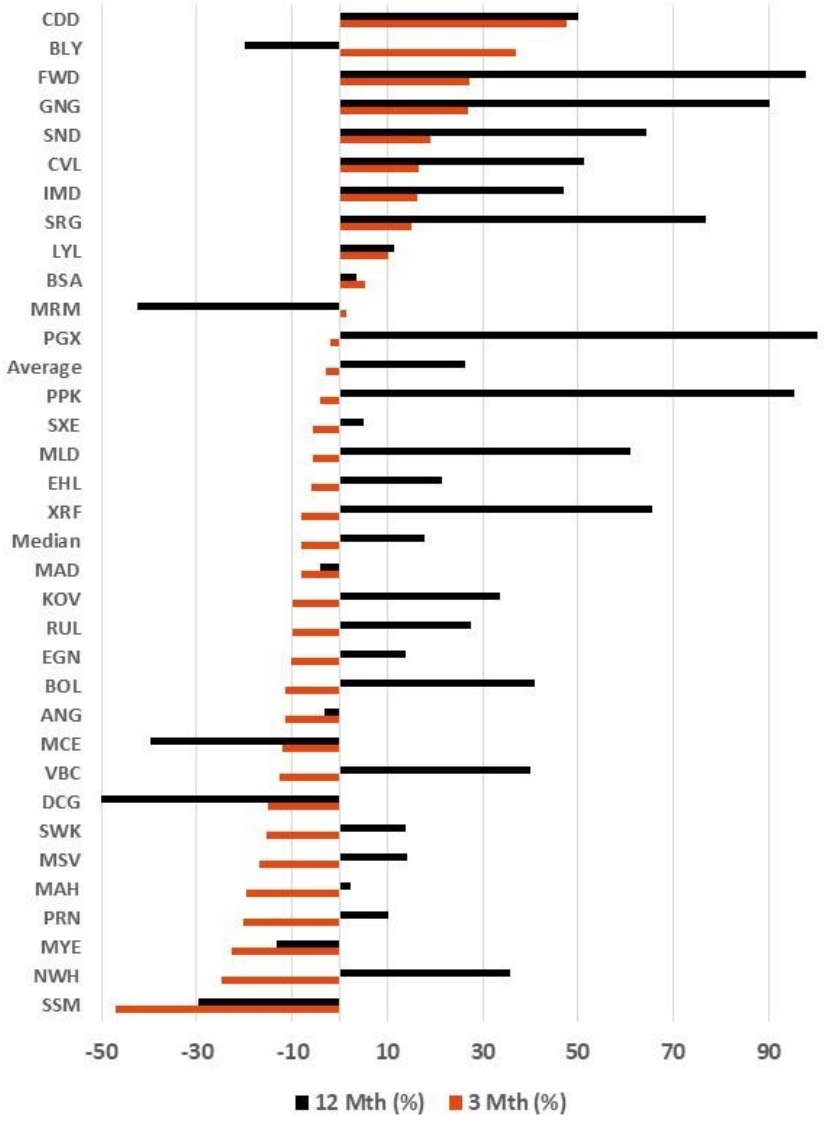
Balance Sheet (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash	58.3	28.1	27.0	29.4	31.4
Accounts Receivable	118.0	124.2	141.3	142.6	148.1
Inventory	13.0	15.6	18.0	20.2	21.9
Other Current Assets	5.1	8.8	8.8	8.8	8.8
PPE	71.5	79.3	76.3	75.4	74.9
Goodwill & Intangibles	137.6	107.3	107.3	107.3	107.3
Investments	0.0	0.0	0.0	0.0	0.0
Other Non Current Assets	27.2	59.6	59.6	59.6	59.6
Total Assets	**430.6**	**422.9**	**438.2**	**443.2**	**452.0**
Accounts Payable	99.7	104.5	115.0	113.1	113.6
Short Term Debt	21.2	12.7	12.7	12.7	12.7
Long Term Debt	24.9	23.9	23.9	23.9	23.9
Income Taxes Payable	1.7	2.5	2.5	2.5	2.5
Other	30.4	57.9	57.9	57.9	57.9
Total Liabilities	**177.9**	**201.4**	**211.9**	**210.1**	**210.5**
Total Shareholder Equity	**252.7**	**221.4**	**226.3**	**233.1**	**241.5**

Ratios	FY19A	FY20A	FY21E	FY22E	FY23E
ROE (%)	5.6%	0.6%	6.1%	7.8%	9.2%
ROIC (%)	7.2%	1.6%	10.0%	12.5%	14.6%
Gearing (%)	(5.1%)	3.7%	4.1%	3.0%	2.1%
Net Debt / EBITDA (x)	(0.4)	0.3	0.2	0.1	0.1
Price to Book (x)	nm	nm	nm	nm	nm

Relative Valuation

Post a good half year result, we recently upgraded our target price on SRG Global ('SRG' or the 'Company') to $0.60 from $0.50 per share, see our research note "$750mn Not Out" (26th February 2021). We however outlined how our valuation was still been held back by the recent weakness in some peer group companies and hence this had negatively impacted our relative multiple valuation for SRG. This weakness in the peer group has generally continued and we feel this is largely unwarranted given the positive outlook for both mining and asset services in Australia.

Figure 1: 3 and 12-month Performance – Mining and Asset Services and Contractors



Source: Shaw and Partners, FactSet

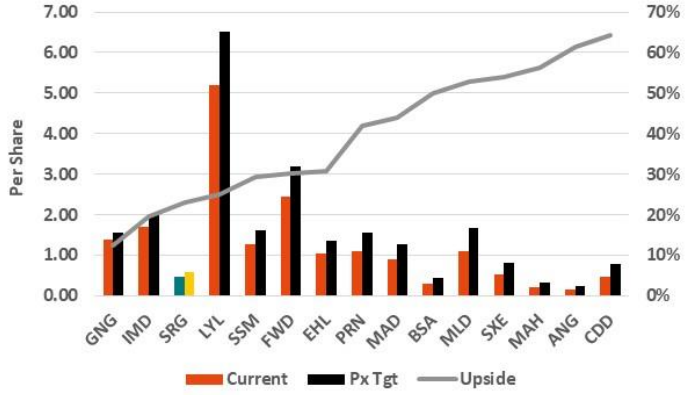
SRG's asset service peer group now has on average 31% upside to consensus target prices; the construction names have an implied 46% upside to their average target price.

As such, we believe it is treating SRG unfairly to value it based on the current (share price) multiples of these peer groups, rather than the projected multiples using the consensus target prices of these stocks.

Chart 2 shows the upside to target prices, Chart 3 how this translates to the target multiples these stocks are projected to trade on (assuming they reach consensus target prices).

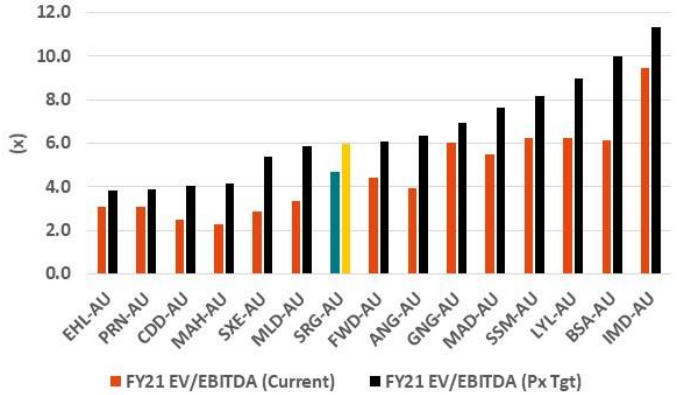
We believe that our target valuation for SRG should be based on these target multiples, and we now incorporate this into our relative expected PE multiple and Sum of the Parts valuations. This moves the target price estimated from both these methodologies much closer to our DCF valuation, which as we outlined in "$750mn Not Out" was considerably higher than that implied by our relative multiple analysis (using current share prices). If sell side consensus for these peers is correct, both the mining and asset service sectors are cheap, with SRG even cheaper (49% upside, see below).

Figure 2: Current versus Consensus Target Prices (and Upside)



Source: Shaw and Partners, FactSet to 15th March 2021

Figure 3: FY21 Consensus EV/EBITDA multiples – Current and Target



Source: Shaw and Partners, FactSet to 15th March 2021

Valuation, Outlook and Recommendation

The recovery in SRG's operational performance continues as the Company continues to win contracts and WIH stands at record levels. The confidence to provide EBITDA guidance (in this uncertain macro environment and continually upgrade), reflects not only the shift to more alliance, maintenance, annuity style contracts, but also their ability to deliver on these contracts.

We expect the macro outlook to remain strong, across infrastructure (Shovel-Ready stimulus), asset services, mining and select construction. Overseas Specialist Civil Engineering may also provide a further boost from FY22.

The Company also reiterated on their recent 1H21 conference call that liquidity and their current corporate structure supports the delivery of the strong WIH and a substantial increase in revenue from the current cost base.

The company's risk profile has also lowered, with 75% of earnings now from recurring/annuity contracts and the paring down of under-performing businesses (e.g. Structures Victoria).

In 2020, our positive call on SRG was based primarily on the potential re-rating we foresaw in its multiples as it won contracts and more importantly de-risked the business. In 2021, there is still scope for a further re-rating (as outlined above), but the delivery of the earnings growth we expect for years to come will also now become a key driver of the share price.

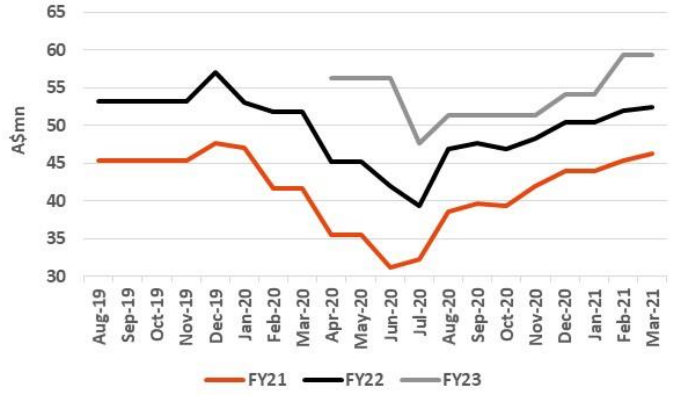
We value SRG on a relative basis to peers and the market (PE Relative 16.2x (from 13.6x due to 30% upside to consensus price target of close peers) = $0.65ps (from $0.55ps)) as well as sense checking the relative valuation using a DCF ($0.78ps, unchanged) and Sum of the Parts (break up) valuation ($0.69ps from $0.50ps, due to 46% upside to consensus target price for construction peers and 31% for SRG's asset service peers).

From this, our 12 month forward composite valuation and price target is now $0.70 per share, up from $0.60 previously. Based on our target price the stock would be trading on 6.8x, 5.9x and 5.3x our FY21-23 EBITDA forecasts respectively.

Our DCF assumes a WACC of 9.9% (unchanged), average annual FCF of circa $24.7mn (from $18mn) over the 10-year forecast period and a 2.5% terminal growth rate (TV=55% of EV). Our Sum of the Parts assumes relative peer EV/EBITDA multiples for each division (4.7x for Construction (from 3.2x), 4.4x for Mining (from 3.3x) and 6.8x for Asset Services (from 5.7x). Our peer multiples are now based upon target rather than current share prices.

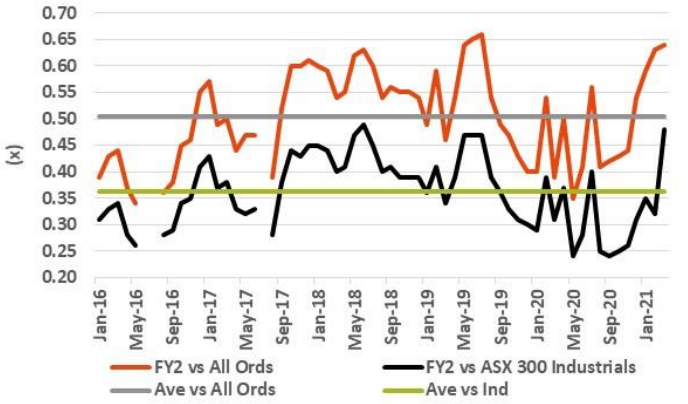
SRG is still trading at a substantial discount to both the broader market and ASX 300 Industrials. It is currently trading at circa 0.48x FY2 forward earnings versus the S&P ASX 300 Industrials index and 0.64x versus the broader S&P ASX All Ordinary Index. This compares to an historical range of circa 0.24-0.49x and 0.34-0.66x respectively.

Figure 4: SRG FactSet Consensus EBITDA



Source: Shaw and Partners, FactSet Consensus (to 15th March 2021)

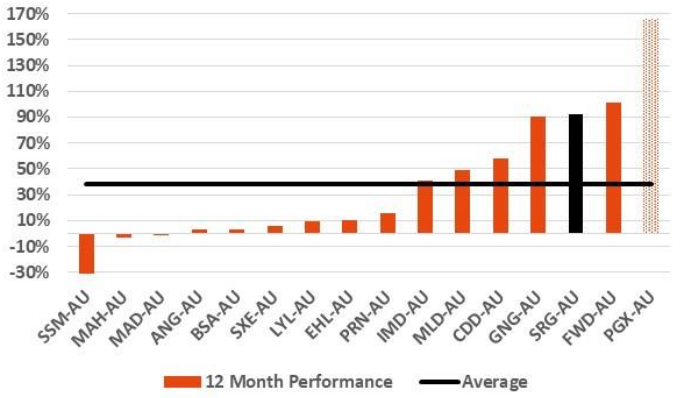
Figure 5: SRG FY2 PE Relative to ASX All Ordinaries / Industrials



Source: Shaw and Partners, FactSet Consensus (to 15th March 2021)

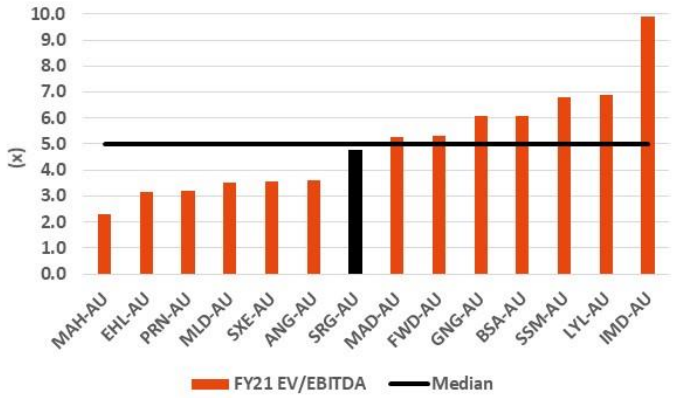
While SRG is currently trading close to the average EV/EBITDA multiples of the small cap Mining Service/E&C stocks (see below), given its shift to lower risk annuity contracts, strong pipeline of work and recovery in reported financial performance, we would expect SRG to re-rate along with earnings towards a valuation closer to lower risk maintenance focused peers (6.0x FY22 EBITDA).

Figure 6: 12 Month Share Price Performance (close peers)



Source: Shaw and Partners, FactSet Consensus (to 15th March 2021)

Figure 7: SRG vs 'Peers' FY21 EV/EBITDA (current share prices)



Source: Shaw and Partners, FactSet Consensus (to 15th March 2021)

We believe the outlook for SRG remains very positive due to;

- FY21-22 revenue underpinned by high quality WIH.
- Large pipeline of work identified and hence likely news flow catalysts as more contracts are secured.
- Lower risk profile due to annuity earnings, alliance style contracts, breadth of clients and geographies etc.
- Marginally improving competitive landscape.
- Exit from the underperforming businesses.
- Solid balance sheet and forecast strong earnings momentum in the next few years.
- M&A Potential.

As such we would expect SRG to re-rate along with a recovery in reported financial performance towards a valuation closer to lower risk maintenance focused peers (FY22 6.0x EBITDA).

Given the upside in relative valuation, current WIH and likely positive catalysts from the tendering pipeline, we continue to rate SRG a Buy.

SWOT analysis

Strengths

- Strong relationships from project delivery, resulting in majority of contract wins coming from repeat customers.
- Fully integrated service offering - breadth of service offering from engineering, through construction to ongoing maintenance.
- Lower risk earnings, with 75% of earnings now recurring, longer term contracts.
- Breadth of clients and geographical exposure lowers risk further.
- Balance sheet supportive of growth.

Weaknesses

- Still a relatively small player in the sector.
- Construction remains relatively low margin.

Opportunities

- $1bn WIH.
- $6bn identified pipeline of opportunities.
- Potential acquisition opportunities.
- Industry consolidation likely.
- Growth in maintenance activity in Australia.
- Recovery in overseas work as COVID restrictions are lifted.
- Growth of lower risk contract types (e.g. Alliance).

Threats

- Construction industry remains competitive.
- Mining sector cyclicality.
- Asset services attracting greater competition.
- Potential high working capital requirements.
- Potential takeover target.
- Ability to attract and retain employees as market conditions improve.

Key risks

SRG has lowered its risk profile in recent years through exiting underperforming businesses and shifting its WIH away from construction towards Asset and Mining Services.

COVID risk

Generally, to date, the construction and mining service operations in Australia that SRG are exposed to have been considered critical infrastructure and as such has been allowed to continue as essential businesses. There has been some (hopefully) temporary delays in the award of new projects and some maintenance work. Assuming a recovery from the COVID-19 slowdown, the outlook for SRG's core businesses remains very positive, as a result of a resilient mining sector and numerous stimulus packages that were announced by governments in SRG's core Construction and Services markets.

Industry risk

S&P categorize the global construction sector as having above-average risks. However, SRG's focus on Asset and Mining Services and annuity (and alliance) style contracts have helped manage this risk.

Geographical risk

SRG has a very focused geographical portfolio by country with most of its revenue from projects in Australia. However, within Australia, the projects are spread widely across a large number of different projects, regions and clients, substantially lowering risk overall.

Customer risk

SRG has a broad range of customers across its three business units. No revenue from transactions with a single external customer amount to 10% or more of the Group's revenue. Key Government (good relationships with State and Federal NZ and Australia) and

blue-chip corporate clients including Rio Tinto, Woodside. South 32, Yara, Multiplex, CPB etc.

Employee risk

SRG has roughly 2,300 employees, 21% are technical, engineering and management with the remaining 79% operational. In regard to key personnel, the Board and Management own 12.1% of the issued capital, aligning their interests with other shareholders.

Cash Flow / Balance sheet risk

SRG is in a strong liquidity position with available funds of $82mn at the end of 1H FY21. Banking facilities are not due for renewal until early FY22 and the Company has access to additional equipment finance facilities. At the end of 1H FY21, net cash was $5.3mn.

Contract Risk

As stated earlier, no one single external customer accounts for 10% or more of the Group's revenue. There has also been a general trend towards greater exposure to alliance style contracts and maintenance work.

SRG is also a relatively highly diversified business and the contracts in its different sectors have varying lengths. The average duration of contracts in each segment are (generally) as follows;

- Construction 1-4 years
- Mining 3-6 years
- Services 4-10 years

Commodity Prices

SRG is exposed to commodity price risk through its consumption of steel its operations use for post-tensioning, and to a lesser degree in the mining services business. SRG monitors forward steel prices and endeavors to lock in agreed prices on a project by project basis prior to formalizing bid prices wherever possible.

Foreign Exchange

SRG is exposed to foreign exchange risk in overseas projects executed by local subsidiaries. SRG does not hedge this risk however continues to monitor exchange rates so that currency exposure is maintained at an acceptable level. There is a natural hedge in place to the extent project costs are materially of the same foreign currency.

The major exchange rates relevant to SRG are USD, ZAR, AED, HKD and NZD. Based on the carrying amounts exposed to foreign currencies for FY19, had the Australian dollar weakened by 5% / strengthened by 5% (2018: weakened by 5% / strengthened by 5%) against these foreign currencies with all other variables held constant, SRG's profit or loss would have been $0.7m lower / $0.7m higher (2018: $1.2m lower / $1.1m higher).

Core drivers and catalyst

- Infrastructure investment by both governments and private sector.
- Maintenance expenditure continues to increase, driven by number of assets and outsourcing trend.
- Rising commodity prices boosting Mining investment.
- All the above, resulting in Improving order book / WIH / pipeline.
- Higher recurring revenues.
- Lower risk alliance style contracts.
- Acquisitions / M&A potential.
- Margin improvement, especially in construction.
- Exiting unprofitable businesses.
- Completion / exit of problematic work contracts (Structures Victoria).

Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

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