

GR ENGINEERING SERVICES LTD

BUY

Specialist contractor with proven delivery record. Initiate with BUY.

Materials / Diversified Metals & Mining

5 December 2018

INITIATION

Ticker	GNG
Stock Price	\$1.200
Target Price	\$1.470
Forecast Capital Return	22.5%
Forecast Dividend Yield	7.5%
Estimated Total Return - 12 Mth Forward	30.0%

Company market data

Market Cap.	\$184.2m
Free Float (%)	38.6
Enterprise Value	\$162.9m
52 Week Range	\$1.20 - \$1.60
Shares Out.	153.5m
Avg. Daily Value	\$0.0m

Estimates changes	2018a	2019e	2020e	2021e
Core NPAT - <i>old</i>	-	-	-	-
Core NPAT - <i>new</i>	16.3	12.3	19.4	21.1
% Change	-	-	-	-
Core EPS dil. (€) - <i>old</i>	-	-	-	-
Core EPS dil. (€) - <i>new</i>	10.6	8.0	12.6	13.8
% Change	-	-	-	-
DPS (€) - <i>old</i>	-	-	-	-
DPS (€) - <i>new</i>	11.0	9.0	10.0	11.7
% Change	-	-	-	-

All figures are in AUD unless otherwise specified.

Share price performance

GR Engineering Services Ltd vs. AS51 (rebased index)



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EVENT

We initiate coverage on GR Engineering Services Limited (GNG) with a BUY rating and a \$1.47/share 12 month target price. GNG is an ASX listed contractor specialising in fixed price, design and construction of mineral processing plants and related mine infrastructure in Australia and internationally (71% of FY18 revenue). GNG also provides operations & maintenance (O&M) and well management services to the Australian and South East Asian oil and gas industry (29% of FY18 revenue).

INVESTMENT HIGHLIGHTS

Integrated service offering enables early project involvement & de-risks construction execution. The provision of study work: 1) embeds GNG at the start of the project development process and assists with securing subsequent design & construct work; and 2) enables project delivery continuity that de-risks execution of construction, particularly for fixed price contracts.

Highly experienced and aligned leadership team with a proven track record of delivery across multiple commodities & jurisdictions. GNG's leadership team have been involved in the provision of services to the minerals processing sector for >30 years across a range of commodities including precious, base and industrial metals. Directors and senior management own ~38% ensuring a high degree of alignment with shareholders.

Consistent delivery of profitability and sector leading margins throughout the cycle as a result of GNG's integrated service offering and highly experienced and aligned leadership team. This has facilitated the payment of >\$100m of dividends since its IPO in 2011.

Strong pipeline of opportunities and robust balance sheet. The number of studies currently being undertaken (~30) is at historically high levels and we expect some of these to convert into larger packages of work from 2H19 onwards. Potential work include SFX's Thunderbird mineral sands project (\$366m) and CMM's Karlawinda gold project (\$93m). No external funding expected with net cash of \$21m as at 30 June and ~\$115m bonding headroom.

INVESTMENT VIEW

While we expect FY19 earnings to be impacted by the completion of a couple of large contracts in FY18 and a slower start for new projects, we expect a recovery in earnings from 2H19 driven by the conversion of the opportunity pipeline. We believe GNG's valuation of 5.6x FY20 EBITDA and 9.5x PE does not reflect its high quality (and high margin) business and view GNG's 7.5% yield as attractive. **Initiate with a BUY rating and \$1.47/share 12mth TP.**

Y/E Jun 30	2018a	2019e	2020e	2021e
EBITDA	24.1	18.8	28.9	31.6
EV/EBITDA	6.7x	8.7x	5.6x	5.2x
Core NPAT	16.3	12.3	19.4	21.1
Core EPS (Diluted) (€)	10.6	8.0	12.6	13.8
P/E	11.3x	15.0x	9.5x	8.7x
EPS growth	26.2%	(24.5%)	57.9%	8.9%
DPS (€)	11.0	9.0	10.0	11.7
Yield	9.2%	7.5%	8.3%	9.8%
DPS growth	120.0%	(18.2%)	11.1%	17.1%
Dividend Payout Ratio	103.7%	112.4%	79.1%	85.0%

All figures are in AUD.

COMPANY SNAPSHOT

Founded in 2006¹, GNG is a specialist provider of fixed price, design and construction services for mineral processing plants and related mine infrastructure. GNG listed on the ASX in 2011, raising \$30m as part of its IPO at an issue price of \$1.00/share. In 2014, GNG acquired (Upstream) Production Solutions for \$5.8m cash (~2.4x CY14 EBITDA) which delivered the company oil & gas operations and maintenance (O&M) and well management services capabilities.

Headquartered in Perth, GNG employs more than 300 professional and support staff throughout Australia and internationally, in addition to a direct construction workforce and subcontracted personnel. Key commodity exposures include gold, base metals (nickel, lead, copper), industrial minerals (mineral sands, tungsten & tin) and oil & gas. Previous and current clients include junior to Tier-1 mining and energy companies including Sirius Resources (acquired by Independence Group), Wolf Minerals, Dacian Gold, Western Areas, AngloGold Ashanti, Saracen Resources, Rio Tinto, Origin Energy and Santos.

Figure 1: Key service offering overview

Segment	Key services provided	FY18 rev.	% FY18 rev.	Industry participants
Mineral processing	<ul style="list-style-type: none"> Feasibility studies (PFS, DFS) EPC/EPCM of processing plants & related infrastructure 	\$202m	71%	Sedgman (CIM), Ausenco (RCF), Lycopodium (LYL), Primero (PGX), Mondium (MND-LYL), AMEC, Como Engineers
Oil & gas	<ul style="list-style-type: none"> Operations & maintenance Well management services 	\$81m	29%	UGL (CIM), Broadspectrum (Ferroval), Monadelphous (MND)

Source: Company, Moelis Analysis

Figure 2: Key Moelis earnings estimates and implied valuation metrics

Moelis estimates		2018a	2019e	2020e
Revenue	\$m	284	222	320
EBITDA	\$m	24	19	29
EBIT	\$m	23	17	27
NPAT	\$m	16	12	19
EPS	cps	10.6	8.0	12.6
DPS	cps	11.0	9.0	10.0
Yield	%	9.2%	7.5%	8.3%
Revenue growth	%	+19%	-22%	+44%
EBITDA growth	%	+43%	-22%	+54%
EBIT growth	%	+47%	-25%	+60%
NPAT growth	%	+45%	-25%	+58%
EBITDA margin	%	8.5%	8.5%	9.0%
EBIT margin	%	8.0%	7.7%	8.5%
NPAT margin	%	5.7%	5.5%	6.1%
EV/EBITDA	x	6.8	8.7	5.6
EV/EBIT	x	7.1	9.5	6.0
P/E	x	11.3	15.0	9.5
ND(NC)/EBITDA	x	(0.9)	(1.1)	(0.7)
Variance to consensus		2018a	2019e	2020e
Revenue	\$m	-	+2%	-4%
EBITDA	\$m	-	+16%	+2%
EBIT	\$m	-	+18%	+2%
NPAT	\$m	-	+17%	+1%
EPS	cps	-	+19%	+2%
DPS	cps	-	+3%	-7%

Source: Factset, Moelis Analysis

¹ It is noted GNG was set up by the previous founders of JR Engineering Services, which was established in 1986 and was subsequently acquired by Downer in 2001 for 23 million DOW shares (~\$66m @ \$2.88/share) and net cash consideration of \$19m.

INVESTMENT HIGHLIGHTS

#1 Integrated service offering enables early project involvement & de-risks construction execution

As mentioned above, GNG delivers its services via 2 key segments: 1) mineral processing and 2) oil & gas.

In mineral processing, GNG provides services across the typical mining project lifecycle including:

- Initial project evaluation and feasibility studies (exploration and feasibility phase);
- Engineering design and construction (development phase); and
- Asset management and operational support (production phase).

Figure 3: GNG key service offering over mining asset lifecycle

		Mining Asset Lifecycle		
		Exploration & Feasibility	Development	Production
Key Services Provided	Contract mining & drilling	Exploration drilling	Water management Waste stripping Underground development	Grade control Drill & blast Load & haul Crush & screen Underground mining } Open cut (surface) mining
	Engineering, construction & maintenance	Project evaluation (feasibility studies) GNG	Bulk earthworks GNG Civil works GNG Engineering services GNG Project delivery (EPC, EPCM) GNG Structural, mech. and piping (SMP) GNG Electrical and instrumentation (E&I) GNG Rail/Port construction	Operational & maintenance support GNG Operational enhancement (modifications, upgrades, de-bottlenecking) GNG
	Equipment & consumables	Equipment hire/sale Minerals testing & analysis Consumables (drilling fluids, drill bits)	Equipment/parts/hire/sale Minerals testing & analysis	Equipment/parts/hire/sale Minerals testing & analysis Consumables (explosives, fluids, drill bits) Equipment maintenance
	Logistics & power generation	Logistics	Logistics Power generation Mining accommodation	Logistics Power generation Mining accommodation

Source: Moelis Analysis

Key services provided include:

- feasibility studies ranging from scoping, pre-feasibility and definitive engineering studies through to bankable feasibility studies;
- engineering and process consulting;
- design and construction of minerals processing facilities and associated infrastructure for greenfields and brownfields projects;
- plant modifications, debottlenecking, optimisation, upgrades and expansions;
- plant evaluation and condition reports;
- plant operations and maintenance technical support and optimisation;
- plant relocation, refurbishment and recommissioning;
- asset management; and
- provision of owners representatives and teams for project management and delivery.

GNG predominantly delivers its mineral processing services via an engineering, procurement and construction (EPC) contracting model, either on a fixed price, lump sum or guaranteed maximum price basis. In addition, GNG also delivers projects via engineering, procurement and construction management (EPCM) and hybrid contracting arrangements. The key features of each of these contracting models are outlined below:

Figure 4: Typical contracting models

Contract model	Brief description	Benefit of cost underruns	Impact of cost overruns	Other comments
EPC: Fixed price / lump sum	Fixed margin on total estimated project cost	100% GNG	100% GNG	<ul style="list-style-type: none"> May include incentives/penalties for early/late project delivery Typically higher margin than EPCM to reflect risk profile accepted by GNG
EPC: Guaranteed maximum price	Fixed margin on total estimated project cost	Shared with client (agreed percentage)	100% GNG	<ul style="list-style-type: none"> May include incentives/penalties for early/late project delivery Typically higher margin than EPCM to reflect risk profile accepted by GNG
EPCM	Cost reimbursable ie. Margin earned on actual cost incurred	100% client Some contracts may involve GNG sharing cost underruns	100% client Some contracts may involve GNG sharing cost overruns, limited to margin or less	<ul style="list-style-type: none"> May include incentives/penalties for early/late project delivery

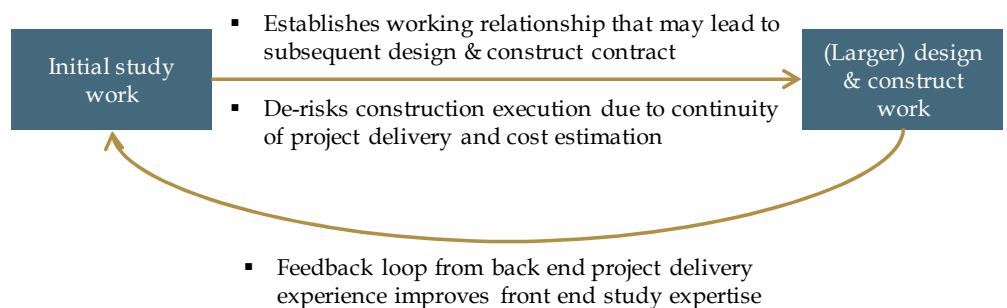
Source: Company, Moelis Analysis

As highlighted above, whilst EPC contracting exposes GNG to greater risk in the form of cost overruns, it also has the potential to generate higher rewards (see below for historical margins and track record of delivery). However, we believe this risk is, to a degree, mitigated by GNG’s integrated business model. With GNG being involved at the early stages of a project development via the provision of initial study work, we are of the view that this:

- embeds GNG at the start of the project development process that may lead to subsequent (larger) design and construct contract; and
- de-risks the execution of construction by delivering accurate estimation of scope, design, costs, time and performance due to continuity of project delivery activity.

GNG’s integrated business model also provides a feedback loop from back end project delivery experience into front end study expertise.

Figure 5: Benefits of GNG’s integrated business model



Source: Company, Moelis Analysis

This, along with GNG’s track record of delivery (see below), has enabled the company to confidently offer fixed price contracting to its clients as well as guarantee delivery timing and performance of facilities, which we view as a key point of differentiation. We note some other operators in the space may elect to provide services on a cost reimbursable basis (eg. EPCM) or outsource key components of the project delivery eg. outsource engineering design and only provide construction services.

With oil and gas maintenance services, these are typically delivered on a cost plus basis.

#2 Highly experienced and aligned leadership team with a proven track record of delivery across multiple commodities & jurisdictions

GNG's board and management team, which include key founders and management team of JR Engineering which was established in 1986 and subsequently acquired by Downer in 2001, have extensive experience...

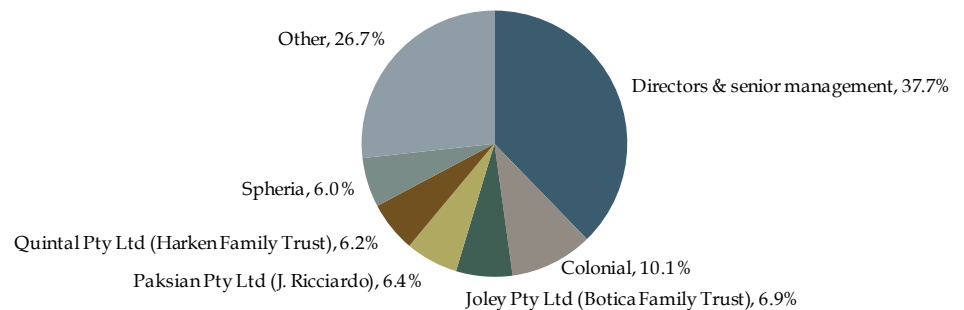
Figure 6: Key Board members and senior management team (see Appendix for further info)

Name	Position	Skills/experience	Year(s) in industry	No. of GNG shares (m)	% GNG interest
Phillip Lockyer	Non-executive Chairman	Mining engineer & metallurgist	>50	0.1	0.0%
Geoff Jones	Managing Director	Civil engineer	>30	0.8	0.5%
Tony Patrizi	Executive Director	Mechanical engineer	>30	9.8	6.4%
Barry Patterson	Non-executive Director	Mining engineer	>50	7.5	4.9%
Peter Hood	Non-executive Director	Chemical engineer	>40	0.5	0.3%
David Sala Tenna	Manager - Projects	Mechanical engineer	>30	12.3	8.0%
Joe Totaro	CFO & Company Secretary	Certified practicing accountant	>30	8.0	5.2%
Rodney Schier	Engineering Manager	Mechanical engineer	>30	8.1	5.3%
Stephen Kendrick	Manager - Projects	Mechanical engineer	>30	4.9	3.2%
Terry Condipodero	Manager - OHSE & HR	Occupational health & safety	>30	6.0	3.9%
Total Directors & Senior Management				57.9	37.7%

Source: Company

... with a high degree of alignment with shareholders (~38% owned by directors and senior management)...

Figure 7: Key shareholders



Source: Company, Moelis Analysis

... and a proven track record in the delivery of multiple projects across a range of commodities including gold, nickel, lead, zinc, copper, tungsten/tin, mineral sands in multiple jurisdictions.

Figure 8: Selected completed projects

Announce date	Project	Customer	Commodity	Location	Est. value (\$m)	Contract type
Jun-17	Sunrise Dam upgrade	AngloGold Ashanti	Gold	WA	31	EPC
Apr-17	Cosmic Boy mill recovery enhancement	Western Areas	Nickel	WA	24	GMP
Jul-17	Dalgaranga	Gascoyne Resources	Gold	WA	67	GMP
Apr-17	Mt Morgans	Dacian Gold	Gold	WA	107	GMP
Sep-16	Davyhurst	Eastern Goldfields	Gold	WA	13	EPC

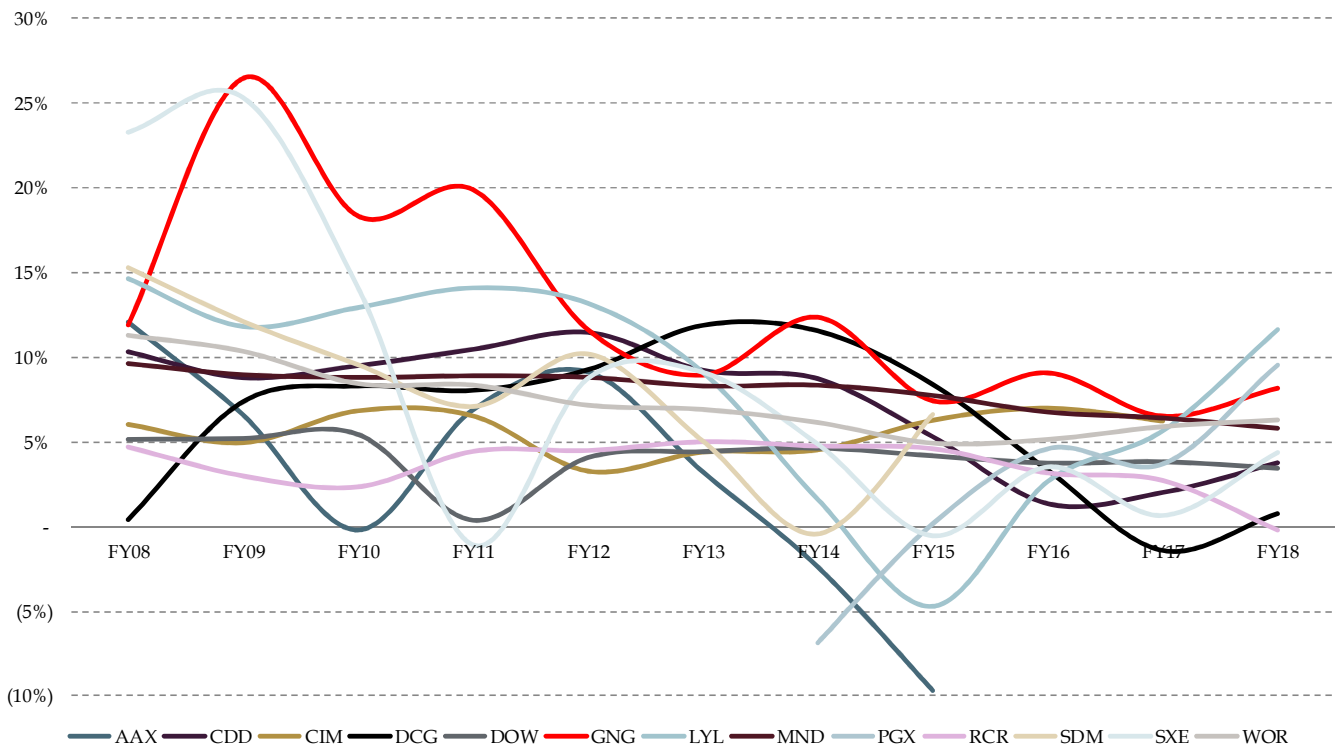
Announce date	Project	Customer	Commodity	Location	Est. value (\$m)	Contract type
Jul-16	Mungana upgrade	Auctus Resources	Zn-Pb-Cu-Au	QLD	37	EPC
Nov-15	Deflector	Doray Minerals	Gold	WA	51	EPC
Oct-15	Olympias Phase 2	Hellas Gold	Gold	Greece	20	EPCM
Jul-15	Nova NPI	Sirius Resources	Nickel	WA	12	EPC
Mar-15	Nova	Sirius Resources	Nickel	WA	120	EPC
Nov-14	Keysbrook	MZI Resources	Mineral Sands	WA	55	EPC
Nov-14	Wetar	Finders Resources	Copper	Indonesia	10	EPCM
Jun-14	Paraburdoo moisture reduction project	Rio Tinto	Iron ore	WA	20	EPC
Mar-13	Hemerdon	Wolf Minerals	Tungsten & Tin	England	130	EPC
Mar-13	Whyalla brownfields upgrade	Leighton Contractors	Iron ore	SA	na	EPC
Jul-12	Andy Well	Doray Minerals	Gold	WA	30	EPC
Apr-12	Telfer LP237 dump leaching facility	Newcrest	Gold	WA	18	EPC
Apr-12	Degrussa paste backfill	Sandfire Resources	Copper	WA	12	EPC
na	Prominent Hill Paste Fill Plant	OZ Minerals	Copper	SA	14	EPC
na	Cosmos Upgrade	Xstrata	Nickel	WA	15	EPC
na	Randalls Upgrade	Integra Mining	Gold	WA	8	EPC
na	Rasp	Toho Zinc	Lead, Zinc	NSW	76	EPC
na	Gold Ridge	Allied Gold	Gold	Solomon Island	62	EPC
na	Randalls	Integra Mining	Gold	WA	37	EPC
na	Edna May	Catalpa Resources	Gold	WA	52	EPC
na	Porgera Paste Fill Plant	Barrick	Gold	PNG	na	EPCM
na	Cosmic Boy mill recovery enhancement	Western Areas	Nickel	WA	60	EPC
na	Sinclair	Xstrata	Nickel	WA	50	EPC
na	Higginsville	Avoca Resources	Gold	WA	56	EPC

Source: Company, Moelis Analysis

#3 Consistent delivery of profitability and sector leading margins throughout the cycle

GNG's integrated business model, extensive experience and aligned leadership team has led to a history of consistent profitability throughout the cycle...

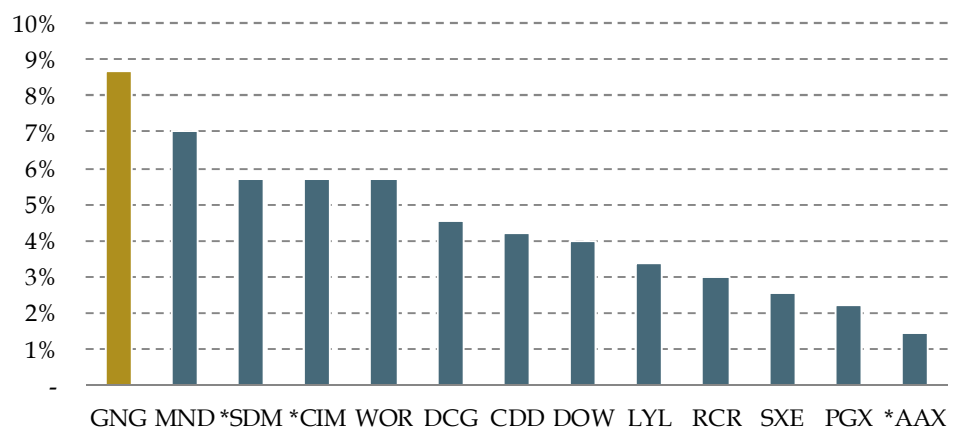
Figure 9: Historical EBIT margins for engineering and construction providers (%)



Source: Company filings, Factset, Moelis Analysis. Note: AAX and SDM were both acquired in 2016.

... and sector leading margins:

Figure 10: Average EBIT margin (Last 5 years, FY14-FY18*)

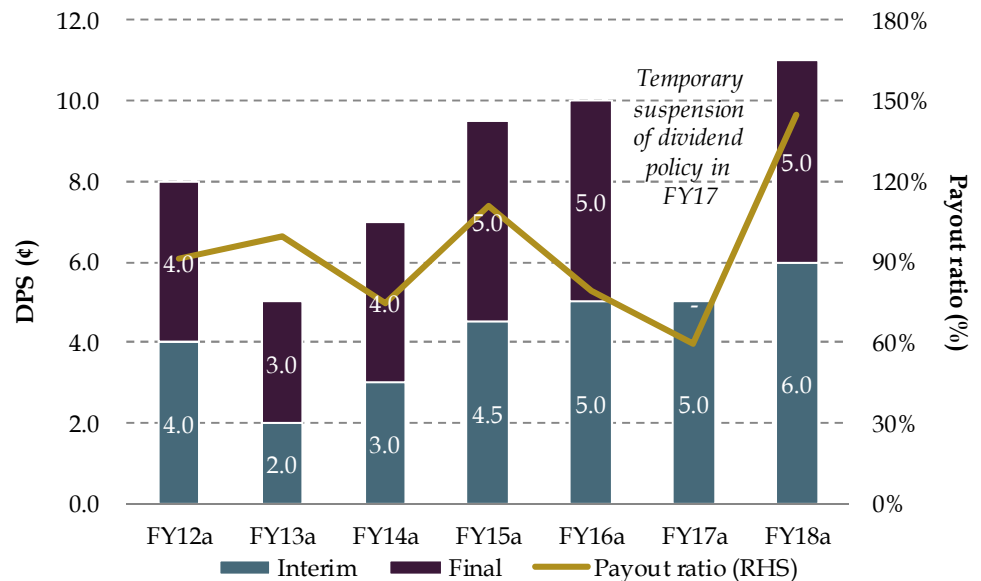


Source: Company filings, Factset, Moelis Analysis. *Note: AAX and SDM were both acquired in 2016, average margin based on FY11-FY15. CIM average margin calculated based on FY13-FY16.

We believe GNG's consistently higher margins demonstrate its ability to consistently estimate and manage project delivery costs particularly under fixed pricing contracts which also provide it with more "margin for error" should there be cost overruns.

This track record and profitability have also enabled fairly consistent payment of dividends, apart from FY17 when GNG temporarily suspended its dividend policy due to the uncertainty around the Wolf Minerals and Eastern Goldfields contracts (see below).

Figure 11: Historical dividends and payout ratio



Source: Company, Moelis Analysis

We note that GNG has a limited history of disputes over its 12 operating history as GR Engineering (37 year history since JR Engineering was established by GNG's key management/founders) with 2 of the 3 disputes settled in GNG's favour:

Figure 12: Limited history of disputes with no disputes outstanding

Date	Project	Customer	Est. contract value (\$m)	Contract type	GNG disputed amount (\$m)	Client disputed amount (\$m)	Settled amount (\$m)	Impact to GNG (\$m)	Status
2011	Gold Ridge	Allied Gold	62	EPC	5	(45)	+3	(2)	Settled
2017	Hemerdon	Wolf Minerals	130	EPC	na	na	Not disclosed	(7) non cash + undisclosed settlement sum	Settled
2017	Davyhurst	Eastern Goldfields	13 + 10 in variations	EPC	10	(7)	+8	(2)	Settled

Source: Company, Moelis Analysis

Gold Ridge-Allied Gold

May 2010: GNG enters into \$62m EPC contract with Allied Gold's subsidiary, Gold Ridge Mining Limited (GRML) for the expansion and refurbishment of the Gold Ridge processing plant in the Solomon Islands.

Jun 2011: GNG commences confidential commercial arbitration against GRML to recover \$4.5m of outstanding costs and associated damages relating to the EPC contract.

Oct 2011: Allied Gold makes a counterclaim in those arbitration proceedings, alleging: 1) defects in work performed and 2) misrepresentations regarding EPC contract.

May 2012: Allied Gold makes a further counterclaim for gold losses arising from alleged defects and alleged representations regarding performance and seeks a total of \$45m damages. GNG notes the EPC contract contains express and specific provisions excluding liability for consequential loss, indirect loss or loss of profit and considers that there is no basis for the new counterclaim. GNG provisions \$1.5m in doubtful debts for FY12 but no provision for counterclaim due to GNG position.

Oct 2012: Settlement reached with GRML, now a wholly owned subsidiary of St Barbara Limited. GNG receives \$2.65m cash settlement. GNG writes off a further \$0.5m in addition to the previous \$1.5m provision.

Hemerdon-Wolf Minerals

Mar 2013: GNG awarded a £75m (A\$130m) EPC contract to design and construct a 3Mtpa processing plant for Wolf Minerals' Hemerdon Tungsten and Tin project in England. As part of the contract, GNG agreed to provide performance bonding which included a £7.5m (A\$12m) unconditional bank guarantee.

Sep 2015: Completion of processing plant commissioning; Wolf takes full operational control.

Aug 2017: GNG receives notice of a claim and an intention to call on the performance bond within 21 days of notice if GNG fails to rectify alleged defect relating to low frequency noise emanating from the plant. GNG considers WLF claim without merit and no grounds to pursue recourse to the bank guarantee. At the time, GNG had received 97% of contract value and had \$5.3m receivables relating to the contract.

Apr 2018: GNG agrees to contribute an undisclosed settlement sum to WLF to fully fund the expected cost of the noise and vibration management plan. WLF in turn agreed to return all security under contract including £7.5m performance bond. GNG recorded a \$6.5m non-cash impairment in 2H FY18 which relates to value of progress claims which were unpaid at date of settlement that will become unrecoverable including a \$4.8m impairment in receivables.

Davyhurst-Wolf Minerals

Sep 2016: GNG awarded \$12.5m EPC contract for the refurbishment of Eastern Goldfields' (EGS) 1.2Mtpa Davyhurst processing facility.

Jul 2017: GNG commences proceedings against EGS for the payment of outstanding progress and variation claims totalling \$9.9m, plus interest and costs. Amended contract price including variations is \$18.5m. EGS alleges wrongful suspension of works by GNG (following non-payment by EGS) and counterclaims \$6.8m in delay costs.

Aug 2018: Entry into settlement deed with EGS. Terms confidential but contemplates \$8.25m payment to GNG in 3 instalments by 3 Oct 2018 (subsequently amended to 30 Nov 2018 following proposed recapitalisation of EGS).

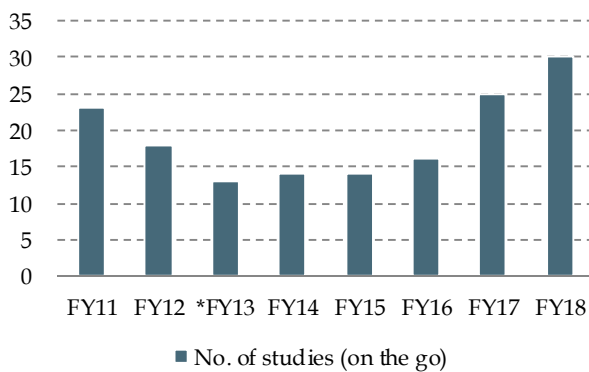
Nov 2018: \$7.25m (of \$8.25m settlement sum) remains outstanding following failed recapitalisation of EGS. EGS is considering alternative transactions including entering into voluntary administration.

It is further noted GNG does not have any outstanding disputes.

#4 Strong pipeline of opportunities & robust balance sheet

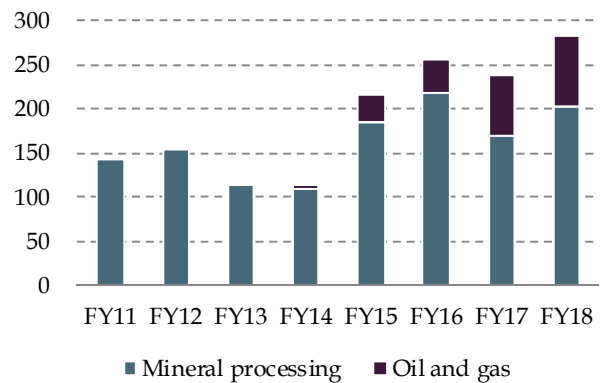
Historically, the no. of studies on the go has been instructive of future mineral processing services activity (and revenue):

Figure 13: No. of studies on the go



Source: Company, Moelis. *Note: FY13 is an estimate – no public data.

Figure 14: GNG sales revenue



Source: Company, Moelis

GNG is currently undertaking 30 studies, which is at historical highs, across a diverse range of commodities including mineral sands, gold, graphite and base metals. Selected current projects and studies include:

Figure 15: Selected current projects & studies

Announce date	Project	Customer	Commodity	Location	Estimated contract value (\$m)	Contract type	Status
Nov-18	Thunderbird	Sheffield Resources	Mineral Sands	WA	366	EPC	Conditional
Oct-18	Fungoni	Strandline	Mineral Sands	Tanzania	20	EPC	Conditional
Aug-18	Fosterville Pastefill Plant	Kirkland Lake	Gold	VIC	24	EPC	Ongoing
Aug-18	Carosue Dam Pastefill Plant	Saracen	Gold	WA	18	EPC	Ongoing
Jun-18	Epanko	Kibaran Resources	Graphite	Tanzania	100	EPC	Non-binding LOI
Apr-18	Karlawinda	Capricorn Metals	Gold	WA	93	EPC	Conditional LOI
Feb-18	Crushing plant upgrade	OK Tedi Mining	Copper-Gold	PNG	na	EPCM	Ongoing
Total					621		

Source: Company, Moelis Analysis

As at 30 June 2018, GNG had cash of \$21.8m, minimal debt (\$0.5m) and \$130m of bonding facilities (of which ~\$15m were drawn; \$115m headroom). Given bonding requirements for EPC contracts are typically 10% of total contract value, we estimate GNG has ample headroom to support >\$1b in new contract wins.

FINANCIAL ANALYSIS

Figure 16: Moelis key earnings estimates

\$m unless indicated otherwise	FY18a	1H19e	2H19e	FY19e	FY20e	FY21e	Change on pcp		
							FY19e	FY20e	FY21e
Mineral processing	202.4	40.0	100.0	140.0	235.5	256.5	-31%	68%	9%
Oil and gas	81.2	41.2	41.2	82.4	84.9	87.4	1%	3%	3%
Sales	283.6	81.2	141.2	222.4	320.4	343.9	-22%	44%	7%
EBITDA	24.1	5.4	13.4	18.8	28.9	31.6	-22%	54%	9%
<i>margin</i>	8.5%	6.6%	9.5%	8.4%	9.0%	9.2%	-0.1%pts	0.6%pts	0.2%pts
D&A	(1.4)	(0.6)	(1.1)	(1.7)	(1.6)	(1.7)	22%	-4%	7%
EBIT	22.8	4.8	12.3	17.1	27.3	29.9	-25%	60%	9%
<i>margin</i>	8.0%	5.9%	8.7%	7.7%	8.5%	8.7%	-0.3%pts	0.8%pts	0.2%pts
Net Interest	0.5	0.2	0.2	0.5	0.4	0.3	-0%	-11%	-29%
Profit Before Tax	23.2	5.0	12.6	17.6	27.7	30.2	-24%	58%	9%
Tax	(7.0)	(1.5)	(3.8)	(5.3)	(8.3)	(9.1)	-24%	58%	9%
<i>Tax rate (%)</i>	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	-	-	-0.0%pts
NPAT (Underlying)	16.3	3.5	8.8	12.3	19.4	21.1	-24%	58%	9%
Non-recurring items	(4.6)	-	-	-	-	-	-100%	-	-
NPAT (Reported)	11.6	3.5	8.8	12.3	19.4	21.1	6%	58%	9%
EPS (¢) (Reported)	7.6	2.3	5.7	8.0	12.6	13.8	6%	58%	9%
EPS (¢) (Underlying)	10.6	2.3	5.7	8.0	12.6	13.8	-24%	58%	9%
DPS (¢)	11.0	4.0	5.0	9.0	10.0	11.7	-18%	11%	17%
Payout ratio (%)	103.7%	175.2%	87.3%	112.4%	79.1%	85.0%	8%	-30%	8%

Source: Company, Moelis Analysis

Key assumptions/commentary

- We expect mineral processing revenues to come off in 1H19 following the completion of the Mt Morgans (\$107m total announced contract value) and Dalgara (\$67m) projects in FY18 however expect revenues to recover in 2H19 and FY20, assuming key projects like Thunderbird-Sheffield and Karlawinda-Capricorn secure funding to commence construction. Our FY19e revenue estimate of \$222m is at the lower end of management guidance of \$220-240m (Moelis 1H19e: \$81m; 1H19e guidance: \$80-85m).
- We expect margins to improve from 2H19 onwards, due to: 1) the fixed cost leverage as project revenues increase; 2) an improvement in oil & gas margins which were temporarily impacted in FY18 due to non-achievement of certain KPIs however are expected to be achieved in FY19 onwards; and 3) unwinding of warranty provisions previously provided.
- As highlighted above, we do not anticipate any requirement for external funding to fund its organic growth given the availability of \$115m headroom in current bonding facilities which imply ability to support >\$1b in new contract wins.

VALUATION & PRICE TARGET

As outlined below, our \$1.47/share 12 month price target is based on our EV/EBIT valuation rolled forward at the cost of equity, less any forecast dividends.

Figure 17: Moelis valuation and price target summary

FY20e EBIT	\$m	27.3
Multiple	x	7.0
Enterprise value	\$m	191.2
Net cash (net debt)	\$m	21.3
Equity value	\$m	212.5
No. of shares	m	153.5
Valuation per share	\$	1.38
Avg. value grown for 12 mths at Ke	\$	1.56
Less: Forecast 12mth dividends	\$	(0.09)
12 month share price target	\$	1.47
12 Month Yield	%	7.5%
12 Month Capital Return	%	22.5%
12 Month Total Return	%	30.0%

Source: Moelis Analysis

Trading comparables for GNG are provided below.

Figure 18: Consensus trading comparables

Company name	Mkt Cap (\$m)	EV (\$m)	EV/EBITDA (x)		EV/EBIT (x)		P/E (x)	
			2019e	2020e	2019e	2020e	2019e	2020e
CIMIC Group	13,515	12,175	7.0	6.7	10.3	9.9	16.2	15.4
WorleyParsons	6,382	7,085	13.7	9.3	16.8	11.0	21.2	14.9
Downer EDI	3,794	5,012	5.8	5.5	10.2	9.4	12.5	11.3
Monadelphous Group	1,356	1,169	11.0	9.2	13.3	10.9	21.4	17.5
Cardno	469	488	8.0	6.6	10.1	8.1	12.9	10.1
Lycopodium	199	129	5.4	4.9	5.7	5.1	10.7	9.5
Decmil Group	169	153	5.8	5.0	6.4	5.6	9.0	6.7
Southern Cross Electrical	145	87	3.7	3.2	4.5	3.8	10.7	9.1
Primero Group	58	60	5.1	5.0	5.7	5.6	8.0	8.0
Average	2,899	2,929	7.3	6.2	9.2	7.7	13.6	11.4
GR Engineering Services (Consensus)	184	163	10.1	5.8	11.2	6.1	18.4	10.1
GR Engineering Services (Moelis)	184	163	8.7	5.6	9.5	6.0	15.0	9.5

Source: Factset, Moelis Analysis

KEY RISKS

- Contract underperformance – GNG predominantly provides its services under a EPC contracting model (eg. fixed price). Any significant cost overruns could adversely impact GNG’s financial performance however we note GNG’s track record of delivery, as highlighted above.
- Competitive pressure – high levels of competition within sector could lead to aggressive pricing, margin pressure and/or market share loss.
- Liquidity/ perceived overhang – GNG’s directors and senior management own ~38% of GNG’s shares on issue. It is unclear what the parties’ intentions are in relation to their shareholdings however we note that they are predominantly members of the board and senior management team and therefore we view the risk of a disorderly sell-down as minimal.
- Labour availability/cost pressures – given the expected multi-year infrastructure and resources spend, GNG’s ability to recruit/cost of recruiting skilled labour may be adversely impacted. We understand that wage cost pressures are somewhat mitigated for GNG given (1) the typical duration of its contracts (12-18months) and (2) labour cost inflation is typically factored into tender pricing and finalised as near as practicable to contract start.
- Weaker than expected levels of mining activity or investment from a sustained commodity price retreat may reduce demand for GNG’s services or lead to contract/project deferrals/cancellations.

APPENDIX

Board and Management

Figure 19: Board of Directors & senior management

Name & Position	Overview of experience
Phil Lockyer Non-Executive Chairman	<ul style="list-style-type: none"> ▪ Mining engineer and metallurgist with over 50 years' experience in the mineral industry ▪ Previously worked at WMC Resources, Dominion Mining and Resolute Limited ▪ Former directorships include Perilya, Focus Minerals and CGA Mining ▪ Currently a non-executive director of Swick Mining Services and RTG Mining Inc
Geoff Jones Managing Director & Chief Executive Officer	<ul style="list-style-type: none"> ▪ Civil engineer with over 30 years' experience in construction, engineering, minerals processing and project development in Australia and overseas ▪ Formerly the general manager of Sedgman's metals engineering business ▪ Currently non-executive director of Marindi Metals, Blackham Resources and Ausgold
Tony Patrizi Executive Director	<ul style="list-style-type: none"> ▪ Co-founder of GNG ▪ Mechanical engineer with over 30 years' experience in the mining and minerals processing industries
Barry Patterson Non-Executive Director	<ul style="list-style-type: none"> ▪ Co-founder of GNG and contract mining companies Eltin, Australian Mine Management and National Mine Management ▪ Mining engineer with over 50 years' experience in the mining industry ▪ Former non-executive chairman of Sonic Healthcare and Silex Systems ▪ Currently a non-executive director of Dacian Gold
Peter Hood Non-Executive Director	<ul style="list-style-type: none"> ▪ Chemical engineer with over 40 years' experience in the resources and energy sectors ▪ Former CEO of Coogee Chemicals and Coogee Resources ▪ Current chairman of Matrix Composites and Engineering and non-executive director of Cue Energy Resources
Joe Totaro Chief Financial Officer & Company Secretary	<ul style="list-style-type: none"> ▪ Co-founder of GNG and company secretary since 4 Sep 2006 ▪ Appointed Chief Financial Officer on 19 Apr 2011 ▪ CPA with over 30 years' experience in commercial and public practice in mining and mining services

Source: Company

GR Engineering Services Ltd (GNG)

Market Cap: \$184m

Last Price: \$1.200

Target Price: \$1.470

Buy

Y/E Jun 30

Profit and Loss (\$m)	2017a	2018a	2019e	2020e	2021e
Revenue	238.7	283.6	222.4	320.4	343.9
<i>Growth</i>	(6.5%)	18.8%	(21.6%)	44.1%	7.3%
EBITDA	16.9	24.1	18.8	28.9	31.6
<i>Growth</i>	(32.6%)	42.7%	(22.3%)	54.1%	9.4%
Dep'n & Amort	(1.4)	(1.4)	(1.7)	(1.6)	(1.7)
EBIT	15.5	22.8	17.1	27.3	29.9
<i>Growth</i>	(33.4%)	46.7%	(24.9%)	59.8%	9.5%
Net Interest Expense	0.8	0.5	0.5	0.4	0.3
Profit Before Tax	16.3	23.2	17.6	27.7	30.2
Tax	(3.4)	(7.0)	(5.3)	(8.3)	(9.1)
<i>Tax Rate (%)</i>	21.0%	30.0%	30.0%	30.0%	30.0%
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT (Underlying)	12.9	16.3	12.3	19.4	21.1
<i>Growth</i>	(29.7%)	26.4%	(24.4%)	57.9%	8.9%
One-Off Items	0.0	(4.6)	0.0	0.0	0.0
NPAT (Reported)	12.9	11.6	12.3	19.4	21.1
EPS (Underlying) (¢)	8.4	10.6	8.0	12.6	13.8
<i>Growth</i>	(30.3%)	26.2%	(24.5%)	57.9%	8.9%

Balance Sheet (\$m)	2017a	2018a	2019e	2020e	2021e
Cash	34.9	21.8	30.6	31.3	29.6
Inventory	19.8	6.9	6.7	9.6	10.3
Current Receivables	66.2	45.6	42.7	52.7	56.5
PPE	2.7	3.9	3.3	3.3	3.3
Intangibles	0.0	0.0	0.0	0.0	0.0
Other	6.9	6.4	6.4	6.4	6.4
Total Assets	130.4	84.6	89.7	103.4	106.2
Current Payables	62.2	15.2	22.3	31.9	34.2
ST Debt	0.5	0.3	0.0	0.0	0.0
LT Debt	0.2	0.1	0.0	0.0	0.0
Provisions	11.5	14.2	11.7	15.8	16.8
Other	7.1	2.2	2.2	2.2	2.2
Total Liabilities	81.6	32.1	36.3	50.0	53.3
Net Assets	48.9	52.5	53.4	53.4	52.9
Equity & Reserves	29.8	31.0	33.5	29.4	25.7
Retained Profits	19.0	21.5	19.9	24.0	27.2
Shareholders' Equity	48.9	52.5	53.4	53.4	52.9
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	48.9	52.5	53.4	53.4	52.9

Cashflow (\$m)	2017a	2018a	2019e	2020e	2021e
EBITDA	16.9	24.1	18.8	28.9	31.6
Net Interest	0.8	0.0	0.5	0.4	0.3
Tax	(3.8)	(3.4)	(5.3)	(8.3)	(9.1)
Δ in Working Capital	(17.8)	(13.5)	10.3	(3.3)	(2.3)
Other	(9.6)	(8.1)	0.0	0.0	0.0
Operating Cash Flow	(13.5)	(0.9)	24.3	17.7	20.6
<i>Growth</i>	(174.2%)	(93.4%)	2,832.8%	(27.1%)	16.3%
Capex	(0.5)	(2.7)	(1.1)	(1.6)	(1.7)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	(0.4)	(0.3)	0.0	0.0	0.0
Investing Cash Flow	(0.8)	(2.9)	(1.1)	(1.6)	(1.7)
Equity Raised	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(15.3)	(9.2)	(13.8)	(15.3)	(20.6)
Net Borrowings	(0.8)	(0.7)	(0.5)	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	(16.0)	(9.9)	(14.3)	(15.3)	(20.6)
FX / Non Cash Items	0.3	0.6	0.0	0.0	0.0
Change in Cash	(30.3)	(13.7)	8.9	0.7	(1.8)
Free Cash Flow	(13.9)	(3.5)	23.1	16.1	18.8

Valuation Summary	
Current Mkt Capitalisation	184.2
Shares on Issue	153.5
Last Price	1.200
12 Mth Target Price	1.470
Total Estimated 12 Mth Return	30.0%
12 Mth Fwd Capital Return	22.5%
12 Mth Fwd Dividend Yield	7.5%

Valuation Ratios	2017a	2018a	2019e	2020e	2021e
EPS (Underlying) (¢)	8.4	10.6	8.0	12.6	13.8
<i>Growth</i>	(30.3%)	26.2%	(24.5%)	57.9%	8.9%
P/E (x)	14.3x	11.3x	15.0x	9.5x	8.7x
Small Industrials (ex Fin's)	0.0x	0.0x	17.9x	16.3x	0.0x
Premium / (Discount)	nm	nm	(16.5%)	(41.9%)	nm
EV/EBITDA (x)	9.6x	6.7x	8.7x	5.6x	5.2x
Small Industrials (ex Fin's)	0.0x	0.0x	10.9x	10.2x	9.9x
Premium / (Discount)	nm	nm	(20.5%)	(44.8%)	(48.1%)
DPS (¢)	5.0	11.0	9.0	10.0	11.7
<i>Growth</i>	(50.0%)	120.0%	(18.2%)	11.1%	17.1%
Yield (%)	4.2%	9.2%	7.5%	8.3%	9.8%
Payout Ratio (%)	59.5%	103.7%	112.4%	79.1%	85.0%
Franking (%)	100.0%	54.5%	100.0%	100.0%	100.0%
NTA	48.9	52.5	53.4	53.4	52.9
NTA/Share (\$)	0.32	0.34	0.35	0.35	0.34

Performance Ratios	2017a	2018a	2019e	2020e	2021e
ROA	10.7%	15.1%	14.1%	20.1%	20.2%
ROE	25.5%	32.1%	23.2%	36.4%	39.8%
ROIC	917.2%	69.5%	44.3%	85.3%	92.3%
Net Debt (Cash) (\$m)	(34.2)	(21.3)	(30.6)	(31.3)	(29.6)
Net Debt/EBITDA (x)	(2.0x)	(0.9x)	(1.6x)	(1.1x)	(0.9x)
ND/(ND + Equity) (%)	(232.9%)	(68.3%)	(134.3%)	(142.1%)	(126.9%)
Interest Cover (x)	17.7x	38.2x	22.5x	30.7x	37.0x
Working Capital	10.5	24.0	16.3	15.6	16.9
Working Capital/Sales (%)	4.4%	8.5%	7.3%	4.9%	4.9%

Cash Flow Metrics	2017a	2018a	2019e	2020e	2021e
FCF/Share (\$)	(0.09)	(0.02)	0.15	0.10	0.12
Price/FCPS (x)	nm	nm	8.0x	11.5x	9.8x
Free Cash Flow Yield (%)	(7.6%)	(1.9%)	12.6%	8.7%	10.2%
Gross Cash Conversion	(62.2%)	10.2%	154.8%	88.5%	92.8%
Capex/Sales (%)	0.2%	0.9%	0.5%	0.5%	0.5%
Capex/Depreciation (x)	0.3x	1.9x	0.7x	1.0x	1.0x

Margins	2017a	2018a	2019e	2020e	2021e
EBITDA	7.1%	8.5%	8.4%	9.0%	9.2%
EBIT	6.5%	8.0%	7.7%	8.5%	8.7%
NPAT	5.4%	5.7%	5.5%	6.1%	6.1%

Valuation Methodology	
WACC (%)	11.3%
Discounted Cash Flow Valuation	n/a
Sum-of-the-Parts Valuation	1.384
Average Valuation	1.384
12 Mth Target Price	1.470

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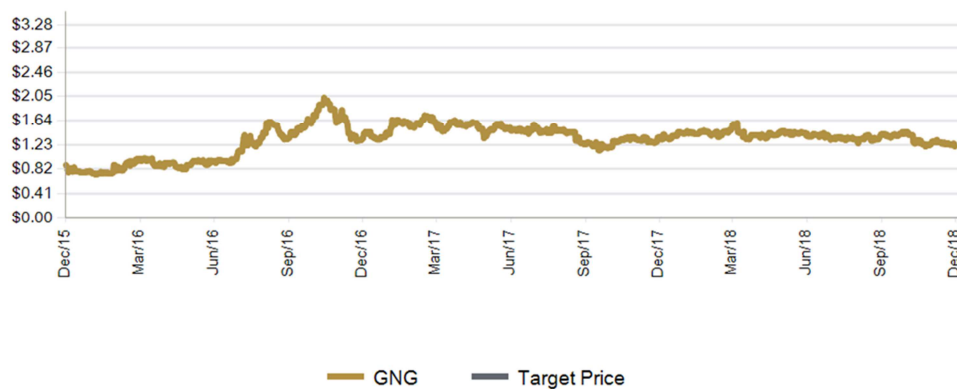
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Distribution of Ratings as at 5 December 2018

SELL	HOLD	BUY
5.7%	39.6%	52.8%

Rating and Price Target History: GR Engineering Services Ltd (GNG) as of 5/12/2018



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