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SRG Global (SRG)

Guidance upgrade on the horizon

Recommendation
Buy (unchanged)
Price
$1.28
Target (12 months)
$1.55 (previously $1.40)

Sector

Commercial Services and Suppliers

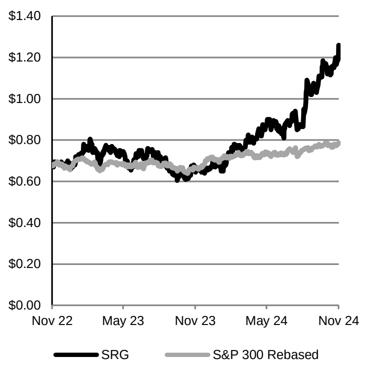
Expected Return	
Capital growth	**21%**
Dividend yield	**4%**
Total expected return	**25%**

Company Data & Ratios	
Enterprise value	**$843m**
Market cap	**$773m**
Issued capital	**604m**
Free float	**96.1%**
Avg. daily val. (52wk)	**$1.4m**
12 month price range	**$0.63-132.5**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.17	0.87	0.68
Absolute (%)	9.9	47.1	88.2
Rel market (%)	8.9	40.5	70.6

Absolute Price



SOURCE: IRESS

Contract update: Awards reflect diverse & quality clients

Contract update: SRG has announced several contract awards with existing, repeat clients in the Water, Transport, Health, Resources and Dairy sectors across Australia and New Zealand, totalling $700m in value. The value of new contract awards and extensions in FY25TD is $925m (vs $475m in the PcP; and $785m+ in FY24), representing one of the largest contract updates in the company's recent history. This update highlights the diversity of SRG's operating model, servicing clients in multiple industries and geographies, which should protect overall Group activity from underperforming sectors. We are also encouraged by the Diona contracts, which should expand work-in-hand from $1.0b (at the time of acquisition), and underlines the recurring nature of project delivery by Diona.

Greater confidence in outlook: These contracts are a representation of the company's significant skew towards recurring-style work (80% of Group EBITDA; pro forma FY24). In addition, several contracts were secured with a 5+ year term (some with extensions), highlighting continuity and visibility of workflow in the medium-to-long term. Following this update, we have greater confidence in our short to medium term earnings growth outlook. We are forecasting 18.1% EPS CAGR over FY24-27.

Upside risk to FY25 guidance: Our updated FY25 EBITDA forecast of $128.5m is 2.8% ahead of guidance. We emphasise an upward bias to our updated forecast, outlining that management's historical guidance beats have typically ranged 3-15%.

EPS changes: Reflects our upgraded revenue growth and EBITDA margin forecasts for the Maintenance & Industrial Services segment (including Diona): +1% FY25; +6% FY26; +6% FY27.

Investment thesis: Buy; TP$1.55/sh (previously $1.40/sh)

Today's contract update highlights the diversity and quality of SRG's client base across multiple end-markets, while emphasising a strong tilt towards recurring work. Pleasingly, SRG's valuation gap with the Industrial Services peer group has closed; we argue SRG should trade at a premium given its above average EPS growth outlook.

Earnings Forecast

Year ending 30 June	2024a	2025e	2026e	2027e
Sales ($m)	1,069	1,353	1,482	1,587
EBITDA ($m)	99	129	143	155
NPAT (reported) ($m)	34	47	59	67
NPAT (adjusted) ($m)	35	51	59	67
EPS (adjusted) (¢ps)	6.7	8.6	9.7	11.1
EPS growth (%)	9.1%	27.2%	13.4%	14.1%
PER (x)	19.0x	15.0x	13.2x	11.6x
FCF Yield (%)	10.3%	-12.5%	10.1%	11.1%
EV/EBITDA (x)	8.6x	6.6x	5.9x	5.5x
Dividend (¢ps)	4.5	5.0	6.0	6.5
Yield (%)	3.5%	3.9%	4.7%	5.1%
Franking (%)	100%	100%	100%	100%
ROE (%)	12%	15%	15%	16%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Guidance upgrade on the horizon

Table 1 outlines SRG's prior initial guidance statements and subsequent upgrades.

Management have historically exceeded initial guidance in each financial year since FY21 by 3-18%. At the low end of this range, FY25 EBITDA could exceed $128.5m.

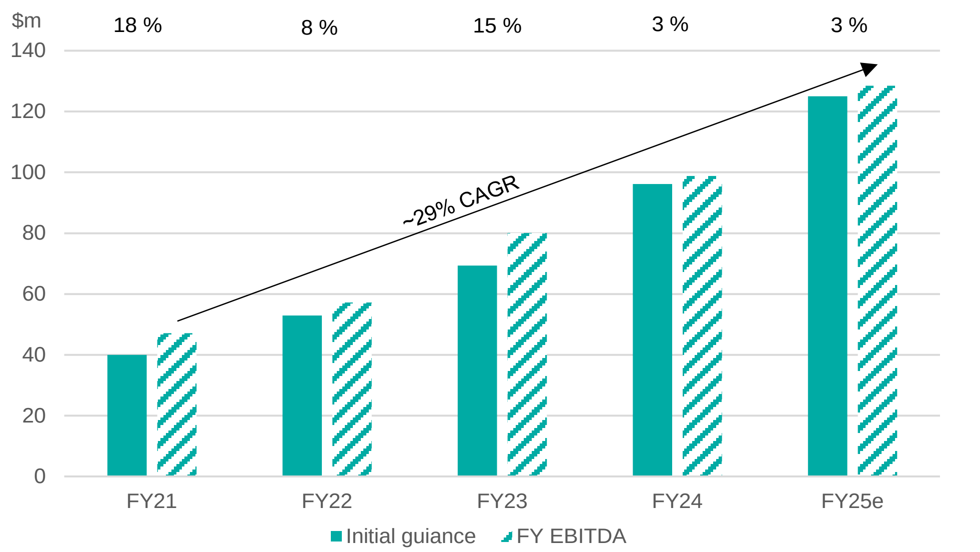
We anticipate an outlook upgrade at the company's interim FY25 result, with prior year upgrades suggesting potential for a 2-9% increase on the initial $125m FY25 EBITDA forecast.

Table 1 - Historical guidance & upgrade timeline

	Initial	Upgrade #1	Upgrade #2	FY EBITDA	Upgrade # 1 vs initial guidance
FY21					
Aug-20	$38 - 42m				
Dec-20		**$42 - 45m**			**9%**
Feb-21			$45 - 47m		
Aug-21				$47.1m; above top-end	
FY22					
Jul-21	15% growth to $53m				
Feb-22		**$54 - 57m**			**5%**
Aug-22				$57.2m; above top-end	
FY23					
Jul-22	~25% growth to $69m				
Feb-23		**$72 - 75m**			**7%**
May-23			$79 - 80m*		
Aug-23				$80.1m; above top-end	
FY24					
Aug-23	~20% growth to $96m				
Feb-24		**$95 - 100m**			**2%**
Aug-24				$98.5m	
FY25					
Jul-24	~10% growth to $109m				
Aug-24		**$125m^**			

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES
NOTE: * 4 MONTHS EARNINGS CONTRIBUTION FROM ACQUIRED ASSET CARE BUSINESS ($4.5-5.0M); AND ^ 10 MONTHS EARNINGS CONTRIBUTION FROM ACQUIRED DIONA BUSINESS

Figure 1 - Initial guidance vs FY EBITDA (beat % at top of chart)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES
NOTE: FY25E EBITDA IS OUR UPDATED $128.5M EBITDA FORECAST, IMPLYING A 3% BEAT TO THE FY25 $125M EBITDA GUIDANCE

Earnings & valuation changes

Earnings changes

We have updated our SRG financial model for today's contract announcement. We note the following:

- We upgrade our revenue growth forecasts for the Maintenance & Industrial Services segment, both for Diona and the core business.
- We lift our EBITDA margin assumptions modestly for the Maintenance & Industrial Services segment (excluding Diona) over FY25-27.
- Raised our corporate cost estimates by 6-12% over FY24-27 to better reflect the overhead integration of Diona.

Our updated FY25 EBITDA forecast of $129m is ahead of the company's $125m guidance.

Our EPS changes are outlined in the table below.

Table 2 - Changes to earnings estimates

	Previous			New			Change		
Year ending 30 June	**FY25**	**FY26**	**FY27**	**FY25**	**FY26**	**FY27**	**FY25**	**FY26**	**FY27**
Revenue $m	1,326	1,443	1,545	**1,353**	**1,482**	**1,587**	2%	3%	3%
EBITDA (underlying) $m	125	137	148	**129**	**143**	**155**	3%	4%	5%
NPAT (underlying) $m	49	56	63	**51**	**59**	**67**	4%	6%	6%
EPS (underlying) cps	8.4	9.2	10.4	**8.6**	**9.7**	**11.1**	1%	6%	6%
EPS(A) (underlying) cps	9.9	10.6	11.6	**10.0**	**11.1**	**12.3**	1%	5%	6%
DPS cps	5.0	6.0	6.5	**5.0**	**6.0**	**6.5**	0%	0%	0%
Valuation $/sh	1.38			**1.55**			12%		

SOURCE: BELL POTTER SECURITIES ESTIMATES

Valuation summary

We have upgraded our Target Price to $1.55/sh (previously $1.40/sh), reflecting the model changes mentioned above. We maintain our Buy recommendation.

Table 3 - SRG valuation summary

Valuation methodology mix	Weighting (%)	Valuation ($/sh)
Discounted cash flow	50%	0.76
ROIC	50%	0.80
Final valuation	**100%**	**1.55**

SOURCE: BELL POTTER SECURITIES ESTIMATES

SRG Global (SRG)

Company description

SRG is a diversified industrial services group that provides multidisciplinary construction, maintenance, drilling and geotechnical services to clients in sectors including Mining, Industrial Processing, Infrastructure, Renewable Energy and Commercial. SRG operates three segments: Asset Maintenance; Mining Services; and Engineering and Construction. Asset Maintenance delivers inspection, condition monitoring, testing, access solutions, repair and maintenance and shutdown services, underpinned by long-term contracts that generate recurring revenue. Mining Services provisions production drilling and geotechnical services through long-term contracts that also generate recurring revenue. Engineering and Construction's specialist capabilities include bridge, dam and tank construction, structural concrete contracting, design, supply and installation of facades and engineered product sales.

Investment thesis: Buy; TP$1.55/sh (previously $1.40/sh)

Today's contract update highlights the diversity and quality of SRG's client base across multiple end-markets, while emphasising a strong tilt towards recurring work. Pleasingly, SRG's valuation gap with the Industrial Services peer group has closed; we argue SRG should trade at a premium given its above average EPS growth outlook.

Valuation methodology

Our SRG valuation is based on a 50% / 50% blend of discounted cash flow and ROIC-based valuation methods. A nominal WACC of 10.1% and a terminal growth rate of 3.0% have been applied in our valuation determination.

Investment risks

Risk to investment thesis

Key risks to SRG include, although are not limited to:

EPC/Construction risk: The construction industry is inherently risky, and particularly so when EPC contracts are involved. This is exacerbated by the general fixed cost nature of construction contracts. Any unforeseen project costs and delays will thus be borne by the contractor. EPC contracting, and construction contracting more generally, is fraught with examples of major contract disputes which can impact profitability, cash flow and ongoing viability. While SRG appears to have a solid track record of achieving profits, there always remains a risk that negative project cash outflows may occur.

Contract completion risk: There is always a risk that unforeseen issues prevent SRG from completing a contract as initially intended, or that a disagreement arises with the party that awarded the contract. This risk has grown as project developers have attempted to shift a greater proportion of risks onto contractors, and is particularly pertinent with EPC contracts, where contractors are responsible for project delivery.

Contract mispricing risk: In addition to customer disputes, SRG could misprice projects for which it tenders. This could result in SRG winning work on uneconomic terms, which may result in SRG recording large losses on some projects that were not originally anticipated. Mispricing could occur as a result of not factoring into account for unforeseen costs, time constraints and project risks. A potential push into larger sized projects increases this risk, as the potential for larger cost overruns and disputes is greater. A cost inflationary environment can increase this risk, particularly when combined with fixed price contracts.

Contract renewal/replenishment risk: In order to maintain revenue, SRG needs to continually win new projects from clients to replace revenue from other projects as they are completed. The amount of work available for tender varies significantly across periods of time as a result of the cyclical nature of client industries and capital expenditures. During times of low construction activity there is a heightened risk that SRG will not be able to replace completed projects with new work. During times of low project activity, margins are also more likely to come under pressure as engineering & construction companies aggressively tender for a smaller supply of opportunities.

Bad debt risk: Given SRG is not paid entirely upfront for its contracts, there is a risk that a customer(s) will not be able to fully pay SRG for its services in the event that they suffer cash flow issues. This risk is somewhat mitigated given the company's large exposure to tier-1 repeat customer base.

Availability and cost of employees/subcontractors risk: During times of an upturn in construction activity, there is a possibility that staff shortages can occur. This may impact SRG's ability to source adequate staff to tender for new projects and increase its revenue. Even if staff are able to be secured, it may require SRG to pay substantially higher rates to both current and newly hired employees/subcontractors in order to secure their services.

Occupational Health & Safety risk: Electrical and construction activity carries with it significant health and safety risks. If not properly mitigated by sufficient safety procedures, there is a risk that employees may suffer serious harm. A lack of proper safety procedures and a proper safety culture would damage employee morale, impact the ability to hire and retain staff, potentially cause litigation risks, and impact a company's social licence.

Commodity price risk: Given SRG's exposure to the mining sector, any sustained fall in commodity prices is likely to lead to a reduction in work opportunities and demand for services.

SRG Global
as at 19 November 2024

Recommendation	Buy
Price	$1.28
Target (12 months)	$1.55

Table 4 - Financial summary

Date		19/11/24
Price	$/sh	1.28
Target price	$/sh	1.55

Bell Potter Securities
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PROFIT AND LOSS

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
Revenue	**$m**	**809**	**1,069**	**1,353**	**1,482**	**1,587**
Other income	$m	3	3	3	4	4
Expenses	$m	(732)	(974)	(1,227)	(1,343)	(1,436)
Equity share of accounted investee profits	$m	(0)	0	-	-	-
Underlying EBITDA	**$m**	**80**	**99**	**129**	**143**	**155**
Depreciation & amortisation	$m	(29)	(33)	(35)	(39)	(42)
Underlying EBIT	**$m**	**47**	**59**	**81**	**92**	**102**
Net interest expense	$m	(4)	(7)	(9)	(8)	(6)
Underlying profit before tax	**$m**	**42**	**52**	**73**	**84**	**96**
Tax expense	$m	(13)	(16)	(22)	(25)	(29)
Underlying NPAT	**$m**	**29**	**35**	**51**	**59**	**67**
Adjustments (post-tax)	$m	(7)	(1)	(3)	-	-
Reported NPAT	**$m**	**23**	**34**	**47**	**59**	**67**
Customer relationship amort. (post-tax)	$m	(2)	(5)	(8)	(8)	(6)
Underlying NPATA	**$m**	**32**	**40**	**59**	**67**	**74**

CASH FLOW STATEMENT

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
OPERATING CASH FLOW						
Receipts from customers	$m	884	1,166	1,308	1,474	1,578
Payments to suppliers and employees	$m	(834)	(1,052)	(1,192)	(1,330)	(1,423)
Tax paid	$m	(2)	(13)	(20)	(25)	(29)
Net interest	$m	(4)	(7)	(9)	(8)	(6)
Other	$m	-	-	(5)	(0)	0
Operating cash flow	**$m**	**43**	**94**	**82**	**110**	**120**
INVESTING CASH FLOW						
Capital expenditures	$m	(30)	(26)	(28)	(30)	(31)
Disposal of assets	$m	4	2	-	-	-
Other	$m	(77)	(2)	(148)	(3)	(3)
Investing cash flow	**$m**	**(102)**	**(25)**	**(176)**	**(32)**	**(34)**
Free cash flow	***$m***	***(59)***	***68***	***(94)***	***78***	***86***
FINANCING CASH FLOW						
Proceeds from share issues (net)	$m	49	-	66	-	-
Debt proceeds / (repayments)	$m	26	(9)	38	(15)	(15)
Dividends paid	$m	(17)	(21)	(28)	(33)	(36)
Other	$m	(10)	(13)	(14)	(15)	(15)
Financing cash flow	**$m**	**48**	**(43)**	**61**	**(63)**	**(66)**
Change in cash	**$m**	**(12)**	**26**	**(32)**	**15**	**19**

BALANCE SHEET

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
ASSETS						
Cash	$m	48	73	41	56	75
Receivables	$m	110	121	169	181	194
Inventories	$m	21	26	26	26	26
Capital assets	$m	119	123	130	135	140
Intangibles	$m	46	41	121	112	104
Other assets	$m	247	256	332	334	335
Total assets	**$m**	**591**	**640**	**820**	**844**	**874**
LIABILITIES						
Payables	$m	116	144	179	192	204
Borrowings	$m	65	56	93	78	63
Provisions	$m	57	64	64	64	64
Leases	$m	27	32	38	39	40
Other liabilities	$m	35	40	55	55	55
Total liabilities	**$m**	**301**	**335**	**429**	**428**	**426**
NET ASSETS						
Share capital	$m	267	267	333	333	333
Reserves	$m	8	9	9	9	9
Retained earnings	$m	15	29	48	74	105
SHAREHOLDER EQUITY	**$m**	**290**	**305**	**390**	**416**	**447**
Weighted average shares	m	473	521	588	601	601

FINANCIAL RATIOS

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
VALUATION						
EPS (underlying)	c/sh	6.2	6.7	8.6	9.7	11.1
EPS growth	%	40.3%	9.1%	27.2%	13.4%	14.1%
EPSA (underlying)	c/sh	6.7	7.7	10.0	11.1	12.3
EPSA growth	%	34.0%	15.0%	29.8%	10.4%	10.7%
PER	x	20.8x	19.0x	15.0x	13.2x	11.6x
DPS	c/sh	4.0	4.5	5.0	6.0	6.5
Franking	%	100%	100%	100%	100%	100%
Yield	%	3.1%	3.5%	3.9%	4.7%	5.1%
FCF/share	c/sh	(12.6)	13.1	(15.9)	13.0	14.2
FCF yield	%	-9.8%	10.3%	-12.5%	10.1%	11.1%
EV/EBITDA	x	10.5x	8.6x	6.6x	5.9x	5.5x
NTA	$/sh	0.25	0.26	0.17	0.22	0.29
P/NTA	x	5.0x	4.9x	7.7x	5.8x	4.5x
LIQUIDITY & LEVERAGE						
Net debt / (cash)	$m	44	14	90	61	28
Net debt / Equity	%	15.2%	4.7%	23.1%	14.7%	6.2%
Net debt / Net debt + Equity	%	13.2%	4.5%	18.7%	12.8%	5.8%
Net debt / EBITDA	x	0.6x	0.1x	0.7x	0.4x	0.2x
EBITDA / net interest expense	x	18.4x	13.7x	15.1x	18.1x	24.1x
PROFITABILITY RATIOS						
EBITDA margin	%	9.9%	9.2%	9.5%	9.6%	9.7%
EBIT margin	%	5.8%	5.5%	6.0%	6.2%	6.5%
EBIT(A) margin	%	6.2%	6.1%	6.9%	6.9%	7.0%
Return on assets	%	5.5%	5.8%	7.0%	7.1%	7.8%
Return on equity	%	11.2%	11.9%	14.6%	14.6%	15.6%
Return on capital employed	%	12.9%	15.6%	15.9%	17.6%	19.0%
Return on invested capital	%	18.9%	20.3%	21.7%	21.5%	23.4%

SEGMENTS

Year ending 30 June	Unit	2023a	2024a	2025e	2026e	2027e
Maintenance & Industrial Services						
Revenue	$m	443	661	946	1,055	1,125
Underlying EBIT	$m	42	64	89	100	107
Underlying EBIT margin	%	9.6%	9.6%	9.4%	9.4%	9.5%
Underlying EBIT(A)	$m	46	70	100	111	118
Underlying EBIT(A) margin	%	10.3%	10.6%	10.6%	10.5%	10.5%
Engineering & Construction						
Revenue	$m	366	408	407	427	462
Underlying EBIT	$m	23	22	21	22	25
Underlying EBIT margin	%	6.4%	5.4%	5.1%	5.2%	5.3%

HALF YEARLY ASSUMPTIONS

Year ending 30 June	Unit	1H 2023a	1H 2024a	1H 2025e	1H 2026e	1H 2027e
Revenue	**$m**	**380**	**511**	**647**	**727**	**780**
Other income	$m	2	2	2	2	2
Expenses	$m	(348)	(468)	(588)	(658)	(706)
Equity share of accounted investee profits	$m	(0)	0	-	-	-
Underlying EBITDA	**$m**	**34**	**45**	**61**	**70**	**76**
Depreciation & amortisation	$m	(13)	(17)	(17)	(19)	(20)
Underlying EBIT	**$m**	**19**	**24**	**38**	**45**	**50**
Net interest expense	$m	(1)	(4)	(4)	(4)	(3)
Underlying profit before tax	**$m**	**18**	**20**	**34**	**40**	**47**
Tax expense	$m	(6)	(6)	(10)	(12)	(14)
Underlying NPAT	**$m**	**12**	**15**	**24**	**28**	**33**
Adjustments (post-tax)	$m	-	-	(3)	-	-
Reported NPAT	**$m**	**12**	**15**	**21**	**28**	**33**
Customer relationship amort. (post-tax)	$m	(1)	(3)	(4)	(4)	(3)
Underlying NPATA	**$m**	**13**	**18**	**28**	**32**	**36**

VALUATION SUMMARY

12-month valuation		
Valuation method	**Weight (%)**	**Val. ($m)**
DCF	50%	0.76
ROIC	50%	0.80
Blended equity valuation	**100%**	**1.55**
Current share price		1.28
Upside to current share price (%)		21%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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