

## Cash-backed services leverage

### Investment Highlights

- Emerson Stewart Group Ltd (ESW) is an engineering service provider to the resources, infrastructure and energy sectors. It currently has a forward order book of \$49m with exposure to infrastructure, energy and resources engineering.**
- Cash-backed.** Following its \$8.0m capital raising, ESW's balance sheet is well-placed to participate in consolidation of the resource services engineering sector with net cash of \$10.7m (8.7cps). With the majority of ESW's expertise focused on front-end work, acquisitions will be targeted that increase capabilities further down the engineering value chain.
- Leveraged to government infrastructure spend.** The currently positive outlook for public sector works based on fiscal stimulatory measures should benefit ESW's infrastructure business line. Within this sector, ESW is targeting property, transportation, water and telecommunications infrastructure.
- Energy division upside.** Thus far failing to fire and accounting for the recent downgrade to earnings guidance, ESW's energy division is targeting power generation projects in the short-term. We consider the potential for revenue streams linked to developing and managing assets in this sector as attractive.
- Experienced management team.** A major element of our investment thesis revolves around the experience of the ESW board and management team. We regard this as being crucial to advancing the company's presence in the engineering services sector.
- Catalyst:** While we view ESW as speculative due to its size, limited market liquidity and its short track record, a substantial increase in revenue generating capacity (acquisitive or otherwise) and a good 2H09 performance would go some way to a re-rating in our view.
- Risks & Sensitivities.** ESW faces a number of risks, not least of which relate to its brief history, along with its reliance on resources sector project revenue in addition to building a suitably scalable engineering workforce.

9 February 2009

12mth Rating

Speculative

Price A¢ 7.0

RIC: **ESW.AX**

BBG: **ESW AU**

Shares o/s m 123.6

Free Float % 46.7

Market Cap. A\$m 8.7

Cash A\$m 10.7

Net Debt/Equity % na

3m Av. D. T'over A\$m 0.01

52wk High/Low A\$ 0.25/0.065

2yr adj. beta na

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### Investment Summary

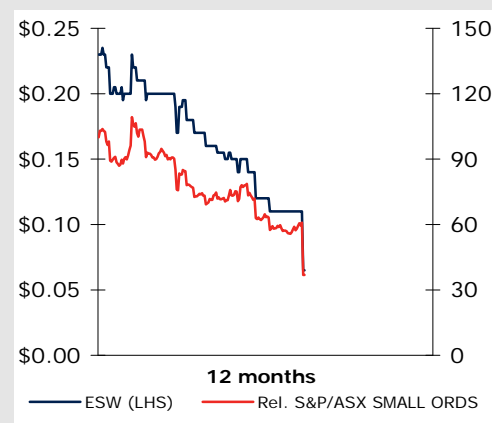
#### Directors

Name	Position
Steven Cole	Non-Executive Chairman
Dario Amara	Managing Director
Marino Evangelisti	Executive Director
Jamie Cullen	Non-Executive Director
David Richardson	Non-Executive Director

#### Substantial Shareholders

Substantial Shareholders	%
Dario Amara	28.0
Angelo Dabala	25.3
Entust Private Wealth	18.0
Top 20	63.3

### Share Price Performance



Performance	%1mth	3mth	12mth
Absolute	-36.4	-54.8	na
Relative	-31.7	-43.1	na

## Background

ESW is a service provider to the resources, infrastructure and energy sectors. The company was established in 2005 and achieved a back-door listing in June 2008 following the acquisition of Emerson Stewart Ltd in January 2008 by Howard Capital Group Ltd.

The acquisition of Emerson Stewart by Howard Capital Group valued the business at \$10m.

**Capital raising:** In June 2008, ESW raised \$8.0m at 20cps in order to:

- Raise funds for growth opportunities and acquisitions;
- Provide the company with greater access to working capital;
- Provide an opportunity for the company's employees to participate in the ownership of the company.

ESW provides advisory and project implementation services including the following:

Figure 1: Capabilities		
Advisory	Project Implementation	Development
Feasibility studies	Execution strategies	Build, own and operate
Technology sourcing	Project management	Build, own, operate and transfer
Risk management	Construction management	Lease back
Peer reviews	Self performance	
Implementation strategies and plans	Design management	
Project audits	Engineering design (selected)	
Cost plans and budgets	Procurement and expediting	
Value improvement	Owners' representation	
Regulatory/statutory	Commissioning	
Approvals and compliance	Health, safety and environmental management	
	Planning and scheduling	
	Program management	
	Asset and facilities management	

Source: Emerson Stewart Ltd

## Business Lines & Growth Strategy

ESW aims to grow each of its business lines via cross-selling opportunities on major resources and infrastructure projects. While each business line is driven by its own targets, projects in each of the resources, infrastructure and energy sectors often combine complementary elements from at least one of the other sectors.

### 1. Resources

ESW's resources business line targets the mining and minerals sectors, principally projects in Western Australia and the international operations of Australian companies. Established as ESW's foundation business line, it has been engaged on projects encompassing iron ore, gold, copper, antimony, vanadium, nickel and coal.

The group's preference is to enter into strategic alliances and umbrella service agreements with mineral producers. Under those arrangements, the business line integrates its personnel with its clients to provide project and construction management services.

## 2. Infrastructure

ESW's infrastructure business line provides advisory, engineering and construction management services to both public and private clients. The business line is targeting the following market sectors:

- Property and building;
- Transportation;
- Water and environment;
- Defence.

The immediate strategy includes increasing its market share in WA, establishing a presence in the east coast market and establishing a South East Asian office to support its growth plans.

In July 2008 the division also signed a MOU with Bovis Lend Lease Consulting to jointly pursue program and project management opportunities arising through the WA Government initiative.

## 3. Energy

ESW's energy business line focuses on developing and managing energy assets for the generation of electricity from gas and renewable resources.

Initial targets include projects for gas-fueled, dual fuel and LNG-fueled power stations ranging from 5-100MW capacity, with a specific focus on 'island' power stations, which are isolated from the electricity grid. Initial targets for renewable energy projects include small-to-medium (5-1,000KW) renewable power systems for the commercial and industrial market, with a focus on wind power.

### Well-funded for acquisitions

Following its \$8.0m capital raising, ESW's balance sheet is well-placed to capitalise on low valuations historically in the resource services engineering sector with net cash of \$10.7m. With the majority of ESW's expertise focused on front-end work, acquisitions will be targeted that increase capabilities further down the engineering value chain. Criteria can be summarised as follows:

- Complementary business lines or service offerings;
- Enhanced scale in targeted sectors; operational capability and geographic footprint;
- Diversified risk profile across sectors; across regions;
- Access to alternative labour sources and bases within lower cost environments.

**Low-risk contracts:** ESW targets niche service areas and aims to collaborate with its clients in order to minimise contracting risk. This extends to integrating personnel with a client's project team.

To align with its clients' interests, ESW also aims to structure its remuneration to combine both reimbursable and performance-benchmarked incentive payments, such as performance incentives for project completion on-time and within budget.

Certain contracting styles (such as lump sum contracting) fall outside ESW's acceptable risk/reward constraints with the client integration model preferred due to its low-risk consultative nature linked to client performance.

## Earnings drivers

### 1. Mineral commodity prices

Prices for raw materials are a major driver across all three of ESW's business lines given client cross-over.

Recent sharp falls in bulk and base metal commodity prices (iron ore, nickel, zinc and aluminium) are expected to result in significantly reduced expenditure on capital investment in mining projects in WA over the medium term.

### 2. Government infrastructure investment

Levels of government investment in infrastructure are predicted to rise dramatically over the next 18 months with the Federal Labor Government expected to make significant spending commitments on large-scale projects.

ESW is well-placed to capitalise on civil infrastructure projects given its expertise in this area.

### 3. Electricity demand

Australian electricity generation is expected to grow substantially to meet increased demand over the next 25 years.

ESW is targeting execution of one non-renewable and one renewable project in the short-to-medium term.

## Current order book

The total value of work-in-hand is \$49m. Recently announced significant contracts include:

Figure 2: Current disclosed contracts				
Project	Role	Client	Commodity	Value
Cairn Hill	Project management	IMX Resources	Magnetite, copper, gold	n/d
Mundijong and Byford subdivision	EPCM	Peet Ltd	Civil infrastructure	n/d
Devils Creek storage and administration buildings	Engineering services	Apache Energy	Gas	n/d
Sebuku	Study management	Straits Asia	Coal	n/d
Sebuku	Project Management	Straits Asia	Coal	n/d

Source: Emerson Stewart Ltd

## Major Clients

Past and current clients (by business line) include:

**Resources:** Australasian Resources, Crescent Gold, Gindalbie Metals, Inpex, Midwest Corporation, OMG, Straits Resources, Territory Resources and Windimurra Vanadium.

**Infrastructure:** Western Australian Department of Housing and Works, Peet Ltd and Stockland.

**Energy:** The business line is yet to secure a keystone client but has identified a number of target projects and is establishing a presence in its two key areas of electricity generation from gas and renewable resources.

## Risks and sensitivities

**Acquisition risk:** ESW intends to acquire complementary businesses which will require operational and financial integration.

**Market risk:** Earnings are influenced by the company's ability to win new projects, which are a function of market conditions.

**Reliance on key clients:** ESW derives a large proportion of its revenue from contracts with a relatively small number of clients based on ongoing relationships.

**Competition risk:** ESW faces competition from both other firms servicing the same sectors and from the possibility that its clients may choose to bring advisory/management services in-house.

**Contractual disputes and litigation:** Disagreements with clients could result in material claims against earnings/equity.

**Capital requirement risk:** ESW may in the future require further equity financing, which could have a potentially dilutive effect on existing issued capital.

**Limited history:** The Emerson Stewart business has only been in operation since 2005.

## Financial Information

In FY08, ESW achieved NPAT of \$2.1m (normalised for \$0.7m one-off after-tax costs associated with the reverse-takeover, which included a goodwill impairment charge of \$0.3m). This was ahead of prospectus forecasts of \$1.4m.

**Figure 3: Income Statement**

Y/E June 30 (\$m)	2007A	2008A	1H09P*	1H09F**
<b>Revenue</b>	<b>4.4</b>	<b>10.5</b>	<b>11.3</b>	<b>8.3</b>
Cost of sales	(3.4)	(6.7)	-	-
Gross profit	1.0	3.7	-	-
Marketing expense	(0.0)	(0.0)	-	-
Occupancy expense	(0.1)	(0.1)	-	-
Administration expense	(0.6)	(1.4)	-	-
<b>EBITDA</b>	<b>0.4</b>	<b>2.2</b>	<b>2.4</b>	<b>1.9</b>
Depreciation and amortisation	(0.0)	(0.0)	(0.1)	(0.0)
<b>EBIT</b>	<b>0.3</b>	<b>2.2</b>	<b>2.3</b>	<b>1.9</b>
Net interest	0.0	0.1	0.3	0.3
<b>Pre-tax profit</b>	<b>0.3</b>	<b>2.3</b>	<b>2.6</b>	<b>2.2</b>
Tax expense	(0.1)	(0.8)	(0.8)	(0.7)
Significant items	0.0	(0.7)	0.0	0.0
<b>NPAT</b>	<b>0.2</b>	<b>0.8</b>	<b>1.8</b>	<b>1.5</b>
<b>Normalised NPAT</b>	<b>0.2</b>	<b>2.1</b>	<b>1.8</b>	<b>1.5</b>

Source: Emerson Stewart Ltd \*Prospectus forecast \*\*Downgraded forecast as at November AGM

ESW's prospectus forecast was for 1H09 NPAT of \$1.8m on \$11.3m of revenue, however this was revised at the company's November AGM to \$1.5m on \$8.3m of revenue due to underperformance of the Energy business line, which was headed up by major shareholder Angelo Dabala, who has subsequently retired from the position.

**Figure 4: Balance Sheet**

	2007A	2008A
Cash	0.2	10.7
Receivables	0.4	2.1
Work in progress	0.4	0.1
Fixed Assets	0.0	0.1
Intangibles	0.0	0.0
Other Assets	0.0	0.3
<b>Total Assets</b>	<b>1.1</b>	<b>13.3</b>
Creditors	0.7	1.8
Current Borrowings	0.0	0.0
Non-current Borrowings	0.0	0.0
Other Liabilities	0.1	0.5
<b>Total Liabilities</b>	<b>0.9</b>	<b>2.3</b>
<b>Shareholders Funds</b>	<b>0.2</b>	<b>11.0</b>

Source: Emerson Stewart Ltd

**Figure 5: Key Ratios**

	2007A	2008A	1H09P	1H09F
<b>Profitability</b>				
Revenue growth (%)	na	137.4	-	-
EBITDA margin (%)	8.1	20.8	21.1	23.3
EBIT margin (%)	7.7	20.6	20.4	22.9
ROE (%)	122.7	7.1	-	-
ROA (%)	31.5	16.1	-	-
Effective tax rate (%)	29.2	33.3	30.0	30.0
<b>Balance sheet</b>				
Net Debt (Cash) (\$m)	(0.2)	(10.7)	-	-
Net debt/Equity (%)	nm	nm	-	-
Interest Cover (x)	(113.3)	(15.4)	(7.7)	(6.3)
NTA (\$/share)	0.0	0.2	-	-
Price/NTA (x)	35.1	0.7	-	-

Source: Patersons estimates

## Substantial Shareholders, Directors & Management

**Figure 6: Substantial Shareholders**

Shareholder	Shares (m)	%
Dario Amara	34.7	28.0
Angelo Dabala	31.3	25.3
Entrust Private Wealth Management	22.3	18.0

Source: Emerson Stewart Ltd

### Directors

#### Steven Cole, non-executive independent chairman

Steven Cole has 35 years' professional, corporate and business experience through senior legal consultancy, as well as a range of executive management and non-executive appointments. He has held senior executive management roles with major law firms Parker & Parker and Allens Arthur Robinson before retiring from legal practice in 2007.

#### Dario Amara, managing director, director energy

Dario Amara is an engineer with business experience gained over 29 years in Australian and international markets and across the resources and infrastructure sectors. For the past 16 years, he has occupied senior executive roles with major construction and engineering groups. Prior to co-founding Emerson Stewart, he successfully led GRD Minproc as managing director/chief executive and John Holland Asia as chief executive officer.

#### Jamie Cullen, non-executive director

Jamie Cullen is a qualified Chartered Accountant with extensive commercial experience covering several industries and countries. From 1994 to 2007, he was managing director of PCH, an ASX-listed Australian company providing a range of industrial services to numerous industry sectors. These sectors included mining and processing, oil and gas, petrochemicals, pharmaceuticals, infrastructure, commercial and residential.

#### David Richardson, non-executive director

David Richardson is a mechanical engineer with 24 years' experience in the resources industry. He co-founded Toussaint and Richardson, a company that specialised in design and execution of process plant projects in the resources sector. Following the 2000 sale of Toussaint and Richardson to WorleyParsons, David served as an executive director of WorleyParsons. In 2003, he established WorleyParsons' Mining and Metals division prior to that company's ASX listing.

### Senior Management

#### Marino Evangelisti, director infrastructure

Marino Evangelisti is a qualified civil engineer with over 25 years' experience in the consulting industry in Australia and overseas. He has held senior executive roles in engineering design and management and the construction of civil infrastructure associated with urban development, transportation and mining projects. Prior to taking up the position of director infrastructure at Emerson Stewart, he successfully led the engineering group of Parsons Brinckerhoff in Western Australia.

#### John Morhall, director resources

John Morhall is an engineer with commercial experience gained over 40 years in both Australian and international markets in the resources sector. Prior to joining Emerson Stewart, John served as the chief executive officer of the Hancock Group of Companies and as general manager of Signet Engineering. Between 1989 and 1994, John served as chief executive officer of the Western Australian Departments of State Development and Resources Development.

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