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Gale Pacific (GAP): Reinvestment into the high margin commercial channel

Recommendation: **BUY, target price $0.50 (no change)**

Share price: $0.39 | Market cap: $115.9m

Year end June	2016A	2017A	2018E	2019E	2020E
Sales ($m)	173.3	175.4	177.1	190.0	203.9
EBITDA ($m)	22.2	21.4	23.6	26.3	27.9
Adj NPAT ($m)	10.2	10.1	11.9	13.9	15.0
Adj EPS (cps)	3.4	3.4	4.0	4.7	5.0
EPS growth	51%	(1%)	18%	17%	8%
PER (x)	11.3	11.5	9.7	8.3	7.7
DPS (cps)	1.8	2.0	2.3	2.5	2.8
EV/EBITDA	5.6x	5.4x	4.9x	4.0x	3.4x
P/Cash Flow	6.6x	6.0x	6.2x	5.7x	5.5x

Underlying NPAT of $10.1m was in line with expectations of $10.2m. 2.00 cent dividend (unfranked) surprised on the upside by 0.25 of a cent. Operating cash flow of ~$19m (+10%) and free cash flow of $15m (+15%) has allowed the balance sheet to de-lever to a net-cash position. Australia/NZ ($92.4m revenue, -5%) was impeded by the staged exit of non-core residential market SKU's and competition from excess inventory associated with the Masters closure, as previously flagged. The Americas ($62m revenue, +16%) was the stand-out geography, benefitting from higher penetration with existing customers Amazon, Lowes and positive comp store sales. We see continued opportunity to grow Americas, unlocking growth in the residential shade market. MENA ($13m revenue, -17%) performance is consistent with 1H results and deliberate management of sales channels given the challenging construction market/debtor days.

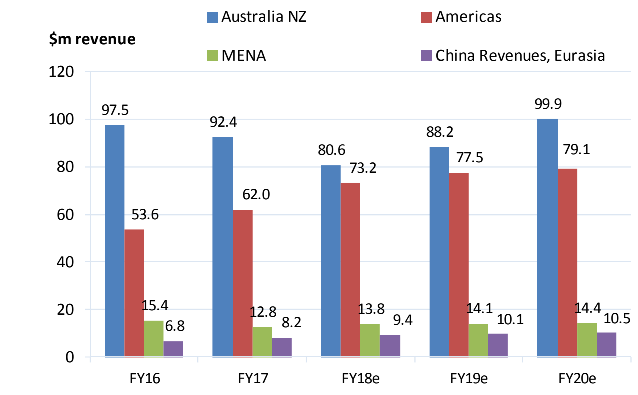
Underlying EBIT of $15m represents EBIT margins of 8.6% (from 8.7%), with a soft domestic residential performance offset by steady resin prices and lower CNY/AUD conversion rate, reducing the cost of manufactured products within the company-owned facility in China. We expect margin growth during FY18-FY20 as the revenue mix favours a higher share of core (Coolaroo) and commercial (Grain cover, Horticulture) product categories. FY18 outlook implies underlying profit growth. We expect 14% EBIT growth with a lower revenue/higher margin product mix and on-going top line growth in the Americas.

Reported profit includes ~$0.9m after tax costs relating to the closure of the Everton glass business, including inventory write-downs and redundancy costs. Importantly, the carried forward cost base into FY18 from Everton pool fence, balustrade and mirrors is zero. Write-down extracts a high touch, low margin product category and is consistent with the rationalisation strategy employed by the current management team. **The clearing of the decks also includes$17.5m non-cash impairment to the carrying value of the Aus/NZ segments acquired prior to 2012.** Of this we expect that ~$3m relates specifically to the Everton write-down, ~$4m likely relates to the Zone blinds business and the balance represents the CGU top line growth revenue being written back to ~1% (from 4%). This is conservative accounting for future revenue growth. Pre-tax ROIC on the written down invested capital rises to 17% in FY18 (from 15%). **Extraction of the ~$15m revenue Everton business and other non-core SKU's carries a ~$80m revenue run-rate for the Aus/NZ business into FY18.**

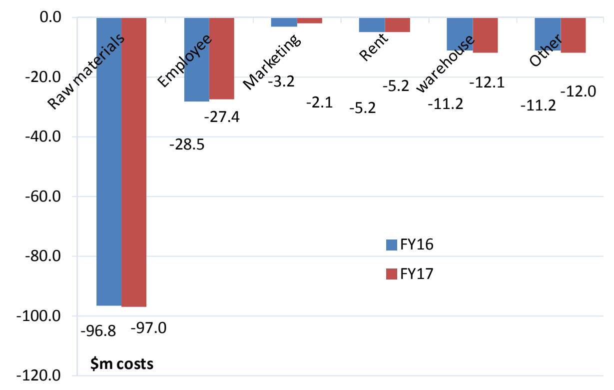
An estimated ~$30m of the Aus/NZ revenue is higher margin commercial product lines servicing mainly the agricultural, construction and mining sectors. **New commercial coating machine for the Braeside headquarters has been ordered, with commissioning expected in November 2018 (1H19). We have increased capex to ~$8m in FY18 (from $6m) and** expect the machine to contribute ~$6m to Commercial revenues in FY19 and ~$16m in FY20. Commercial products are accretive to group margins and are a point of difference in product quality and innovation, and leverage the cost advantage of a local/offshore manufacturing combination.

We maintain the view that that the existing commercial business has reached supply-side capacity constraints. The new machine, once installed, roughly doubles the capability to service commercial customers, adding a further $20m-$25m revenue opportunity by FY20-FY21. Product manufacturing capability includes grain covers, irrigation lining and refrigerated produce cardboard storage, amongst other applications. Extra supply will likely be exported into the American coated fabric commercial market.

Aus/NZ revenues managed for non-core exit



Cost benefit from resin prices, exchange rates



Source: CCZ Equities, Bloomberg

Result scorecard

- **$19.5m operating cash flow represents 91% conversion from EBITDA,** assisted by reduction in group debtor days to 61 (from 64) and inventory days to 78 (from 94). $4.3m capex was in line with expectations inclusive of $0.5m roll-out of the ERP system. In FY18, we expect group capex of $11m including $8m for the new coating machine, completion of the new California warehouse facility and conclusion of the ERP system roll-out to the Chinese operation.

- **$A group costs (excluding D&A, interest) were flat**, assisted by a ~3% lower CNY/AUD conversion rate, reduction in some SKU holding and processing costs and steady resin prices. We expect the cost containment to continue into FY18, pending exchange rate fluctuations. Effective tax rate reduced to 27% and we expect 26%-29% rate to hold over the forecast period, depending on geographic mix.

- **Revenue from the largest individual customer Bunnings Australia, reduced by 10% to $56.1m** (from $62.3m). On a stand along basis, Bunnings reported comparable sale growth of 7.3% during FY17. We attribute GAP underperformance to the phased and planned reduction in non-core SKU's and to a lesser extent, some operational underperformance versus the record pcp. Our forecasts include ~2% top line growth for FY18 within this specific customer.

Margin mix improves; dividend assumes 50-56% payout ratio; new FY20 forecast

Gale Pacific (GAP): Forecast changes			2017A	2018E	2019E	2020E
Revenue	(AUD'm)	New	176.3	178.0	190.9	204.8
		Old	181.4	193.5	203.7	204.8
		Change	-3%	-8%	-6%	0%
		Growth	-1%	1%	7%	7%
adj EBITDA	(AUD'm)	New	21.4	23.6	26.3	27.9
		Old	22.3	24.8	26.6	27.9
		Change	-4%	-5%	-1%	0%
EBITDA Margin	(%)	New	12.1%	13.3%	13.8%	13.6%
		Old	12.3%	12.8%	13.1%	13.6%
		Change	-0.18%	0.46%	0.71%	0.03%
adj NPAT	(AUD'm)	New	10.1	11.9	13.9	15.0
		Old	10.2	12.3	13.8	15.0
		Change	-1%	-3%	1%	0%
Adj EPS	(AUD cps)	New	3.4	4.0	4.7	5.0
		Old	3.4	4.1	4.7	5.0
		Change	-1%	-3%	1%	1%
		Growth	-1%	18%	17%	8%
Dividend	(AUD cps)	New	2.00	2.25	2.50	2.75
		Old	1.75	2.10	2.40	2.75
		Change	14%	7%	4%	0%

Source: CCZ Equities

Gale Pacific Limited (GAP.AX)

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STOCK INFORMATION	Share Price (AUD)	$ 0.390	Market Cap (AUD)	115.9m
Gale Pacific manufacturers and distributes a range of shade cloth, industrial lining, glass and related products to the retail, construction, hotel and agricultural markets. The three brands are Coolaroo (Shade cloth & sails), Zone Interiors (window furnishings, home wares) and Gale Pacific (Commercial grain covers, waterproof liners, shade cloths, vehicle protection etc). The Coolaroo brand accounts for ~53% of revenue, Gale Pacific is 37%, Zone is ~ 10% of the total. Australasia is the core geographical segment accounting for 53% of FY17 revenues, followed by the Americas at 35%.			Shares (listed)	297.2
	Target Price (AUD)	$ 0.50		
	Recommendation	BUY	Year End	30-Jun
	1yr TSR Potential	34.0%	Market Cap ($m)	115.9

RETURN ANALYSIS	2016A	2017A	2018E	2019E	2020E
Adj EPS (cps): weighted shares	**3.4**	**3.4**	**4.0**	**4.7**	**5.0**
adj EPS %	51%	(1%)	18%	17%	8%
Weighted ordinary Shares (m)	297.5	297.2	297.2	297.2	297.2
Diluted shares at year end (m)	301.2	301.0	301.0	301.0	301.0
reported EPS (cps):	**3.4**	**(2.7)**	**4.0**	**4.7**	**5.0**
PE on adj EPS	**11.3x**	**11.5x**	**9.7x**	**8.3x**	**7.7x**
PE - Emerging Co. Ex 100	18.2x	16.9x	15.7x	14.6x	13.6x
PE Relative	(38%)	(32%)	(38%)	(43%)	(43%)
PEG ratio x	0.22	-9.18	0.55	0.48	1.03
Dividend (AUD cps)	1.75	2.00	2.25	2.50	2.75
Franking	0%	0%	0%	0%	0%
Dividend Yield	**4.5%**	**5.1%**	**5.8%**	**6.4%**	**7.1%**
Payout Ratio	51%	59%	56%	53%	55%
EV/EBITDA	**5.6x**	**5.4x**	**4.9x**	**4.0x**	**3.4x**
EV/EBIT	**8.3x**	**7.7x**	**6.7x**	**5.4x**	**4.5x**
adj EBITDA/Sales	12.5%	12.1%	13.3%	13.8%	13.6%
adj EBIT/Sales	8.7%	8.6%	9.7%	10.3%	10.3%
ROE	**10.3%**	**12.1%**	**13.0%**	**14.2%**	**14.2%**
ROIC (pre-tax)	**12.4%**	**14.8%**	**17.1%**	**18.2%**	**18.3%**
ROFE	14%	16%	20%	22%	25%

VALUATION SUMMARY

Models (AUD/share)		DCF - Key Inputs		DDM - Key Inputs FY15	
DCF	0.50	WACC	11.7%	Retention Ratio	56%
DDM	0.28	Cost of Equity	11.5%	Expected Growth	5.2%
PE	0.54				
Weighted Avg	**0.50**				

		PE - Key Inputs	2017A	2018E	2019E	2020E
		Target PER relative	90%	90%	90%	90%
Valuation Weighting		Discount Rate	101%	96%	92%	87%
DCF	100%	PV of EPS	0.52	0.57	0.62	0.62
DDM	0%	PV of Dividend	0.02	0.02	0.02	0.02
PE	0%	PE Valuation	0.54	0.59	0.64	0.64

PROFIT & LOSS (AUD'm)	2016A	2017A	2018E	2019E	2020E
Revenue	**173.3**	**175.4**	**177.1**	**190.0**	**203.9**
Operating Cost	(156.3)	(154.9)	(154.3)	(164.6)	(176.9)
EBITDA (adj)	**22.2**	**21.4**	**23.6**	**26.3**	**27.9**
Depreciation	(6.2)	(5.3)	(5.5)	(5.8)	(6.0)
Amortisation	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
D&A (total)	(7.2)	(6.4)	(6.5)	(6.8)	(7.0)
EBIT (adj)	**15.06**	**15.03**	**17.11**	**19.48**	**20.92**
Net Interest	(1.54)	(1.53)	(0.81)	(0.37)	(0.37)
Pre-Tax Profit	**13.5**	**13.5**	**16.3**	**19.1**	**20.5**
Other Significants (after tax)	0.0	(18.1)	0.0	0.0	0.0
Tax	(3.3)	(3.4)	(4.4)	(5.2)	(5.5)
effective tax rate	24%	25%	27%	27%	27%
Reported NPAT	**10.2**	**(8.0)**	**11.9**	**13.9**	**15.0**
Underlying NPAT	**10.2**	**10.1**	**11.9**	**13.9**	**15.0**
Income Growth	*19%*	*(1%)*	*1%*	*7%*	*7%*
EBITDA Growth	*25%*	*(4%)*	*10%*	*11%*	*6%*
EBIT Growth	*47%*	*(0%)*	*14%*	*14%*	*7%*
Underlying PBT Growth	*60%*	*(0%)*	*21%*	*17%*	*8%*
Reported NPAT Growth	*98%*	*(178%)*	*49%*	*17%*	*8%*

BALANCE SHEET (AUD'm)	2016A	2017A	2018E	2019E	2020E
Cash	24.6	25.0	16.2	26.7	37.2
Receivables	30.2	29.5	29.3	30.9	33.2
Pre-payments	1.0	1.4	1.4	1.4	1.4
Inventories	44.6	37.4	37.4	37.4	37.4
Other	0.0	0.0	0.0	0.0	0.0
Current assets	**100.3**	**93.3**	**84.4**	**96.5**	**109.3**
Fixed Assets	30.4	27.0	34.8	31.8	28.6
Intangibles	25.2	7.3	6.8	6.0	5.2
Other	4.4	4.3	4.3	4.3	4.3
Non-Current Assets	**60.0**	**38.6**	**45.9**	**42.1**	**38.1**
Total Assets	**160.4**	**131.9**	**130.3**	**138.6**	**147.4**
Creditors	19.6	19.5	19.6	21.1	22.6
Short term debt	13.2	7.3	7.3	7.3	7.3
Current tax liability	2.8	0.9	0.9	0.9	0.9
Employee Benefits	3.6	2.5	2.5	2.5	2.5
Current Liabilities	**39.1**	**30.1**	**30.3**	**31.7**	**33.2**
Debt LT	19.5	16.4	6.4	6.4	6.4
Other & Employee benefits	2.1	2.1	2.1	2.1	2.1
Total Liabilities	**60.8**	**48.5**	**38.7**	**40.2**	**41.7**
Total Shareholder Funds	**99.6**	**83.4**	**91.5**	**98.4**	**105.7**
Total Funds Employed	107.8	82.1	89.0	85.4	82.1
Liquidity and leverage ratios					
NTA per Share $	0.25	0.26	0.29	0.31	0.34
Net Debt (cash) $m	8.2	(1.3)	(2.5)	(13.0)	(23.5)
Enterprise Value $m	124.2	114.6	113.4	102.9	92.4
Net Debt (cash) / (Net debt + Equity)	8%	(2%)	(3%)	(15%)	(29%)
Cash Balance $ per share	0.08	0.08	0.05	0.09	0.12
Intangible / EBITDA	1.13	0.34	0.29	0.23	0.19
Net Debt (cash) / EBITDA	(0.2x)	(0.4x)	(0.4x)	(0.8x)	(1.1x)

CASHFLOW (AUD'm)	2016A	2017A	2018E	2019E	2020E
Gross Cash Flow	19.6	11.8	18.4	20.7	22.0
Change in Working Capital	(1.8)	7.7	0.4	(0.2)	(0.7)
Operating Cash Flow	**17.8**	**19.5**	**18.8**	**20.6**	**21.3**
Capex (PPE)	(3.8)	(3.8)	(11.0)	(3.0)	(3.0)
Capex (Intangible)	(0.7)	(0.5)	(0.5)	(0.2)	(0.2)
Free Cash Flow	**13.3**	**15.2**	**7.3**	**17.4**	**18.1**
Free CFPS (cents)	**4.4**	**5.1**	**2.4**	**5.8**	**6.0**
Price / Free CFPS	8.9x	7.7x	16.1x	6.8x	6.5x
Operating cash / EBITDA	80%	91%	80%	78%	76%
Operating CFPS (cents)	**5.9**	**6.5**	**6.2**	**6.8**	**7.1**
Price / Operating CFPS	6.6	6.0	6.2	5.7	5.5
Capex / Depreciation	0.1x	0.1x	0.1x	0.0x	0.0x
Operating Cash Yield %	15%	17%	16%	18%	18%
Free Cash Yield %	11%	13%	6%	15%	15%

SEGMENT INFORMATION	2016A	2017A	2018E	2019E	2020E
Australia / New Zealand					
revenue $m	97.5	92.4	80.6	88.2	99.9
% growth	17.8%	-5.2%	-12.7%	9.4%	13.3%
Americas					
revenue $m	53.6	62.0	73.2	77.5	79.1
% growth	24%	16%	18%	6%	2%
MENA					
revenue $m	15.4	12.8	13.8	14.1	14.4
% growth	7%	-17%	8%	2%	2%
China Manufac / Eurasia					
revenue $m	6.8	8.2	9.4	10.1	10.5
% growth	-9%	21%	15%	7%	4%
Corporate Costs	-2.0	-2.0	-2.1	-2.1	-2.2

SUBSTANTIAL SHAREHOLDERS		Interim Results	1H17	2H17
Shareholder	**Holding**	Revenue	82.6	92.8
1. Thorney Holdings Pty Ltd	26.8%	EBITDA adj	7.9	13.5
2. Windhager Holding AG	14.1%	NPAT adj	3.3	6.8
3. JP Morgan Nominees	6.8%	EPS (c) adj	1.1	2.3
		DPS (c) adj	1.0	1.0
		EBITDA margin %	9.5%	14.6%
		Operating Cash Flow $m	-0.7	20.3

Gale Pacific FY17: Core Geographies

Market	Australia/NZ	Americas (USA)	MENA	EurAsia
Revenue Share FY17	53% - $92.4m	35% - $61.9m	7% - $12.7m	5% - $8.1m
Headcount	140	45	6	460
Core segment	Retail - 65% but declining as non-core SKU's are reduced	Retail - 90%	Commercial - 97%	Retail - 85%
Main Distribution Point	Dandenong distribution , Braeside manufacturing	Los Angeles manufacturing and distribution, Orlando head office and manufacturing	Dubai - UAE	Shanghai sales office, Beilun production facility - China
Main Sales Channels	hardware stores, distributors including Bunnings, Bartlett's	Hardware, home centres, clubs, online: Sam's, Cosco, Lowe's	Commercial distributors: Leeds Trading LLC	Manufacturing hub: Mainly intersegment
Core Brand	Coolaroo and Gale Pacific	Coolaroo, Custom	Gale Pacific	All
Point of Difference	Dominant market share in Coolaroo shade products, customised commercial	Coolaroo brand, (albeit modest starting base)	Commercially Tailored fabrics wide range	Manufacturing facility reduces cost to produce globally
Sensitivities	grain and horticulture, construction, infrastructure, mining, refrigerated produce	Supply chain management, retail trials, increasing penetration within existing customers	Regional growth, oil prices	Resin Prices, Labour costs,
Catalysts	Commercial growth, hot weather	Increased brand recognition and commercial footprint leveraging the new fabric coating machine	Property cycle	Manufacturing efficiency

Source: CCZ Equities

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