20 February 2017

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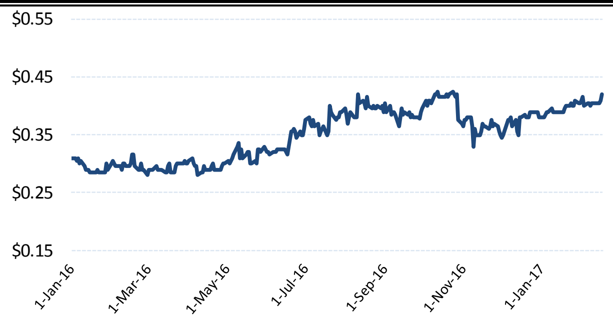
Gale Pacific(GAP): Masters inventory has washed through, set for a positive 2H

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

Share price: $0.42 Market cap: $124.9m

Year end June	2015A	2016A	2017E	2018E	2019E
Sales ($m)	148.0	173.3	178.4	190.5	200.8
EBITDA ($m)	17.9	22.2	23.2	25.6	27.0
Adj NPAT ($m)	6.8	10.2	11.2	12.7	14.0
Adj EPS (cps)	2.3	3.4	3.8	4.3	4.7
EPS growth	(93%)	51%	10%	13%	10%
PER (x)	18.4	12.2	11.1	9.8	8.9
DPS (cps)	1.0	1.8	2.0	2.3	2.5
EV/EBITDA	8.0x	6.1x	5.5x	4.7x	4.1x
P/Cash Flow	28.8x	7.1x	7.2x	6.5x	6.1x



$3.3m NPAT (+5%) and 1.0 cent dividend were in line with expectations. Seasonality within the Australia/NZ and Americas segments provides significant revenue (46%/54%) and profit (30%/70%) skew to the second half. **Guidance of cautious optimism that PBT can grow during FY17 could be interpreted as guiding marginally below our $15m (+11%) full year PBT expectations.** The main Australia/NZ business posted $56.8m revenues (-1%). Visibility into the performance of the individual product ranges is limited. The three residential brands (Coolaroo, Zone, Everton) account for 70% of Australia/NZ sales and were cycling a strong pcp. Levels of clearance inventory washed through the *Masters* hardware chain likely impacted most product ranges during 1H. Bunning's domestic stores reported 1H17 comparable sales growth of ~7% and Coolaroo/Zone/Everton sales have significantly lagged this number. True metric is the 2H. Record heat waves across urban areas of Eastern Australia during January and February are likely to support 2H Coolaroo sales growth.

Commercial products account for ~30% of Australia/NZ sales and likely had a flat result on pcp. Buoyant demand from customers in the Agricultural sector – especially grain storage covers and cardboard box inputs for fresh produce refrigeration and transportation- likely supported numbers. Record grain harvest has caused many grain handlers to manage silo overflow with the purchase of ground based tarps. Commercial sales are margin accretive to the group and we see clear opportunity to expand share in this space, particularly agricultural product ranges where innovative new products (such as the recycled grain tarp developed in conjunction with Deakin University) are gaining traction.

Americas segment reported sales of $17.1m (+21%). ~70% of sales are recorded during the second half. We expect mid single digit 2H sales growth, assisted by positive impact from management changes in 2016 and an expanding footprint in hardware clubs (Sam's and Cosco) and online distribution (Amazon and Blinds.com) plus warehouse upgrades and supply chain consolidation reducing inventory lead times. **MENA sales of A$6.1m declined by 30% on pcp.** This fall is consistent with AGM commentary and in line with the strategy of restricting supply as the debtor day's increase. Payments delays are a cyclical trickle down symptom of lower oil prices and associated pressure on Government budgets and spending on infrastructure/property projects.

The cost-out and simplification program continues steadily. We expect that around 5% or around 300 SKU's have been taken out of the business during 1H17. This strategy continues management's focus on exiting non-core product ranges, delivering higher margin A&B category items faster throughout the supply chain by maximising productivity and efficiency rates within the China manufacturing hub. **This is largely a 2 year process and is supportive of GAP's capacity to respond faster to demand in core selling regions and deliver higher profit margins on average.** EBIT/Sales margins declined to 5.7% (from 6.4%) during 1H.

Share buyback of up to 10% (30m) of shares on issue. Ex the buy-back, forecasts indicate minimal net debt by the end of FY17. **Maintain BUY and $0.50 valuation. Expect continued PE re-rating as margin is extracted through the supply chain, America's growth profile picks up and domestic commercial segments increase share.**

1H Highlights

- Debtor's days remained steady at 68 at 31 December. We expect that MENA customers are averaging 90+ currently.
- Net debt increased by $13.7m from $8.2m with the seasonal built up in funding for working capital purposes. Depending on the aggressiveness of the share buyback, 2H cash flow generation would (all else equal) reduce net debt to ~$1m on CCZ estimates.
- Operating cash out flow of ($0.7m) relates to the seasonality of sales and strategy to manufacture USA seasonal requirements earlier than prior years.
- Inventory days pushed out to 105 (from 97). Considering the sku's exited during the half and focus on inventory management, this increase is a signal in the positive order book from customers during 2H.
- "EBITDA" fell further than expected, directly related to lower "D&A" which are denominated in Chinese currency and thereby impacted by the depreciation vs. $A during the 1H.

Flat 1H revenue: cycling a high base in Aus and Masters inventory wash through

Revenue A$m	1H16	2H16	1H17	2H17e
Australia	57.4	40.1	56.8	44.6
			-1%	*11%*
Americas	14.1	39.5	17.1	41.9
			21%	*6%*
MENA	*8.6*	*6.8*	*6.1*	4.8
			-30%	*-30%*
EurAsia	2.4	4.4	2.6	4.7
			6%	*6%*
Total	*82.5*	*90.8*	*82.5*	*95.9*
			0%	*6%*

Source: CCZ Equities

1% NPAT beat, Forecasts assume a stronger 2H, 25% tax rate.

Half yearly	1H16	2H16	1H17	2H17e	*1H17e*	beat (miss)	1H vs. pcp
Sales revenue	82.4	90.9	82.6	95.8	*83.8*	-1%	0.2%
EBITDA	8.2	14.0	7.9	15.3	*9.2*	-14%	-4.1%
EBIT	5.3	9.8	4.7	11.5	*5.2*	-9%	-11.3%
Adj NPAT	3.2	7.0	3.4	7.9	*3.3*	1%	4.8%
Reported NPAT	3.2	7.0	3.4	7.9	*3.3*	1%	4.8%
EBITDA / sales	10.0%	15.4%	9.5%	16.0%	*11.0%*	-13%	-0.4%
Adj EPS (¢)	1.08	2.37	1.13	2.65	*1.1*	1%	4.8%
EPS growth on pcp	300%	136%	5%	12%	*4.0%*		
DPS (¢)	0.75	1.00	1.00	1.00	*1.00*	0%	33.3%
% of FY EBITDA	37%	63%	34%	66%	*37%*		

Source: CCZ Equities

Gale Pacific Limited (GAP.AX)

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Publication Date: 20 Feb 2017

STOCK INFORMATION	Share Price (AUD)	$ 0.420	Market Cap (AUD)	124.9m
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 four brands are Coolaroo (Shade cloth & sails), Everton (Pool fencing), Zone Interiors (window furnishings, home wares) and Gale Pacific (Commercial grain covers, waterproof liners, shade cloths, vehicle protection etc). The Coolaroo brand accounts for ~55% of revenue, Gale Pacific is 29%, Zone is ~ 7% each and Everton is ~9% of the total. Australasia is the core geographical segment accounting for 56% of FY16 revenues, followed by the Americas at 31%.			Shares (listed)	297.5
	Target Price (AUD)	$ 0.50		
	Recommendation	BUY	Year End	30-Jun
	1yr TSR Potential	23.8%	Market Cap ($m)	124.9

RETURN ANALYSIS	2015A	2016A	2017E	2018E	2019E
Adj EPS (cps): weighted shares	**2.3**	**3.4**	**3.8**	**4.3**	**4.7**
adj EPS %	(93%)	51%	10%	13%	10%
Weighted ordinary Shares (m)	297.5	297.5	297.5	297.5	297.5
Diluted shares at year end (m)	299.8	301.2	301.2	301.2	301.2
reported EPS (cps):	**1.7**	**3.4**	**3.8**	**4.3**	**4.7**
PE on adj EPS	**18.4x**	**12.2x**	**11.1x**	**9.8x**	**8.9x**
PE - Emerging Co. Ex 100	19.0x	18.2x	16.9x	15.7x	14.6x
PE Relative	(3%)	(33%)	(34%)	(38%)	(39%)
PEG ratio x	-0.20	0.24	1.13	0.74	0.89
Dividend (AUD cps)	1.00	1.75	2.00	2.25	2.50
Franking	0%	0%	0%	0%	0%
Dividend Yield	**2.4%**	**4.2%**	**4.8%**	**5.4%**	**6.0%**
Payout Ratio	44%	51%	53%	53%	53%
EV/EBITDA	**8.0x**	**6.1x**	**5.5x**	**4.7x**	**4.1x**
EV/EBIT	**13.9x**	**8.9x**	**7.9x**	**6.6x**	**5.7x**
adj EBITDA/Sales	11.9%	12.5%	12.7%	13.2%	13.2%
adj EBIT/Sales	6.9%	8.7%	9.1%	9.5%	9.7%
ROE	**6.9%**	**10.3%**	**10.6%**	**11.3%**	**11.7%**
ROIC (operating)	**11.1%**	**11.4%**	**13.1%**	**15.7%**	**16.8%**
ROFE	568%	14%	15%	17%	19%

VALUATION SUMMARY						
Models (AUD/share)			**DCF - Key Inputs**		**DDM - Key Inputs FY15**	
DCF	0.50		WACC	11.4%	Retention Ratio	56%
DDM	0.24		Cost of Equity	11.5%	Expected Growth	5.2%
PE	0.60					
Weighted Avg	**0.50**	**PE - Key Inputs**	**2016**	**2017E**	**2018E**	**2019E**
		Target PER relative	90%	90%	90%	90%
Valuation Weighting		Discount Rate	103%	98%	94%	89%
DCF	100.0%	PV of EPS	0.56	0.58	0.61	0.62
DDM	0.0%	PV of Dividend	0.02	0.02	0.02	0.02
PE	0.0%	PE Valuation	0.58	0.60	0.63	0.64

PROFIT & LOSS (AUD'm)	2015A	2016A	2017E	2018E	2019E
Revenue	**148.0**	**173.3**	**178.4**	**190.5**	**200.8**
Operating Cost	(132.7)	(156.3)	(159.2)	(169.0)	(177.7)
EBITDA (adj)	**17.9**	**22.2**	**23.2**	**25.6**	**27.0**
Depreciation	(6.9)	(6.2)	(6.0)	(6.5)	(6.5)
Amortisation	(0.8)	(1.0)	(1.0)	(1.0)	(1.0)
D&A (total)	(7.6)	(7.2)	(7.0)	(7.5)	(7.5)
EBIT (adj)	**10.23**	**15.06**	**16.15**	**18.08**	**19.54**
Net Interest	(1.76)	(1.54)	(1.15)	(0.64)	(0.35)
Pre-Tax Profit	**8.5**	**13.5**	**15.0**	**17.4**	**19.2**
Other Significants (after tax)	(1.6)	0.0	0.0	0.0	0.0
Tax	(1.7)	(3.3)	(3.7)	(4.7)	(5.2)
effective tax rate	20%	24%	25%	27%	27%
Reported NPAT	**5.2**	**10.2**	**11.2**	**12.7**	**14.0**
Underlying NPAT	**6.8**	**10.2**	**11.2**	**12.7**	**14.0**
Income Growth	*10%*	*19%*	*2%*	*7%*	*5%*
EBITDA Growth	*2%*	*25%*	*4%*	*11%*	*6%*
EBIT Growth	*(40%)*	*47%*	*7%*	*12%*	*8%*
Underlying PBT Growth	*(50%)*	*60%*	*11%*	*16%*	*10%*
Reported NPAT Growth	*9,152%*	*98%*	*10%*	*13%*	*10%*

BALANCE SHEET (AUD'm)	2015A	2016A	2017E	2018E	2019E
Cash	17.8	24.6	19.6	15.7	24.3
Receivables	27.1	30.2	31.3	33.4	35.2
Pre-payments	0.8	1.0	1.0	1.0	1.0
Inventories	39.2	44.6	44.6	44.6	44.6
Other	4.5	0.0	0.0	0.0	0.0
Current assets	**89.4**	**100.3**	**96.5**	**94.7**	**105.1**
Fixed Assets	34.9	30.4	30.4	28.2	29.4
Intangibles	25.3	25.2	24.2	23.9	20.4
Other	0.0	4.4	4.4	4.4	4.4
Non-Current Assets	**60.2**	**60.0**	**59.0**	**56.5**	**54.2**
Total Assets	**149.6**	**160.4**	**155.5**	**151.2**	**159.3**
Creditors	12.9	19.6	20.0	21.4	22.6
Short term debt	33.6	13.2	5.0	5.0	5.0
Current tax liability	2.2	2.8	2.8	2.8	2.8
Employee Benefits	1.8	3.6	3.6	3.6	3.6
Current Liabilities	**50.5**	**39.1**	**31.4**	**32.7**	**33.9**
Debt LT	0.8	19.5	15.7	3.7	3.7
Other & Employee benefits	0.5	2.1	2.1	2.1	2.1
Total Liabilities	**51.8**	**60.8**	**49.2**	**38.6**	**39.7**
Total Shareholder Funds	**97.8**	**99.6**	**106.3**	**112.7**	**119.6**
Total Funds Employed	114.4	107.8	107.4	105.7	104.0
Liquidity and leverage ratios					
NTA per Share $	0.24	0.25	0.28	0.30	0.33
Net Debt (cash) $m	16.7	8.2	1.1	(7.0)	(15.6)
Net Debt (cash) / (Net debt + Equity)	15%	8%	1%	(7%)	(15%)
Cash Balance $ per share	0.06	0.08	0.07	0.05	0.08
Intangible / EBITDA	1.42	1.13	1.04	0.93	0.75
Net Debt (cash) / EBITDA	(1.0x)	(0.2x)	(0.2x)	(0.5x)	(0.8x)

CASHFLOW (AUD'm)	2015A	2016A	2017E	2018E	2019E
Gross Cash Flow	15.5	19.6	18.3	20.2	21.5
Change in Working Capital	(11.1)	(1.8)	(0.7)	(0.8)	(0.6)
Operating Cash Flow	**4.4**	**17.8**	**17.6**	**19.5**	**20.9**
Capex (PPE)	(4.0)	(3.8)	(4.5)	(4.6)	(4.7)
Capex (Intangible)	(2.6)	(0.7)	(0.7)	(0.7)	(0.7)
Free Cash Flow	**(2.2)**	**13.3**	**12.4**	**14.2**	**15.5**
Free CFPS (cents)	**(0.7)**	**4.4**	**4.1**	**4.7**	**5.1**
Price / Free CFPS	(58x)	9.5x	10.2x	8.9x	8.2x
Operating cash / EBITDA	24%	80%	76%	76%	77%
Operating CFPS (cents)	**1.5**	**5.9**	**5.8**	**6.5**	**6.9**
Price / Operating CFPS	28.8	7.1	7.2	6.5	6.1
Capex / Depreciation	0.4x	0.1x	0.1x	0.1x	0.1x
Operating Cash Yield %	3%	14%	14%	15%	17%
Free Cash Yield %	-2%	10%	10%	11%	12%

SEGMENT INFORMATION	2015A	2016A	2017E	2018E	2019E
Australia / New Zealand					
revenue $m	82.7	97.5	101.4	107.5	111.8
% growth	0.9%	17.8%	4.0%	6.0%	4.0%
Americas					
revenue $m	43.4	53.6	59.0	64.3	69.5
% growth	20%	24%	10%	9%	8%
MENA					
revenue $m	14.4	15.4	10.8	11.1	11.5
% growth	11%	7%	-30%	3%	3%
China Manufac / Eurasia					
revenue $m	7.5	6.8	7.2	7.6	8.1
% growth	-17%	-9%	6%	6%	6%
Corporate Costs	-4.1	-2.0	-2.0	-2.1	-2.1

SUBSTANTIAL SHAREHOLDERS		Interim Results	1H17	2H17e
Shareholder	**Holding**	Revenue	82.6	95.8
1. Thorney Holdings Pty Ltd	26.8%	EBITDA adj	7.9	15.3
2. Windhager Holding AG	14.1%	NPAT adj	3.4	7.9
3. JP Morgan Nominees	6.8%	EPS (c) adj	1.1	2.7
		DPS (c) adj	1.0	1.0
		EBITDA margin %	9.5%	16.0%
		Operating Cash Flow $m	-0.72	18.30

Investment Risks

- **Customer Concentration;** Approximately 36% of the Group's external revenue was derived from sales to one customer in the Australasian region during FY16.

- **Resin Input Costs;** Key inputs are oil and high-density polyethylene (HDPE) resin. Both commodities have been at multi-year lows during 2016, which may place downward pressure on COGS if prices increase against a neutral $A backdrop. The company does incorporate resin prices into customer contracts. CCZ estimates that if resin increased 10%, over a 6 month period following this price rise the company would be able to recover ~80% of the loss from customers.

- **Currency Risk;** The company holds the majority of its cash in USD, however it also holds NZD, UAE dirham and Chinese Renminbi on its balance sheet. Based on currency exposure, if the Australian dollar strengthened by 10% / weakened by 10% against these foreign currencies with all other variables held constant, the Group's profit before tax for the year would have been $308,000 higher/lower and equity would have been $1,746,000 higher/lower for FY16.

- **Seasonality;** The business is exposed to seasonality in both the Northern and Southern hemisphere, as sales would be likely to decrease during the colder months. We would expect this to skew sales in the 2H of the financial year resulting from the majority of sales coming from the Australian summer.

- **Manufacturing cost pressure:** Wages and general cost of doing business in China have risen and further cost pressure is likely within the manufacturing activities unless efficiencies can be generated.

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