

Finbar Group Ltd

(FRI \$1.22) Buy

Analyst: Gavin Allen

Price Target: \$1.79/sh

Investment Case:

FRI recently had a very strong sales outcome on the Aurelia project, which achieved 73 sales (62% of the project) on the first weekend of marketing in early March. Meanwhile, analysis of project updates suggests sales in under construction projects continue to tick along. Outcome for 2015 will depend on sales achieved on two major projects and equally timing will play a role in 2016 earnings, however overall we see sufficient sales in place to maintain the current 10c per annum dividend and on this basis FRI yields 8.2% per annum. In the meantime presales are perhaps surprisingly robust and FRI will over the 2017/2018 period deliver on its three largest projects to date, Concerto (50% sold), Aurelia (62% sold) and Civil Heart (right next to Aurelia). Sector headwinds mean obvious catalysts are scarce, however FRI is a proven performer through many cycles and the yield supports the stock at these levels - Buy maintained.

Key Points:

- FRI recently received development approval on its Civic Heart project in South Perth, a major milestone.
- The Civic Heart project is right next to the Aurelia project, which achieved 73 sales during the first weekend of release (62% of the project), an excellent result. This is particularly given what has now been at least 18 month of oversupply sentiment.
- This is not to suggest the market has not slowed, as it undoubtable has, however is testament to the idea demand remains for well placed and priced product.
- In the meantime, outcome for 2015 and 2016 is dependent on timing of the remaining sales at Toccota and Subi Strand (for 2015) and on sales and construction timing on the Motive project (for 2016) – see project pipeline below.
- Our analysis of project sales and timing is consistent with the maintenance of the current 8% yield, even after allowing for fluidity around timing, and we consider our forecasts conservative.
- In the meantime, the three largest projects in FRI's history are in progressed stages, set for delivery in 2017 and 2018 and driving at that time significant further growth.

Finbar Group	Year end 30 June		
Share Price	1.22		A\$/sh
Price Target (PER)	1.78		A\$/sh
Valuation (DCF)	1.78		A\$/sh
WACC	10.6%		
Terminal Growth	2.0%		
Shares on issue	228.4		m, diluted
Market Capitalisation	278.6		A\$m
Enterprise Value	303.4		A\$m
Debt (Dec 2014)	103.0		A\$m
Cash (Dec 2014)	48.8		A\$m
Key Financials	2014a	2015f	2016f
Revenue (A\$m)	273.1	181.1	188.0
EBITDA (A\$m)	59.1	36.3	38.0
EBIT (A\$m)	58.9	36.1	37.9
Reported NPAT (A\$m)	36.5	25.3	26.6
Normalised NPAT (A\$m)	37.6	25.3	26.6
Gross Cashflow (A\$m)	41.7	24.9	26.7
Capex (A\$m)	2.2	-0.5	-0.5
Op. Free Cashflow (A\$m)	99.6	-43.6	-25.0
Revenue Growth (%)	111%	-35%	6%
EBITDA Growth (%)	37%	-39%	5%
Norm. NPAT Growth (%)	28%	-33%	5%
Normalised EPS (Ac)	17.01	11.08	11.64
Norm. EPS growth (%)	25%	-35%	5%
PER (x)	7.2	11.0	10.5
EV:EBITDA (x)	5.1	8.4	8.0
EV:EBIT (x)	5.2	8.4	8.0
DPS (Ac)	10.00	10.00	10.00
Dividend Yield (%)	8.2%	8.2%	8.2%
Net Cash (A\$m)	-17.5	-24.8	-63.5
Net Debt:Equity (%)	7%	10%	24%
Interest Cover (x)	294.6	na	na

Share Price Chart



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Analysis:

We provide below our interpretation of the project pipeline for FRI together with the units required to be sold to hit our numbers:

Fri share of revenues Construction commenced/complete	2015 (\$m)	2016 (\$m)	2017 (\$m)	2018 (\$m)	As at April 2015			
					Units to sell to hit numbers			% Sold
					2015	2016	2017	
AU	3	-	-	-	-	-	-	100%
Ecco	3	-	-	-	-	-	-	100%
The Springs	50	-	-	-	12	-	-	94%
Pelago	-	-	-	13	-	-	-	64%
Mill Point Road	7	-	-	-	-	-	-	100%
Subiaco	70	13	-	-	20	39	-	78%
Toccatà	38	5	-	-	9	3	-	78%
280 Lord Street	-	18	-	-	-	15	-	81%
Concerto and Harmony	-	-	100	-	-	-	116	51%
The Springs (Arbor North)	-	39	-	-	-	52	-	66%
Construction not yet commenced								
Maylands (Unison)	-	42	-	-	-	98	-	42%
Maylands (Kennedy)	-	-	23	23	-	-	90	0%
Dianella	-	-	-	37	-	-	-	0%
The Springs (South and 1014)	-	-	27	38	-	-	116	0%
West Perth	-	-	-	63	-	-	-	0%
Northbridge (James street)	-	65	-	-	-	69	-	41%
West Leederville	-	-	41	-	-	-	115	20%
South Perth (Aurelia)	-	-	67	-	-	-	65	62%
South Perth Civic Triangle	-	-	-	175	-	-	-	0%
Belmont (GE Highway)	-	-	15	15	-	-	-	0%
63 Adelaide Terrace	-	-	-	38	-	-	-	0%
Revenue forecast	171	181	271	401	41	276	502	
<i>Revenues per the above will not equate to reported revenues due to equity accounted developments. This does not impact our view of reported profits</i>								

We note:

Earnings

- During early April we estimated FRI required circa 41 further sales to hit our 2015 forecasts over the next 82 days.
- With a few weeks to go we would expect FRI to be there or thereabouts.
- In 2016 we require a further 276 units sold, again, easily achievable in the context of current run rate.
- To put the 276 in context, we would estimate at least 50% of sales are in place for 2016, a strong position this far out.
- In addition, for 2017 and 2018, 50% of Concerto and 62% of Aurelia are sold, again a strong position.
- Finally, the Civic Heart project, the biggest in FRI history, has recently received DA and the marketing release of this project in 1H 2016, assuming successful, would be a genuine catalyst (the project is next to Aurelia).

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- In the meantime the 288 apartment Pelago project is 64% sold with 91% of the remaining apartments rented, generating circa \$6.5m in annual rent. A healthy return on equity invested given all associated bank debt has been retired.

Headwinds

- It is clear the number of new apartment buildings available for investors to consider has increased.
- Whether these opportunities are ultimately built is a function of achieving the necessary presales to enable the project to be banked.
- In addition, as the mining boom unwinds, rent rates are decreasing and this may impact investor appetite.
- Finally, the media is talking up all of the above which does not help sentiment generally.

Mitigation

- We continue to believe that the market will sensibly address the supply and demand equation, as the nature of presales required to finance a project acts as a supply brake of sorts over the medium term.
- This is not to suggest short term peaks in supply may not occur from time to time, particularly if a number of marginal projects scrape over the presales threshold at the same time potentially resulting in an excess of supply upon completion.
- When this happens new supply doesn't receive presales, the excess supply is eventually cleaned out, and the cycle resumes.

Long term

- Finbar continues to be one of the low cost producers in the WA market with a proven track record of delivery.
- We also continue to believe Finbar product will see a sustained share of the available demand, demand we believe will increase over the medium to long term as WA residents look for alternative living arrangements in a sprawling city. The case precedent for this in other growing cities is clear.
- Short term demand will likely moderate as rents reduce and investors potentially slow however ultimately we see a city continuing to grow over time that is fundamentally underserved in terms of apartment living.

Investment Thesis

- Investment sentiment as it pertains to WA is clearly poor as the mining construction cycle ends and low commodities prices create job and economic uncertainty.
- Finbar is not immune from this and we see no immediate catalysts, particularly as Finbar has been unable to be definitive in terms of 2015 earnings with the half year result. This is because timing on the sale of remaining product at Subiaco and Toccata is unknown.
- That said, we see pipeline the of opportunity as sufficiently robust to maintain and ultimately increase the dividend even as earnings fluctuate somewhat with timing of projects and FRI currently yields 8.2% fully franked.
- We see this as a floor, and while catalysts are skinny and consequently FRI may do some further time over the next 3 months at current levels, we continue to like the business, its track record and management.
- In the meantime the stock trades at 11x our 2015 forecasts, hardly demanding.
- We maintain our Buy recommendation with a long term view, despite some potential short term earnings fluidity.

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FINANCIAL STATEMENTS						PERFORMANCE RATIOS					
	YEAR END 30 JUNE					13A	14A	15F	16F	17F	
Income Statement						Growth & Margins					
Sales	124.2	261.9	170.5	181.0	271.1	Revenue Growth	34%	111%	-35%	6%	50%
Other	16.0	11.2	10.6	7.0	7.0	EBITDA Growth	13%	37%	-39%	5%	49%
Revenue	140.2	273.1	181.1	188.0	278.1	EBIT Growth	13%	37%	-39%	5%	49%
Operating costs	-97.0	-214.0	-144.9	-150.0	-221.5	Normalized Net Profit Growth	45.3%	28.0%	-32.6%	5.0%	48.9%
EBITDA	43.2	59.1	36.3	38.0	56.6	EBITDA margin	30.8%	21.6%	20.0%	20.2%	20.4%
Depreciation	-0.2	-0.1	-0.1	-0.1	-0.1	EBIT margin	30.7%	21.6%	19.9%	20.2%	20.3%
Other non cash	0.0	0.0	0.0	0.0	0.0	Normalized net profit margin	20.9%	13.8%	14.0%	14.1%	14.2%
EBIT	43.0	58.9	36.1	37.9	56.5	Effective tax rate	29%	30%	30%	30%	30%
Net Interest income/(expense)	0.2	-0.2	0.0	0.1	0.1	Liquidity					
Associates	1.3	0.0	0.0	0.0	0.0	Capex/depreciation (x)					
Other income/(expense)	0.0	0.0	0.0	0.0	0.0	Current ratio (x)	2.8	5.7	4.2	3.9	4.1
Abnormal items (pretax)	0.0	0.0	0.0	0.0	0.0	Quick ratio (x)	1.8	6.0	3.3	1.4	2.9
EBT	44.5	58.7	36.2	38.0	56.5	Receivable days	31	39	21	10	17
Tax expense	-13.0	-17.9	-10.9	-11.4	-17.0	Payable days	6	13	6	8	16
Discontinued operations	0.0	0.0	0.0	0.0	0.0	Risk Measures					
Minority interest	-0.3	-4.3	0.0	0.0	0.0	Dividend Cover (x)	n/a	n/a	n/a	n/a	n/a
Reported Earnings	31.2	36.5	25.3	26.6	39.6	Payout ratio (%)	66%	60%	90%	86%	0%
Dividends	-13.1	-13.2	-13.7	-13.7	0.0	Net interest cover (x)	na	294.6	na	na	na
Adjustments (one off)	0.0	0.0	0.0	0.0	0.0	Net debt/equity (%)	50%	7%	10%	24%	1%
Retained earnings	18.1	23.3	11.6	12.9	39.6	Returns					
Net Profit (ex valuation)	29.3	37.6	25.3	26.6	39.6	Return on avg capital employed (%)	21%	25%	14%	14%	19%
Cash flow (A\$m)						WACC (%)					
Pretax Profit	44.5	58.7	36.2	38.0	56.5	Return on assets (%)	12%	16%	16%	15%	14%
+ Depreciation	0.2	0.1	0.1	0.1	0.1	Return on average equity (%)	16%	16%	10%	10%	14%
- Tax Paid	-7.4	-17.6	-10.9	-11.4	-17.0	Company cost of equity (%)					
+ inc (- dec) in provisions	0.0	0.5	-0.5	0.0	0.0	SHARE DATA/VALUATION					
- Profit/+ loss on disposal	0.0	0.0	0.0	0.0	0.0	Share Data					
+/- Other	0.0	0.0	0.0	0.0	0.0	Issued shares (m)	218.2	220.8	228.4	228.4	228.4
Gross Cashflow	37.3	41.7	24.9	26.7	39.7	Weighted ave shares (m)	216.0	220.8	228.4	228.4	228.4
- Capital expenditure	0.3	2.2	-0.5	-0.5	-0.5	Fully diluted shares (m)	216.0	220.8	228.4	228.4	228.4
+/- Changes in working capital	-32.9	55.7	-68.0	-51.3	21.5	Basic EPS (A\$)	0.14	0.17	0.11	0.12	0.17
Operating Free Cashflow	4.7	99.6	-43.6	-25.0	60.7	YoY change (%)	10%	14%	-33%	5%	49%
+/- Investments	0.0	0.0	0.0	0.0	0.0	Fully diluted EPS (A\$)	0.14	0.17	0.11	0.12	0.17
- Dividends	-17.9	-16.4	-13.7	-13.7	0.0	YoY change (%)	44%	25%	-35%	5%	49%
+ Proceeds from equity raised	0.0	8.4	0.0	0.0	0.0	Fully diluted normalised EPS (A\$)	0.136	0.17	0.11	0.12	0.17
+/- (Acquisition) Disposals	0.0	0.0	50.0	0.0	0.0	YoY change (%)	44%	25%	-35%	5%	49%
+/- Minority interests	0.0	0.0	0.0	0.0	0.0	Dividend/share (A\$)	0.095	0.100	0.100	0.100	0.000
+/- Other	-5.4	-5.2	0.0	0.0	0.0	Franking (%)	100%	100%	100%	100%	100%
Net cashflow	-18.6	86.4	-7.3	-38.7	60.7	Gross cashflow/share (A\$)	0.17	0.19	0.11	0.12	0.17
Cash at beginning of period	-85.3	-103.9	-17.5	-24.8	-63.5	NBV/share (A\$)	0.94	1.08	1.10	1.15	1.33
Net debt at end of period	-103.9	-17.5	-24.8	-63.5	-2.8	NTA/Share (A\$)	0.94	1.08	1.10	1.15	1.33
Balance Sheet (\$m)						Valuation					
Cash	35.6	60.9	63.6	24.9	85.6	PER (Basic) (x)	8.4	7.4	11.0	10.5	7.0
Receivables	24.3	11.1	3.1	3.3	5.0	PER (Fully diluted) (x)	9.0	7.2	11.0	10.5	7.0
Inventories	180.0	75.8	114.6	143.2	132.3	PER (Fully diluted, normalized) (x)	9.0	7.2	11.0	10.5	7.0
Other	0.7	0.4	0.4	0.4	0.4	P/CFPS (x)	7.1	6.5	11.2	10.4	7.0
Current Assets	240.6	148.2	181.8	171.8	223.3	Price/NBV (x)	1.3	1.1	1.1	1.1	0.9
Receivables	12.0	46.1	13.0	13.8	20.7	Price/NTA (x)	1.3	1.1	1.1	1.1	0.9
Inventories	4.2	11.8	90.1	112.5	104.0	Dividend Yield (%)	7.8%	8.2%	8.2%	8.2%	0.0%
Property/Plant/Equipment	14.7	12.4	12.7	13.1	13.5	Fully diluted normalized 3 yr EPS Cagr (%)	n/a	n/a	n/a	n/a	n/a
Equity Accounted Investments	1.1	0.0	0.0	0.0	0.0	n/a					
Investment Property	122.1	135.0	85.0	85.0	85.0	PEG ratio (x)	n/a	n/a	n/a	n/a	n/a
Deferred tax assets	2.4	1.9	1.9	1.9	1.9	EV	382.5	296.1	293.4	332.2	271.5
Other	0.0	0.0	0.0	0.0	0.0	EV/EBITDA (x)	7.0	5.1	8.4	8.0	5.4
Non Current Assets	156.5	207.2	202.8	226.4	225.1	EV/EBIT (x)	7.0	5.2	8.4	8.0	5.4
Total Assets	397.1	355.4	384.6	398.2	448.3	EV/Revenue (x)	2.2	1.1	1.7	1.6	1.1
Payables	-33.4	-12.0	-20.1	-20.8	-31.4	NPV/SOP (A\$)					
Interest bearing liabilities	-43.7	0.0	-10.0	-10.0	-10.0	OTHER INFORMATION					
Current tax payable	-9.0	-13.5	-13.5	-13.5	-13.5	12-mth High/Low (A\$/sh)					\$1.80/\$1.28
Provisions	0.0	-0.5	0.0	0.0	0.0	Average daily volume (A\$m)					0.2
Current Liabilities	-86.1	-26.0	-43.6	-44.3	-54.9	ASX Code					FRI
Payables	0.0	0.0	0.0	0.0	0.0	Next result					FY 2015
Interest bearing liabilities	-95.8	-78.4	-78.4	-78.4	-78.4	COMPANY DESCRIPTION					
Tax liabilities	-9.2	-11.8	-11.8	-11.8	-11.8	FRI is a WA based property developer					
Provisions	-0.1	-0.5	-0.5	-0.5	-0.5						
Non Current Liabilities	-105.1	-90.7	-90.7	-90.7	-90.7						
Total Liabilities	-191.2	-116.7	-134.3	-135.0	-145.6						
Net Assets	206.0	238.7	250.3	263.2	302.7						
Contributed equity	137.8	151.7	151.7	151.7	151.7						
Reserves	1.4	1.4	1.4	1.4	1.4						
Retained profits	63.6	78.2	89.8	102.7	142.3						
Minority Interests	3.1	7.4	7.4	7.4	7.4						
Total equity	205.9	238.7	250.3	263.2	302.8						

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