FINANCIAL REVIEW smartinvestor

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HD **Game on in diverse sectors**

BY TREVOR HOEY - Trevor Hoey uses socio-economic trends to identify stocks with the best potential for growth.

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HOEY'S TOP 10

As well as some familiar names in the resources industry, Trevor Hoey identities property, infrastructure, fittings and gambling companies that have reported good news recently.

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1. Independence Group

MINING AND EXPLORATION

Diversification is one of Independence Group's most important attributes. The producer and explorer has exposure to both precious and base metals across a number of projects that are in production and undergoing further exploration.

Following a production update for the three months to September 30, management confirmed its Tropicana joint venture, in which it holds a 30 per cent share, was on track to produce between 141,000 ounces and 147,000 ounces of gold attributable to Independence in 2014-15 at a comparatively low average cash cost of about $610 an ounce.

The company's cornerstone Long Nickel project put in another strong quarter, producing 2600 ounces. Cash costs of $4.11 per pound were below the projections of most analysts, who were expecting about $4.20 per pound.

Management said it is on track to produce between 9000 tonnes and 10,000 tonnes of nickel with mid-range costs of $4.50 per pound in 2014-15. The group continues to extend what has already been a long life project, flagging exploration costs of $12 million. This asset has more than paid its way, and past exploration success suggests this will be money well spent.

The Jaguar zinc-copper project outperformed management's guidance, producing more than 12,000 tonnes of zinc and 2418 tonnes of copper with cash costs better than expected at 19¢ per pound. Zinc production was impressive, as the better than expected result came from higher ore milled as well as improved grades.

This also represents good timing given a supply-constrained market is expected to push the price of zinc higher in 2014-15, with a more pronounced increase forecast for 2016 and 2017.

Management also highlighted positive drilling results at Bentley Deeps and Triumph. It is targeting extensions to the Bentley mine, as well as looking for what could be the next Bentley.

The company could potentially have further exposure to zinc if it brings the Stockman project in Victoria into production.

Si view: Analysts at Bell Potter upgraded Independence Group's recommendation from hold to buy and marginally increased the 12-month share price target from $4.80 to $4.85.

2. Brierty

CONSTRUCTION

Hartleys has initiated coverage of construction and engineering group Brierty, with a "buy" recommendation and 12-month price target of 69¢, a substantial premium to its recent trading range. Brierty's shares hit a 12-month high within weeks of its 2013-14 result, but negative sentiment saw most gains erased in September and October. But it may be a stock to target following the pull-back, with good fundamentals from a valuation and yield perspective.

The 12-month high of 57¢ represented only a slight premium to Brierty's net tangible asset value of 53.8¢ a share at June 30. In this sector, companies rarely have the underlying asset value to support their share prices.

Hartleys' 2014-15 forecasts could be conservative, with its net profit of $10 million representing earnings per share of 8.1¢. This compares with consensus forecasts which have been upgraded over the past month and now point to earnings per share of 10.5¢.

Based on the mid-point of those forecasts, Brierty is trading on a price-earnings multiple of 7.4 relative to Hartleys' 12-month price target. Recent capital management initiatives included a special dividend of 8¢ a share and a placement of $8.25 million. These allowed Brierty to release surplus franking credits and improve liquidity in its stock. Its balance sheet has never looked better with gearing at 2 per cent compared with 30 per cent in 2012-13, and as much as 40 per cent in 2011. Net cash flow from operations hit a five-year high of $28.5 million in 2013-14 and the company seems better placed to tender for large projects.

Si view: Brierty won $571 million of work in 2013-14 and has high-profile, long-term contracts. Its civil work provides income diversification and, with submitted tenders of $250 million, this may grow.

3. GWA Group

BULK FITTINGS

One of Australia's largest suppliers of fixtures and fittings for bathrooms and kitchens, GWA Group said in October it planned to restructure its manufacturing activities, phasing out its plastics operation in Adelaide and vitreous china manufacturing facility in Sydney.

This comes on the back of other restructuring initiatives and asset sales in the past two years, and the financial impact of redundancies and asset write-downs will result in charges to profit in 2014-15.

But sale of the Wetherill Park site in Sydney will be financially beneficial and management expects positive cash flow of about $24 million in 2014-15 with annualised savings expected to be about $4 million.

Though the negative impact on retained earnings will result in a lower dividend in 2014-15, management has committed to other forms of capital management, perhaps pointing to a special dividend.

Si view: Some investors may be disenchanted by the restructuring which has impinged on a solid yield stock. A special dividend would boost investor sentiment and help offset the yield erosion.

4. GR Engineering

RESOURCES

Mining services stocks came under pressure during the September selloff, but GR Engineering's share price gained ground, increasing from 82¢ at the start of the month to close at 90¢, representing a gain of about 10 per cent. While sustained market volatility in October saw its shares come off slightly, they have held up better than most of its peers.

The company delivered a particularly strong 2013-14 result with earnings before interest, tax, depreciation and amortisation up 56.4 per cent, despite nominal revenue growth. Management declared a final dividend of 4¢ a share, bringing the full-year return to 7¢ per share. This implied a healthy yield of nearly 10 per cent.

The company has a strong balance sheet and at June 30 had net cash of $36.9 million. Argonaut expects MZI Resources' Keysbrook project to proceed in 2014-15, underpinning GR Engineering's revenues of $180 million, a year-on-year increase of about 60 per cent.

Si view: Argonaut has a buy recommendation and recently increased its 12-month price target from 91¢ to $1.05. This implies a price-earnings multiple of 10.6 relative to its 2014-15 forecasts, and with the dividend expected to be in line with the previous year it represents a yield of 6.7 per cent.

5. Finbar Group

PROPERTY DEVELOPMENT

Perth-based apartment developer Finbar Group's share price performance has been negatively affected in recent months by flagging sentiment regarding the West Australian property market, as well as the sharp fall in equities markets.

However, this may have thrown up an opportunity to snap up Finbar at a cheap price. The timing of positive news couldn't have been worse for the group as it announced a record net profit of $36.5 million just as the broader market went into free fall. Not only was the 2013-14 result an impressive performance but with a $1.8 billion pipeline of projects, the company is well positioned to build on its growth profile, even after delivering its eighth consecutive year of profit growth in 2013-14.

Finbar has a strong balance sheet to fund upcoming projects, with about $60 million in cash. In October it announced three important developments, including one in East Perth.

Si view: Finbar has extensive exposure to the near CBD apartment market which has proven resilient over the past decade. This still appears to be the case, with Finbar continuing to secure robust pre-sales.

6. Skycity Entertainment Group

GAMING/ENTERTAINMENT

While it took a change in broader market conditions after the rout in September and October for Skycity Entertainment Group's share price to benefit from a positive trading update for the three months to September 30, when the kick came, the stock quickly put on about 20 per cent from a 12-month low of $3.09.

Mass gaming revenue growth of 5.4 per cent generated by its flagship Auckland casino was an extremely good performance, complemented by non-gaming revenue growth of 17.6 per cent.

Income generated from VIP operations in Auckland was up 41.2 per cent, leaving the company well placed to outperform first-half estimates of 30 per cent.

Despite construction activity at the Adelaide casino disrupting turnover in the first quarter, a significant increase in international VIP business was enough to offset this decline, resulting in overall revenues increasing 4 per cent on a year-on-year basis.

Si view: The first-quarter update was seen as proof management is adept at adding value to its assets through development and expansion, and sparked earnings upgrades for 2014-15 and 2015-16.

7. Triton Minerals

MATERIALS

The metals boom has shifted from the likes of gold, iron ore and nickel to commodities such as graphite and lithium. The reason is the anticipated surge in demand from the burgeoning production of a wide range of electronic devices, particularly electric vehicles.

Syrah Resources led the way in establishing a large, high-grade graphite resource, but new players have emerged in the past six months including Triton Minerals. Its share price increased nearly tenfold between May and July as high-grade results were delineated at its Balama North project in Mozambique.

As usual when a commodity comes into favour, many new entrants' share prices rocket, only to fall just as fast when reality sets in about the development prospects.

Triton has done a lot to put itself on the map, after releasing a maiden JORC resource of 1.45 billion tonnes at 10.7 per cent total graphitic carbon six months from the start of drilling.

Si view: The Nicanda Hill maiden resource is part of Balama North, the world's largest graphite and vanadium deposit. Establishing a maiden resource triggered a significant share price rerating. Exploration prospects are promising.

8. Automotive Holdings Group

RETAILING

Australia's largest automotive retailer, Automotive Holdings Group, gave an update in October, a fairly busy month for the company. It heralded changes that are likely to alter the landscape in certain areas of its business.

This doesn't necessarily mean Automotive Holdings will be disadvantaged, but it appears competition will be heightened in its parts retail stores business. It had been reported the company was to divest its West Australian Covs Parts operation, and this was followed by discussions regarding a potential sale to the recently listed Burson Group.

Automotive Holdings decided it would not be in the best interests of shareholders to proceed with the sale. But that won't stop Burson from entering a market that it sees as significantly under-represented.

Automotive added five stores to its network since July, taking the total to 121. It wants 175 by 2019. Don't be surprised if some are in WA.

Si view: The automotive parts business isn't the only changing area in the industry. carsales.com highlights new car consumer traffic grows every month. It is the top destination for potential buyers.

9. Skilled Group

LABOUR HIRE

Skilled Group provided a generally upbeat overview of business conditions in the first quarter of 2014-15 at its annual general meeting in October. News about its engineering and marine division was positive, and there appears to be a slight improvement across the technical professionals business.

While the workforce services division is challenged by margin pressures, the broader outlook is encouraging, which was reflected in the September quarter financial performance.

Stronger activity in the engineering and marine services business, which will benefit in 2014-15 from full-year contributions from two acquisitions, supported solid first quarter revenue and earnings, which are up more than 10 per cent on the previous corresponding period.

Revenues from the Saipem project and new contract wins in its offshore marine services business should provide near to medium term earnings momentum.

Si view: Consensus forecasts before the update indicated earnings per share growth of about 5 per cent in 2014-15. If Skilled maintained its first quarter run rate, it could result in some share price support.

10. Metals X

DIVERSIFIED RESOURCES

A promising quarterly update by Metals X in late October appeared to go unnoticed. Not only did it feature robust gold and tin production, but it also underlined the company's strong financial position, with cash and working capital of $133.3 million as at September 30, 2014.

Management said it had established an annual dividend policy representing 30 per cent of net profit after tax.

Gold production of 42,293 ounces was up 10 per cent on the previous quarter and 20.8 per cent ahead of guidance of 35,000 ounces.

Cash operating costs of $815 per ounce were up slightly on the previous corresponding period, but below Bell Potter's estimates of $850 per ounce. Tin metal production of 1831 tonnes in concentrate was up by 9 per cent on the previous quarter, but lower prices saw earnings before interest, tax, depreciation and amortisation decline by 11 per cent to $4.3 million.

Si view: Bell Potter analysts were upbeat, maintaining their buy recommendation and 12-month price target of 30¢. This implies a price-earnings multiple of 10 relative to the broker's 2014-15 forecasts.

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