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**Sent:** Monday, 20 February 2017 11:39 AM  
**To:** Peter Stamoulis <PStamoulis@evansandpartners.com.au>  
**Subject:** CGL (Positive): Follow up & feedback

In follow up to our first take and the conference call, there were no additional surprises or anything to detract from our Positive view. Management are delivering well across existing contracts, maintaining cost control and building out a pipeline of new opportunities. Management don't expect new contract wins to be dilutive to margins in 2H which is better than we expected.

**The key driver that will underpin any multiple re-rating is strong organic growth in 2H** (EAP expect +50% rev gth on pcp in 2H) and the execution of new wins across its growing pipeline.

We believe the stock is attractively priced at about 13.5-14.0x FY18 PER, given the large % of recurring revenues, high customer retention and superior margin profile to other listed Technology managed service providers.

A few points to highlight from the call:

- i. **New contract wins are not expected to be dilutive to margins in 2H:**
  - a. Monash is on stream and delivering revenues and margins as expected – in line with the core Tech business.
  - b. The new Fed Govt. agency contract progressing well. Importantly, work had commenced prior to the announcement and there is not expected to be upfront costs that dilute earnings in the early stages.
- ii. Most of accrued revenue yet to be paid is relating to the Monash contract. Expect to recover and have most of the work paid for in 3Q.
- iii. Cash flow decline was due to an interim step up specifically for the two large scale projects announced – work has been delivered and not yet paid.
- iv. Selling the entire Knowledge Management product suite “as a service”. **Recently won a new contract across the HP Objective platform.**
- v. **New pipeline of \$20m in eHealth solutions emerged through 1H – these are new opportunities.**

Cheers  
Pete



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## IN SHORT

CGL reported 1H17 EBITDA growth (+23.6%) in line with our expectations and NPAT (+8.7%)/EPS (+8.1%) +2-3% ahead, but on lower than expected revenues (6.4%). Underlying EBITDA rose +23.6% to \$13.6m (EAP \$13.7m) with margins expanding to 30.8% (from 26.6% and \$11m) – margins clearly surprising again to the upside. Revenues rose +6.4% to \$44.1m (EAP \$50.5m) – this is materially below our forecasts (-12%) but appears to be a case of underestimating the profitability/higher margins with the recently acquired Kapish business. Given all FY17 contracts/revenues are locked in, this result should support accelerating 2H EBITDA growth (to >50-60%) but on lower revenues.

Understanding the revenue composition/expectations heading into 2H and any FY margin implications will be the key focus. As we previously highlighted, we acknowledge there's seasonality in CGL's Government revenues (skewed to 2H) and 1H17 growth was subdued as CGL cycle the one-off \$13m payment on the new Royal Adelaide Hospital.

No guidance was provided, but management highlighted that following the successful integration of Kapish, organic growth is picking up across new markets and pipeline of new business (including \$20m in eHealth) is promising. Operating cash flows were weaker on a step up in working capital requirements for new contracts (Monash/Fed Govt.) but is expected to revert with payments due in 3Q17.

## 3 KEY QUESTIONS

- What is the composition of revenue growth via acquisitions vs. organic growth across the business?
- How sustainable are margins heading into 2H? Will new contracts be dilutive to margins?
- What are expectations on new business opportunities and the pipeline across eHealth and Kapish – what success rate % do management apply to these new tenders?

## THE RESULT

- NPAT (continuing operations): \$6.7m, +8.7% on pcp. NPAT from discontinued operations - \$1.4m (as expected).
- EBITDA: \$13.6m, +23.6 on pcp (EAP \$13.7m).
- EPS (ex-discontinued): 10.7cps, +8.1% on pcp.
- Revenue: \$44.1m, +6.4% on pcp.
- DPS: 4.8cps fully franked – in line with pcp.

## CONFERENCE CALL DETAILS

1H FY17 results briefing will be taking place this morning at **10:30am**.

- Australian numbers:
  - Participant Toll: +61 2 9193 3719
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## EAP Recommendation: Positive



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