

ISG**229p****UK construction disappoints; strength elsewhere**

- ISG has issued a trading update which underlines the challenges facing the UK Construction business. Beyond the immediate hit to current year estimates; the key disappointment is that this comes at a time when Fit Out, Engineering Services and International continue to perform very well. The headline impact is material; a net £7m downgrade (UK Construction -£10m, elsewhere +£3m) to FY15E PBT and a further £16m relating to discontinued operations. However, the majority of the impact are provisions made against recovery of historic costs already incurred, which means the balance sheet effect is not as pronounced. Whilst clearly unwelcome, these charges should not impact on the core value drivers for the group. On our revised estimates, the shares are now trading on an FY15E PE of 15.7x and an FY16E PE of 6.8x.

- **UK Construction – continuing operations**

The £10m hit to the continuing UK Construction business principally relates to a large contract which was entered into in 2012. Since the project completed in June 2014, ISG has been in commercial negotiations regarding its entitlements. Given the protracted nature of these negotiations, ISG has now come to the view that it would be prudent to provision accordingly. Whilst disappointing, historic contracts (prior to 2012) have been a well-articulated issue for both ISG and the peer group for some time. ISG has re-affirmed the improving quality and commercial terms for newer contracts but this will clearly now take longer to come through and lift construction margins on a headline basis.

- **UK Construction – discontinued operations**

ISG has also taken the decision to discontinue its London Residential activities and has made a £6m provision relating to costs already incurred, the office closure and the completion of the outstanding business. A further £11m provision is also being made against outstanding contracts following the decision to close the Tonbridge office in 2014. Although disappointing in terms of the initial impact on reported numbers, these provisions are, in effect, worse case and ISG will continue to pursue cost recovery where appropriate.

- **Changes to estimates**

We downgrade UK Construction FY15E EBIT by £10m to a loss of £13m, although this is partly offset by a net £2.5m upgrade to our expectations for Fit Out, UK Retail and Asia. We have also reduced our central costs estimate by c.£0.5m. Our FY15E continuing, adjusted PBT / EPS therefore moves to £8.0m / 15.1p respectively (a 45% downgrade to adjusted PBT). Reflecting the impact of the discontinued items, our reported EPS estimate moves from 24.5p to a negative 35.4p. We now assume a flat dividend (9.45p) although we wait for further guidance from the company on this point. The company has guided towards a £38m net cash position for the year end (our prior estimate had been £47.7m).

Year to June	Revenue (£m)	Adj PBT (£m)	EPS (p)	DPS (p)	Net Cash (£m)	P/E (x)	Yield (%)
FY14a	1,482.9	11.5	23.1	9.5	46.3	14.6	2.8
FY15e	1,768.3	8.0	15.1	9.5	38.0	15.7	4.1
FY16e	1,799.3	18.2	35.0	10.4	42.3	6.8	4.5



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TIDM	ISG
Market cap (£m)	89.8
Net cash (FY1)	38.0
Free float (%)	100%
Avg daily volume (3m)	78k
Broker	Numis
Listing	AIM

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Financial Summary – Year ended 30 June

INCOME STATEMENT, £m	FY12A	FY13A	FY14A	FY15E	FY16E
UK Fit Out	202.1	287.5	519.5	710.2	717.3
UK Retail	322.8	267.3	283.2	317.1	323.5
Europe	101.3	91.6	102.8	92.5	97.2
Asia	81.0	73.5	79.4	110.0	115.5
Middle East	20.7	26.1	34.6	49.8	57.3
UK Construction	553.6	537.9	463.4	488.6	488.6
Revenue	1,281.5	1,283.9	1,482.9	1,768.3	1,799.3
Group EBIT	7.8	9.8	12.2	8.9	19.2
Exceptional items	(3.3)	(3.9)	(2.8)	(1.0)	(0.5)
Goodwill amortisation	(2.9)	(2.2)	(2.0)	(2.0)	(2.0)
Net interest	(0.3)	(0.7)	(0.7)	(0.9)	(1.0)
Reported PBT	1.2	3.0	6.8	5.0	15.7
Adjusted PBT	7.5	9.1	11.5	8.0	18.2
Tax	(0.2)	(0.2)	(1.6)	(1.1)	(3.6)
Minority interests	0.0	0.2	(0.0)	(0.3)	(0.3)
Average no shares - diluted (m)	31.5	32.2	38.2	38.7	39.2
EPS - Reported, basic (p)	3.2	7.9	6.2	(34.8)	30.1
EPS - Adjusted, basic (p)	18.1	22.1	23.1	15.1	35.0
DPS	9.0	9.0	9.5	9.5	10.4

CASH FLOW, £m	FY12A	FY13A	FY14A	FY15E	FY16E
EBITDA	10.3	11.9	14.9	12.3	22.1
Working capital	(5.2)	0.2	25.0	4.5	(6.0)
Other	(4.1)	(4.2)	(11.4)	(0.4)	0.1
Operating cash flow	1.0	7.9	28.4	16.4	16.2
Net interest paid	(0.1)	(0.3)	(0.2)	(0.3)	(0.3)
Net tax	(2.6)	0.5	(2.5)	(1.1)	(3.6)
Net capital expenditure	(2.7)	(1.8)	(4.4)	(2.2)	(2.6)
Net acquisitions / disposals	(0.8)	(0.2)	(2.8)	(0.2)	(2.0)
Other	-0.2	-0.4	-1.5	-16.8	0.0
Pre financing cash flow	(5.2)	5.8	16.9	(4.2)	7.6
Dividends	(4.8)	(2.8)	(3.4)	(3.7)	(3.8)
Net equity issued	(0.7)	7.4	(0.3)	0.0	0.0
Net movement in debt	(3.8)	1.7	(2.7)	(2.4)	(1.2)
Net change in cash	(14.5)	12.1	10.5	(10.3)	2.6

BALANCE SHEET, £m	FY12A	FY13A	FY14A	FY15E	FY16E
Goodwill	82.3	83.2	82.8	83.3	83.8
Intangible assets	7.0	5.0	3.8	3.8	3.8
P,P & E	6.4	5.6	7.2	6.0	5.8
Other	0.1	0.1	1.9	1.9	1.9
Fixed assets	95.8	93.9	95.7	95.0	95.3
Net working capital	(71.5)	(71.1)	(85.1)	(90.2)	(85.2)
Total capital employed	24.2	22.8	10.6	4.8	10.1
Net cash / (debt)	25.4	36.1	46.3	38.4	42.3
Net Assets	49.7	58.9	56.9	43.2	52.3

Source: Broker Profile

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