

Allied Technologies Limited (ATZ)

Price

Secure Data, Voice and Video Specialist Acquires TUSC

\$0.36

Company Overview

Allied Technologies Limited (Allied) was formed through a backdoor listing of the privately owned Allied Technologies Group (ATG) into ServicePoint Limited in April 2004. ATG was established in 1991 by Ray Doak (Allied's Managing Director) and has a 13-year track record of profitable growth with 17% compound organic growth over the past five years.

ATG specialises in the design, integration, installation and maintenance of communication networks, primarily for the delivery of data and voice traffic. With ServicePoint's specialty in secure video communication, the merged entity has a broad capability across secure voice, data and video based communications services.

Management has indicated that the merged Group will continue to actively pursue further complimentary merger and acquisition opportunities. The Company is targeting annual revenue of \$100 million by December 2005 underpinned by both organic and acquisitive growth. Allied has started to implement this growth strategy through the recently announced acquisition of TUSC.

Financial Performance

Allied recently announced that it had exceeded the FY04 prospectus profit forecast. In addition, the Company announced a fully franked dividend of 1.5 cps despite previous guidance that one would not be paid in FY04. The change of policy was a result of the better than expected financial performance.

The Company indicated that it has secured approximately 50% of its FY05 budgeted revenues and has in excess of \$18 million of business in hand (up from \$12 million at the same time in FY04). Lonsec is forecasting 17% organic growth in FY05 EBIT on a 13% increase in revenue.

Investment View

The Company is heavily reliant on business derived from the Department of Defence although this exposes Allied to periods of prolonged downturn or restricted budgetary spending. However, recent history and current government defence policy suggest that the medium term prospects are quite positive. While further acquisitions are likely to reduce this dependence, Lonsec believes that Allied's strategy of significantly increasing its revenue through acquisitions creates an integration risk.

At \$0.36, Allied is trading on 5.9 times forecast FY05 earnings pre goodwill. While the stock appears inexpensive, Lonsec believes this is a result of the Company's limited earnings transparency (due to the sensitive nature of the defence contracts) and its acquisition-based growth strategy. Lonsec believes that Allied must continue to meet its stated earnings targets while implementing its growth strategy before the stock is fully priced by the market.

Key Information

Code	ATZ
Market Capitalisation	\$18.8m
Number of Shares	52.3m
12 Month Range	\$0.20 - \$0.40
Ave Monthly Turnover	1.7m
Sector	IT Services

Earnings Summary

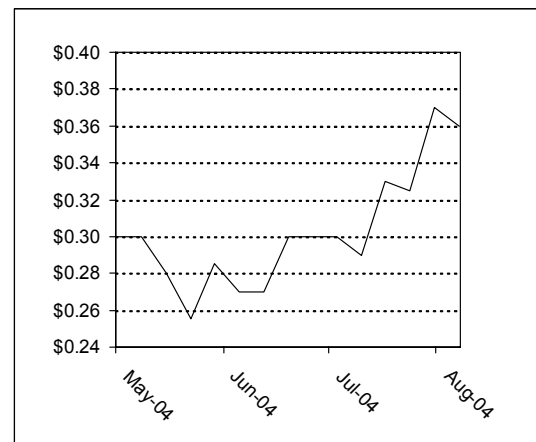
Year to June	2003A*	2004P**	2005F
Revenue (\$m)	22.7	31.0	50.0
EBIT (\$m)	0.4	2.1	4.3
NPAT (\$m)	0.3	1.4	3.2
EPS (c)	n/a	4.6	6.2
DPS (c)	n/a	1.5	2.0
PE (x)	n/a	7.9	5.9
Div Yield (%)	n/a	4.2	5.6
Franking (%)	n/a	100	100
EPS Growth (%)	n/a	n/a	35

Profit and EPS adjusted for goodwill

* Allied financials exclude ServicePoint

** Pro-forma financials for Allied and ServicePoint

Price Performance



Company Background

Allied Technologies Limited (Allied) was formed through a backdoor listing of the privately owned Allied Technologies Group (ATG) into ServicePoint Limited in April 2004. ATG was established in 1991 by Ray Doak (Allied's Managing Director) and has a 13-year track record of profitable growth with 17% compound organic growth over the past five years.

Formed via backdoor listing.

ATG specialises in the design, integration, installation and maintenance of communication networks, primarily for the delivery of data and voice traffic. With ServicePoint's specialty in secure video communication, the merged entity has a broad capability across secure voice, data and video based communication services.

Group specialises in secure voice, data and video services.

Allied is based in Canberra and has regional offices in Sydney, Newcastle, Brisbane and Townsville. The Company services niche communication markets including the Department of Defence, the Department of Foreign Affairs and Trade and other Federal, State and Local Government Departments. Over half of Allied's revenue is generated by Department of Defence related work. This reliance on the government sector has typically resulted in 60% of earnings being generated in the second half as annual budgets come to an end.

Heavily reliant on government sector.

Management has indicated that the merged Group will continue to actively pursue further complimentary merger and acquisition opportunities. The Company is targeting annual revenue of \$100 million by December 2005 underpinned by both organic and acquisitive growth. Allied has started to implement this growth strategy through the recently announced acquisition of TUSC.

Targeting annual revenue of \$100 million by December 2005.

Acquisition of TUSC

TUSC was established in 1981 and provides end-to-end software and service solutions in Infrastructure Management, specialising in critical and real time operations. The acquisition will increase Allied's exposure to the higher margin Infrastructure Management segment and increase the Group's level of recurring earnings.

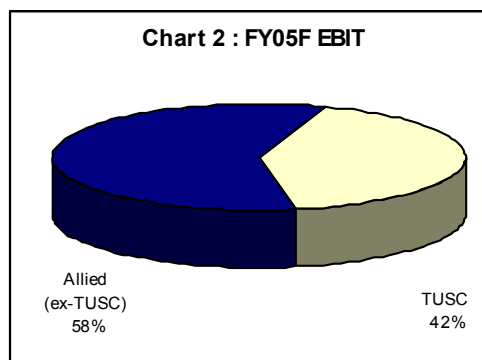
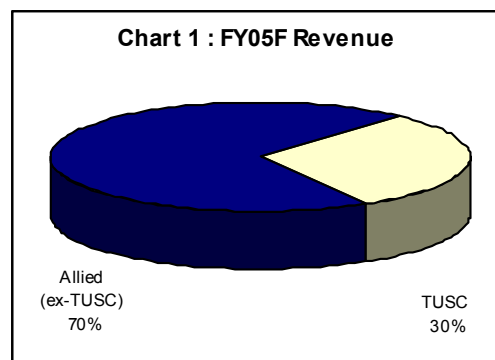
TUSC involved in Infrastructure Management.

TUSC's key customers include AGL, Telstra, United Energy and City West Water. The acquisition is expected to provide cross-selling opportunities with Allied's government client base and TUSC's established customer base in the telecommunication and utilities sectors. In addition, TUSC will provide Allied with immediate scale in Victoria.

Provides cross-selling opportunities and scale in Victoria.

The acquisition will be backdated to 1 July 2004 and is expected to be immediately EPS positive for Allied. TUSC is forecast to add \$15.0 million to FY05 revenue and \$1.8 million to FY05 EBIT. Its worth noting that TUSC is a higher margin business than Allied's existing operations as illustrated in Chart 1 and Chart 2.

TUSC is higher margin than Allied's existing operations.



Consideration for the acquisition will be \$2.0 million in cash and 6.0 million shares at \$0.30 per share (escrowed for 12 months). In addition, a deferred consideration of \$2.9 million will be paid provided TUSC achieves its forecast FY05 EBIT of \$1.8 million. Allied is raising \$5.0 million before costs to fund the cash component of the acquisition, increase its working capital and reduce debt. The capital raising is expected to be via a share placement of 15.6 million ordinary fully paid shares at \$0.32 per share.

Capital raising to fund acquisition and increase working capital.

Key Drivers

Offering Complete Specialised Package

The combined Group will deliver a broad range of highly secure voice, data, video and web based communication services and solutions. Allied has been successful in winning contracts within sensitive areas of secure government-to-government communications. This has been driven by its ability to call on a team of highly skilled technical experts with appropriate security clearances. Approximately a quarter of Allied's workforce is currently deployed across military bases with high-level security clearance. This provides a barrier to entry for competitors targeting sensitive government contracts and reduces the likelihood of margins being dramatically impacted by tendering.

Expertise in secure communications.

Experienced Management

Allied's management has a proven track record in providing communications solutions to government departments and other major clients. Ray Doak (Allied's Managing Director; Founder of ATG) has 15 years experience providing technology solutions to Government. Michael Addison (Allied's Chairman) has 20 years corporate finance experience. Following the acquisition of TUSC, Allied's management and Directors will retain a 45% shareholding in Allied, with Ray Doak holding 25%. Lonsec views this as a positive as the large shareholding should promote the alignment of management and shareholder interests and be a prime source of motivation to increase shareholder value.

Large management shareholding.

Key Issues

Aggressive Growth Strategy

Allied has outlined a relatively aggressive growth target to increase its annual turnover from the current level of \$50 million after completion of the TUSC acquisition to \$100 million by December 2005. This is expected to be achieved primarily via acquisition. In any acquisition, there exist risks in being able to successfully integrate businesses. This strategy is also likely to require additional staffing, management, operations and systems resources. In addition, expansion into new segments may introduce new risks and prove to be disruptive and divert management attention.

Risk in integrating acquisitions.

Reliance on key Clients

A significant proportion of Allied's earnings are currently derived from Department of Defence related work. While the Company is attempting to diversify its client base, Lonsec believes that the Department of Defence will continue to provide a significant amount of Group earnings in the medium term. As such, Lonsec expects Allied's financial performance to be influenced by the level of activity being undertaken by the Department of Defence. This exposes the Company to periods of prolonged downturn or restricted budgetary spending. However, recent history and current government defence policy suggest that the medium term prospects are quite positive.

Heavily reliant on Department of Defence.

Competition

Allied has many competitors in the networking market segment, including electrical contractors and other network integrators. In addition, Lonsec expects the significant number of current opportunities in the communication services market will result in an increase in competition from companies with greater capital and technological resources. Nevertheless, Lonsec notes that Allied's expertise in secure communications provides a strategic advantage over its competitors.

Increasing level of competition.

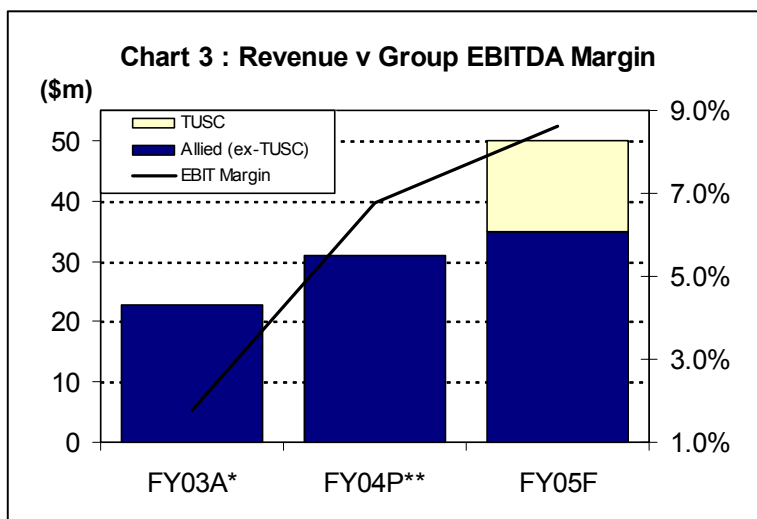
Financial Performance

Allied recently announced that it had exceeded the FY04 prospectus profit forecast. Lonsec has upgraded its forecast pro-forma FY04 EBIT from \$1.8 million to \$2.1 million on revenue of \$31.0 million. In addition, the Company announced a fully franked dividend of 1.5 cps despite previous guidance that one would not be paid in FY04. The change of policy was a result of the better than expected financial performance. Lonsec is forecasting a fully franked dividend of 2.0 cps for FY05 which assumes a payout ratio of 33% before goodwill.

Exceeded FY04 prospectus forecasts.

The Company indicated that it has secured approximately 50% of its FY05 budgeted revenues and has in excess of \$18 million of business in hand (up from \$12 million at the same time in FY04). Lonsec is forecasting 17% organic growth in FY05 EBIT on a 13% increase in revenue. Allied's increasing focus on the Infrastructure Management business is expected to increase margins as illustrated in Chart 3. It is worth noting that the forecasts provided for TUSC assume significant margin improvement in FY05.

Significant margin improvement assumed for TUSC in FY05.



* Allied financials exclude ServicePoint

** Pro-forma financials for Allied and ServicePoint

Investment Summary

Allied has exceeded its FY04 prospectus targets and announced a fully franked dividend of 1.5 cps despite previous indications that one would not be paid. While the FY04 result was impressive, Lonsec does not see a great deal of merit in paying a dividend while the Company is raising money for working capital. However, Allied has indicated that a DRP will be in effect and that the Company's management and Board (who hold a combined 45%) will fully participate. In addition, a dividend provides an efficient way for Allied to distribute some of its \$3 million franking credit balance.

Dividend paid despite capital raising.

The Company is heavily reliant on business derived from the Department of Defence although this exposes Allied to periods of prolonged downturn or restricted budgetary spending. However, recent history and current government defence policy suggest that the medium term prospects are quite positive. While further acquisitions are likely to reduce this dependence, Lonsec believes that Allied's strategy of significantly increasing its revenue through acquisitions creates an integration risk.

Integration risk from growth strategy.

At \$0.36, Allied is trading on 5.9 times forecast FY05 earnings pre goodwill. While the stock appears inexpensive, Lonsec believes this is a result of the Company's limited earnings transparency (due to the sensitive nature of the defence contracts) and its acquisition-based growth strategy. Lonsec believes that Allied must continue to meet its stated earnings targets while implementing its growth strategy before the stock is fully priced by the market.

Market requires further evidence of performance.

Allied Technologies Limited

Price : \$0.36

Year end June. All figures in A\$m

Profit & Loss Summary	2003A*	2004P**	2005F	Ratio Analysis	2003A*	2004P**	2005F
Revenue (\$m)				Allied (pre-TUSC)			
Allied (pre-TUSC)	22.7	31.0	35.0	Revenue Growth (%)	n/a	36.4%	12.9%
TUSC	9.6	13.5	15.0	EBIT Margin (%)	1.7%	6.9%	7.1%
Merged Entity from 1 Jul 2004	22.7	31.0	50.0	NPAT Margin (%)	1.2%	4.5%	5.5%
EBIT (\$m)				TUSC			
Allied (pre-TUSC)	0.4	2.1	2.5	Revenue Growth (%)	n/a	40.6%	11.0%
TUSC	0.9	1.4	1.8	EBIT Margin (%)	9.1%	10.4%	12.0%
Merged Entity from 1 Jul 2004	0.4	2.1	4.3	NPAT Margin (%)	n/a	n/a	8.7%
NPAT pre goodwill (\$m)				Merged Entity from 1 Jul 2004			
Allied (pre-TUSC)	0.3	1.4	1.9	Revenue Growth (%)	n/a	36.4%	61.2%
TUSC	n/a	n/a	1.3	EBIT Margin (%)	1.7%	6.9%	8.6%
Merged Entity from 1 Jul 2004	0.3	1.4	3.2	NPAT Margin (%)	1.2%	4.5%	6.4%
Balance Sheet Summary	2004P**			Per Share Analysis	2003A*	2004P**	2005F
Cash	2.9			EPS pre goodwill (c)	n/a	4.6	6.2
Debtors	7.8			EPS pre goodwill Growth (%)	n/a	n/a	34.9%
Other	2.4			Dividend (c)	n/a	1.5	2.0
Total Current Assets	13.1			Franking (%)	n/a	100%	100%
Fixed Assets	1.8			Payout Ratio (%)	n/a	33%	33%
Goodwill on acquisition	7.7			Multiple Analysis	2003A*	2004P**	2005F
Accumulated Depreciation	(0.7)			Market Cap (\$M)		18.8	
Other	0.7			Net Debt (\$M)		(1.0)	
Total Non-current Assets	9.3			Enterprise Value (\$M)		17.8	
Total Assets	22.4			EV/EBIT (x)	n/a	8.3	4.1
Borrowings	1.9			PE Ratio pre G/W (x)	n/a	7.9	5.9
Creditors	2.8			Dividend Yield (%)	n/a	4.2	5.6
Other	4.0						
Total Liab	8.6						
Shareholders Equity	13.8						

* Allied financials exclude ServicePoint

** Pro-forma financials for Allied and ServicePoint

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