Diploma Group Limited

Price	**$0.36**
ASX Code:	**DGX**
	23 September 2009

Founded in 1976, Diploma Group Limited ("Diploma") is an established commercial construction and property development business operating in WA and the U.A.E. Diploma is vertically integrated, managing projects from the design and development phase through to sale. Diploma's revenue has grown from $23.2m in 2006 to $142.8m in 2009 with an average EBIT margin of 6.1%. Diploma is currently strongly positioned with a record construction order book of $275m and a property development portfolio of $450-500m (100% basis).

Investment Highlights

- **CIP forecasts FY2010 EBIT of $18.1m and PE of 3.5x** as profits from Sky, Rise and Joondalup developments are expected to be **completed and settled in** this financial year and revenue is expected to increase by more than 100%.

- **Gross profit margin is 15-25% from its property development business** generated from Diploma's vertically integrated structure and a 5-10% margin earned on third party properties constructed by its construction business. CIP has assumed the lower end of the range in its earnings forecast.

- **Development inventory is booked at cost and Company debt solely relates to project financing** for the development division. Debt is drawn down and retired as and when projects commence and complete. Diploma's banks continue to fund pipeline projects.

- **Cash positive payment cycle** for the construction division and neutral payment cycle for the development division ensures that Diploma maintains adequate working capital.

- **FY2009 EBIT result of $3.2m** was $6m lower due to a delay in the completion of the Sky project now due to be completed October 2009 (98% sold). The expected $6m will now be booked in FY2010. FY2008 EBIT of $10.9m beat company IPO forecasts.

- **Experienced management in place.** The Di Latte family founded Diploma more than 30 years ago and their experience has led to Diploma's positioning today. They are supported by John Norup, who was instrumental in the construction of both commercial and residential projects worth over $1B, Carl Lancaster, Independent Director, who previously headed the Real Estate Finance division within Macquarie Bank Limited in WA, and Ian Olson, Independent Director, previously a Managing Partner of PKF and currently a Registered Company Auditor.

Industry	**Construction & Engineering**

Capital Structure	
Current Share Price	$0.36
Shares on Issue	120.0 m
Options (ex. @ $0.60, exp. various dates)	12.3 m
Undiluted Market Capitalisation	**$43.2 m**
Cash (as at 30 June 2009)	$5.9 m
Dividend Yield (2009)*	2.8%

*1 cent payable on 1 December 2009

Board

Mr Dominic Di Latte (Executive Chairman)

Mr Nick Di Latte (Managing Director)

Mr John Norup (Executive Director)

Mr Ian Olson (Independent Director)

Mr Carl Lancaster (Independent Director)

Mr Simon Oaten (CFO and Company Secretary)

Substantial Shareholders (18/08/2009)	
Wandina Holdings Pty Ltd	17 %
Mr Nick Di Latte	17 %
Mr John Norup	17 %
UP Investments Pty Ltd	17 %
Healthy Holdings Pty Ltd	17 %
	85 %

FY2010 Forecasted Results	
Revenue	$ 300 m
EBIT	$ 18.1 m
EPS	10.4 cents
PE	3.5 x

Share Price Chart (6 month)

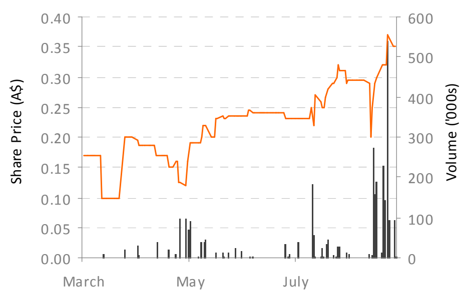


Figure 1 Revenue and EBIT Growth

SOURCE Company Data, CIP Forecast

Figure 2 Balance Sheet (as at 30 June 2009) with CIP Forecasted Half Year Pro Forma[2]

A$'000s	FY2009	Dec. 2009		FY2009	Dec. 2009
Cash[3]	5,864	21,288	Trade and other payables	56,062	78,762
Inventories (at cost)[1]	99,471	33,692	Project specific financing	108,289	33,510
Receivables	45,399	68,099	Other liabilities	3,544	8,697
Other current assets	178	178	**Total Current Liabilities**	**167,895**	**120,969**
Total Current Assets	**150,912**	**124,456**	Non-Current Liabilities	1,373	10,373
Non-current inventories (at cost)[1]	19,769	19,769	**Total Liabilities**	**169,268**	**131,341**
Other non-current assets	7,706	7,706	*Equity (Net Assets)*	*9,119*	*29,390*
Total Non-Current Assets	**27,475**	**27,475**	*Net Tangible Assets*	*7,163*	*17,434*
Total Assets	**178,387**	**150,731**	*NTA/Share*	*0.06*	*0.12*

NOTES 1) Inventories are the at cost carrying value of property development projects and are used for security for project specific financing; CIP estimates 82% of inventory has been pre-sold at a 15-25% gross margin. 2) Pro-forma balance sheet assumes close to 100% sales and settlement of both Sky and Rise by December 2009. 3)Includes payment of $1.2m dividend on 1 December 2009

SOURCE Company Data, CIP Forecast

Development Financing

In 2008 and 2009, Diploma's property development division grew with an associated increase in project specific debt. Total development debt is expected to peak at $110 million, but will be reduced by an estimated $70m once Sky, Rise and Joondalup Stage 1 are completed by year end. Diploma maintains a healthy cash balance due to the construction division payment cycle and has historically paid out most of its profits to shareholders resulting in a relatively low NTA position ($7.2 million as at 30 June 2009).

Development Portfolio

Current projects include a number of apartment complexes and, in the interest of de-risking future revenue and satisfying financing conditions, projects are 66-98% presold prior to commencement of production. Completion dates for the below projects range from the end of CY2009 (Joondalup, Sky and Rise) to FY2012. Projects are financed by project dependant debt guaranteed by the value of the underlying property, to the extent agreed to by the debt providers.

Table 1 End Values of Key Development Projects

Property Development Division	Expected Completion	% Presold	Interest (%)	Value ($ M)
Sky (Perth CBD)	October 2009	98	80	65
Rise (East Perth)	December 2009	75	80	66
Joondalup Village	Stage1:Dec 2009 Stage 2: FY2011	Stage 1: 66 Stage 2: Unreleased	100	85
Zenith (Perth CBD)	July 2010	75	50	80
Eleven78 (West Perth)	FY2012	81	50	82
Rockingham	FY2012	Unreleased	100	35
Mandurah Office	FY2012	Unreleased	33	25
Peninsular	FY2012	Unreleased	100	50
Total				488+

SOURCE Company Data

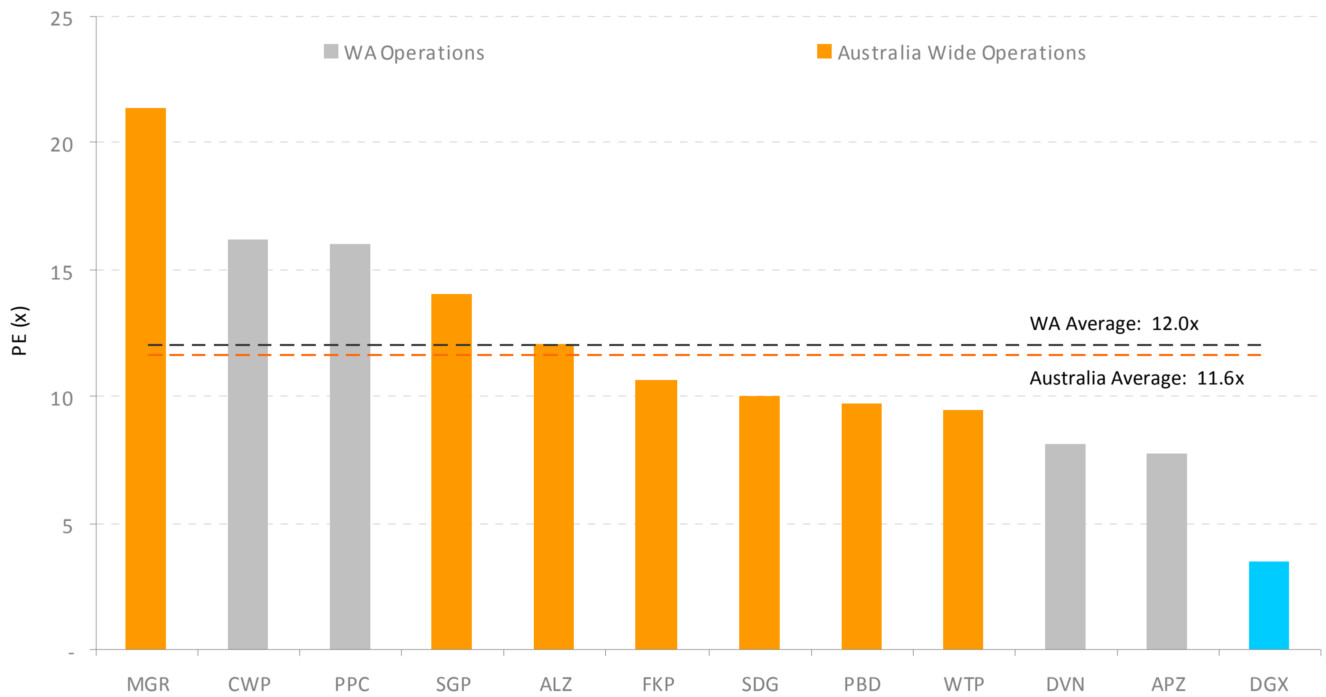
Table 2 Contract Values of Key Construction Projects

Construction Division - 2009/10 Order Book	Contract Value ($ M)
Hay St	56
Riverton Shopping Centre	22
Tully Road	11
Maymont Apartments	12
Garden Office Park	9
Total	110m

SOURCE Company Data

Industry Comparison

Figure 3 FY2010 PE Forecast

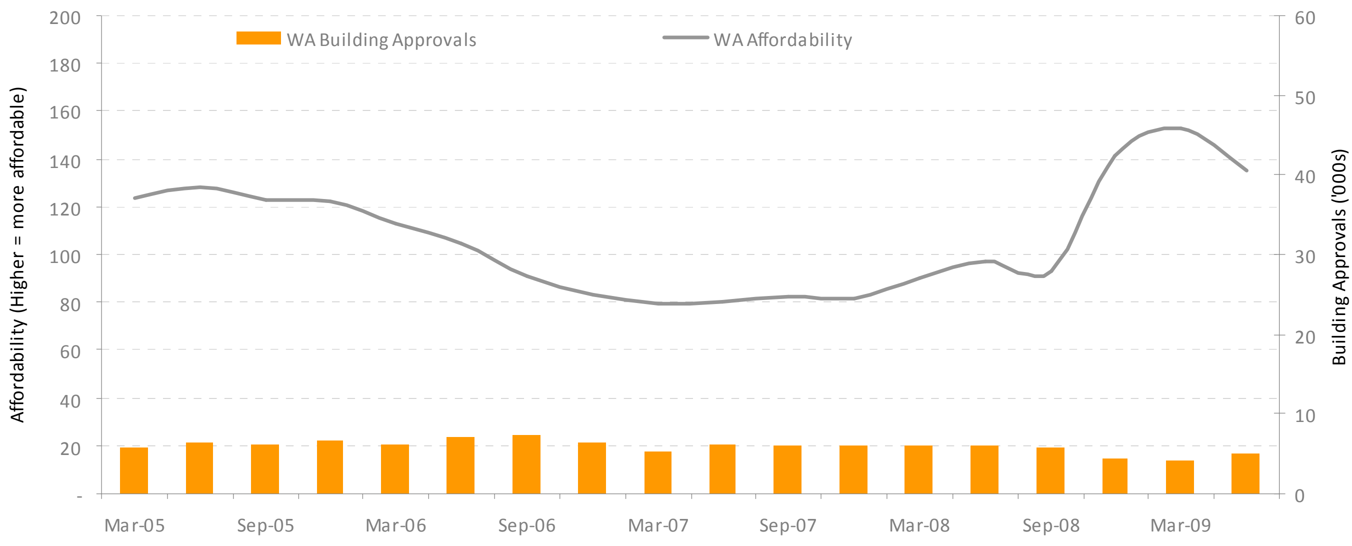


SOURCE Thomson Financial, Aegis, CIP Forecast

Diploma is trading at a heavily discounted forecast PE ratio of 3.5x relative to its industry peers.

Property Development Economic Prospects

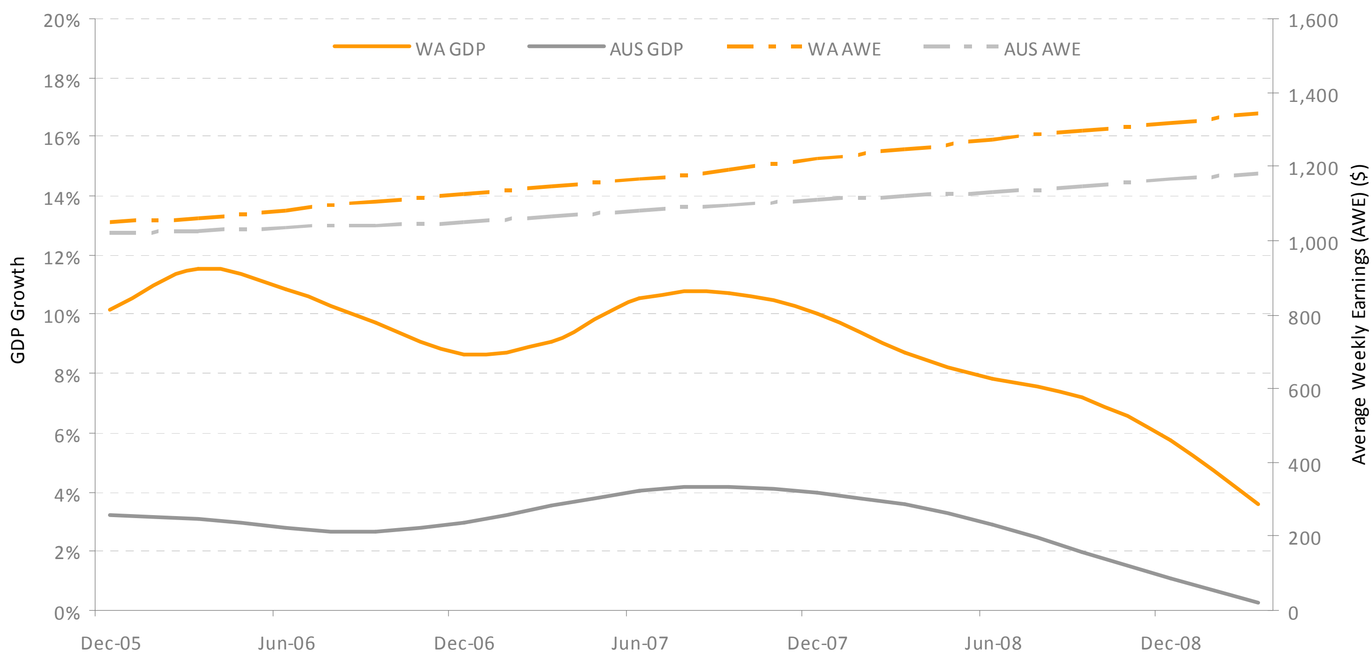
Figure 4 Affordability and Building Approvals



SOURCE ABS, HIA

Affordability has increased in Diploma's established markets, but building approvals have not adjusted to match the growth in potential demand. The increase in affordability and incomes (see below) and decrease in the cost of fuel and other necessary goods has led to an increase in disposable income for many West Australians.

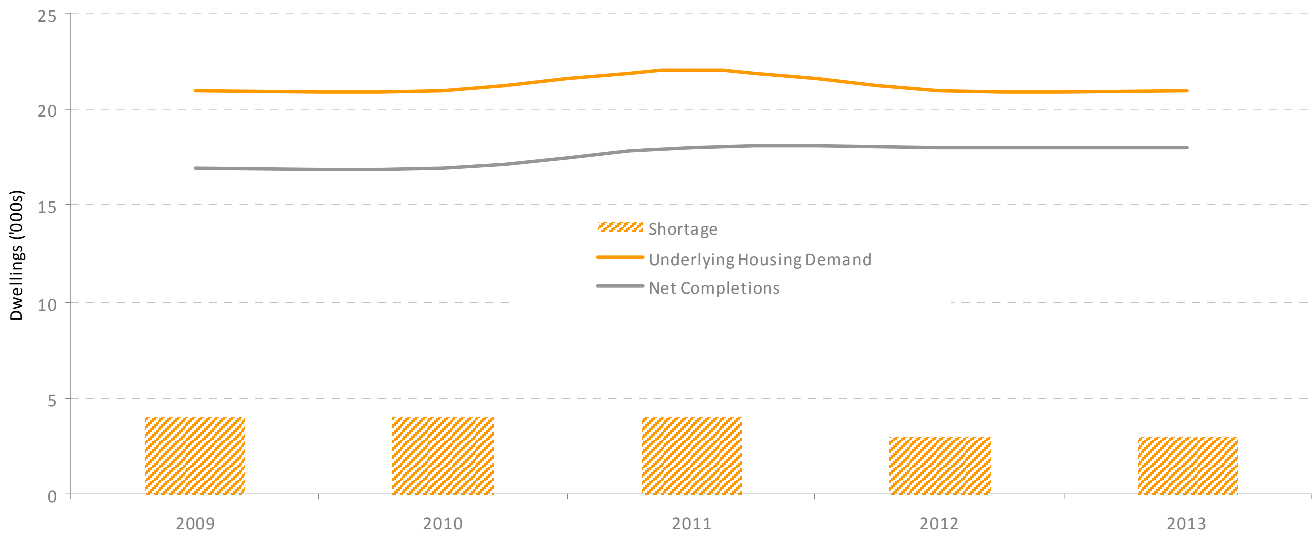
Figure 5 WA comparison of GDP and Earnings Growth



SOURCE ABS

WA has maintained higher GDP growth than the rest of Australia and accordingly, average weekly earnings (AWE) remain higher than the national average.

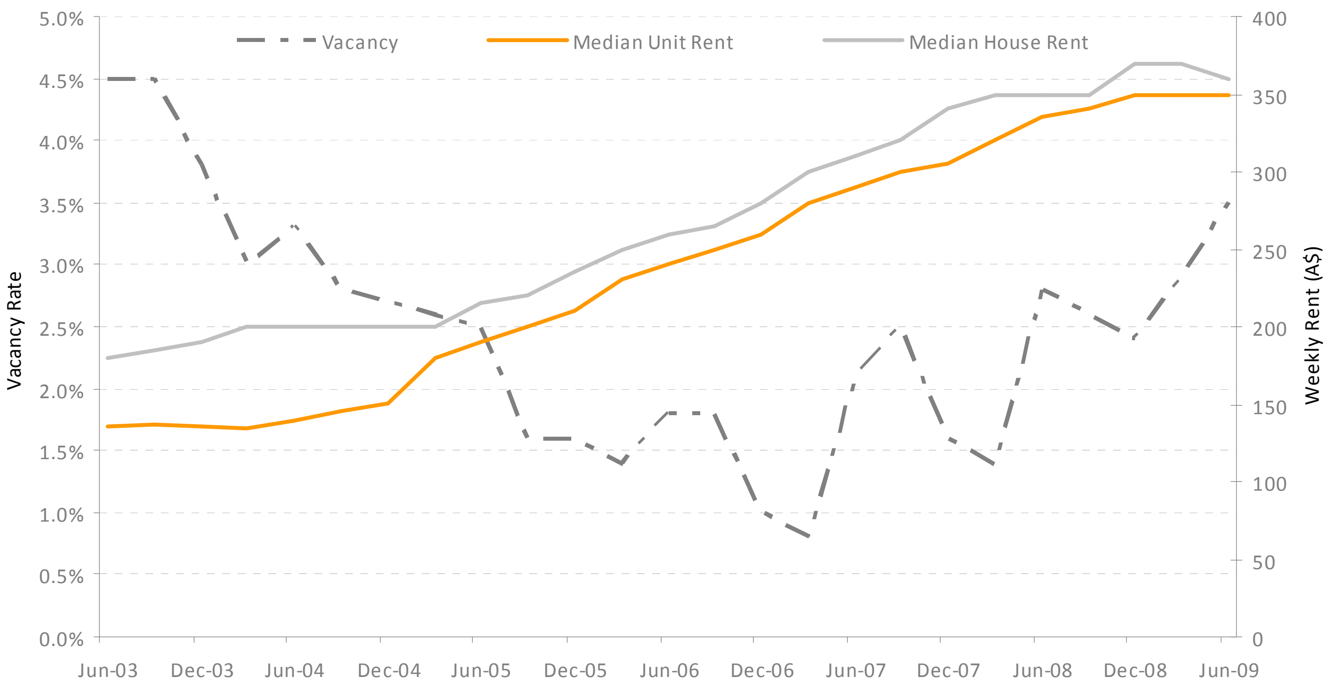
Figure 6 Housing Shortage to Remain in WA



SOURCE ABS, National Housing Supply Council

Going forward, we expect housing supply to continue to fall short of demand and Diploma is well positioned to capitalise on these market conditions.

Figure 7 Perth Rental Rates



SOURCE REIWA

Evidence of the lack of supply can be seen in rental rates that have remained at highs through the recent economic downturn.