



ARGONAUT
The Natural Choice in Resources

EQUITY RESEARCH

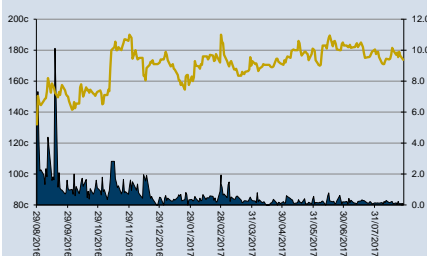
Financial Advisers | Stockbroking & Research | Special Situations Financing
www.argonaut.com PERTH +61 8 9224 6888 HONG KONG +852 3557 4888

BUY

Current Price **\$1.705**
Valuation **\$1.96**

| Ticker: | ASB.ASX | | |
|--------------------------|-------------------|-------|-------|
| Sector: | Ship Construction | | |
| Shares on Issue (m): | 349.5 | | |
| Market Cap (\$m): | 595.9 | | |
| Net Debt / (Cash) (\$m): | 45.9 | | |
| Enterprise Value (\$m): | 641.7 | | |
| 52 wk High/Low: | 1.90 | 1.32 | |
| 12m Av Daily Vol (m): | 0.98 | | |
| Key Metrics | | | |
| | 18F | 19F | |
| EV/EBITDA (x) | 6.8 | 5.9 | |
| EV/EBIT (x) | 10.6 | 8.6 | |
| P/E (x) | 16.1 | 12.8 | |
| Ratios | | | |
| | 17A | 18F | 19F |
| ND / Equity | 10.0% | 6.9% | 0.0% |
| EBIT Mgn | 4.5% | 4.4% | 4.9% |
| RoA | 7.3% | 7.4% | 8.9% |
| RoE | 7.2% | 7.9% | 9.5% |
| Financials*: | | | |
| | 17A | 18F | 19F |
| Revenue (\$m) | 1,309 | 1,382 | 1,518 |
| EBITDA (\$m) | 90.2 | 94.1 | 109.5 |
| EBIT (\$m) | 58.7 | 60.4 | 74.3 |
| NPAT (\$m) | 32.7 | 37.1 | 46.6 |
| Rep. EBIT (\$m) | 45.6 | 60.4 | 74.3 |
| Rep. NPAT (\$m) | 15.4 | 37.1 | 46.6 |
| <i>*Normalised</i> | | | |
| Net Assets (\$m) | 456.9 | 478.3 | 503.9 |
| Op CF (\$m) | -37.9 | 80.1 | 65.6 |
| Per Share Data: | | | |
| | 17A | 18F | 19F |
| Norm. EPS (cps) | 9.4 | 10.6 | 13.3 |
| DPS (cps) | 4.0 | 4.5 | 6.0 |
| Div Yield | 2.3% | 2.6% | 3.5% |
| NTAPS (cps) | 129.8 | 134.7 | 142.3 |
| CFPS (cps) | -10.9 | 22.9 | 18.8 |

Share Price Graph



Monday, 28 August 2017

Austal (ASB)

Growing confidence in US margin

Analysts | Ian Christie, CFA | Daniel Williamson

Quick Read

Solid performance from the US last financial year did two things. It underpinned \$58.7m group underlying EBIT in FY17 and gave ASB the confidence to upgrade margin guidance for US shipbuilding from 5-7% to 6-8%. US ships' revenue in FY17 was \$849m, so it implies a meaningful uplift. It offsets current weak earnings in Australia and the Philippines, where work transition has impacted revenue and profit recognition. There is cause for optimism for both these regions given significant recent intake of ferry contracts and upcoming potential naval work. We expect a marked earnings pick-up in FY19, a year which could see all three regions delivering in tandem. It helps lift our valuation to \$1.96 (prior \$1.80) and brings us to upgrade to buy (prior hold).

Event & Impact | Positive

US performance dominates: ASB followed 1H17's US shipbuilding EBIT of \$29.2m (at a 6.6% margin) with a \$28.4m EBIT result at a 7.0% margin in the 2H. ASB's modern Alabama yard continues to dominate group earnings, offsetting the weak FY17 EBIT contributions from Australia (a loss of \$2.1m) and the Philippines (a small profit of \$0.3m). The former result was largely expected given a transition from prior build programmes to new, although the poor performance on CCPB support necessitated a \$3.2m provision. US construction, systems and support made up nearly 90% of total segment revenue.

US margin guidance a key positive: When ASB reset the bar in mid-2016 by writing off significant WIP, the Company indicated 5-7% US ship construction margins. This has been a key uncertainty given the dominance of US revenue, so two subsequent halves with margins toward the upper end of the range is encouraging. Risk will be further reduced if the delivery of LCS14 and LCS16 in the near term confirms margin near these levels. In the meantime it is telling the Company was confident enough to upgrade margin guidance to 6-8%. We continue to expect decades of naval work for ASB in the US.

Opportunities growing elsewhere: ASB has recently been awarded PPB work (~\$305m) and a number of ferry contracts (two of which are ~\$100m each). This work is in early stages and any profits largely unrecognised to date (we have no issue with prudent profit recognition). Export contracts could be meaningful for both Australia and the Philippines in coming years. The \$3b OPV programme for the Australian Navy provides an excellent opportunity for ASB to secure Henderson's longer term future. An announcement on the successful bidder is expected this calendar year and we believe ASB is well positioned.

Recommendation

Our multiple valuation now takes into account both FY18 and FY19 earnings which, when blended with our DCF, sees our blended valuation rise to \$1.96 (prior \$1.80). With the potential for further positive newsflow in FY18 leading to a potentially more meaningful earnings uplift in FY19 we upgrade from hold to buy.

Austal

Equity Research

Ian Christie, CFA

| | |
|--------------------|------|
| Recommendation | BUY |
| Current Price (\$) | 1.71 |
| Valuation (\$) | 1.96 |

| | |
|------------------|----------------|
| Sector | Shipbuilding |
| Market Cap (\$m) | 595.9 |
| Date | 28 August 2017 |

| Trading Metrics | FY16A | FY17A | FY18F | FY19F |
|--------------------|-------|-------|-------|-------|
| EV / EBITDA (x) | 9.9 | 7.1 | 6.8 | 5.9 |
| EV / EBIT (x) | 18.3 | 10.9 | 10.6 | 8.6 |
| P/E (x) | 23.7 | 18.1 | 16.1 | 12.8 |
| Dividend Yield (%) | 2.3% | 2.3% | 2.6% | 3.5% |

| Per Share Data | FY16A | FY17A | FY18F | FY19F |
|----------------------|-------|-------|-------|-------|
| Reported EPS (cps) | -24.2 | 4.4 | 10.6 | 13.3 |
| Adjusted EPS (cps) | 7.2 | 9.4 | 10.6 | 13.3 |
| Div. per share (cps) | 4.0 | 4.0 | 4.5 | 6.0 |
| NTA per share (cps) | 128.9 | 129.8 | 134.7 | 142.3 |
| CF per share (cps) | 29.4 | -10.9 | 22.9 | 18.8 |

| Profit and Loss (\$m)* | FY16A | FY17A | FY18F | FY19F |
|------------------------|---------|---------|---------|---------|
| Revenue | 1,494.9 | 1,308.6 | 1,381.6 | 1,517.8 |
| EBITDA | 65.0 | 90.2 | 94.1 | 109.5 |
| D&A | (29.9) | (31.5) | (33.7) | (35.2) |
| EBIT | 35.1 | 58.7 | 60.4 | 74.3 |
| PBT | 29.6 | 52.9 | 54.5 | 68.6 |
| NPAT | 25.0 | 32.7 | 37.1 | 46.6 |
| Reported EBIT | (120.9) | 45.6 | 60.4 | 74.3 |
| Reported NPAT | (84.2) | 15.4 | 37.1 | 46.6 |

*Normalised, unless otherwise stated

| Cash Flow (\$m) | FY16A | FY17A | FY18F | FY19F |
|-------------------------|-----------|-----------|-----------|-----------|
| Receipts | 1,536.4 | 1,256.2 | 1,327.5 | 1,498.3 |
| Payments | (1,425.5) | (1,302.8) | (1,235.8) | (1,405.0) |
| Other | (8.8) | 8.7 | (11.6) | (27.6) |
| Cash from Operations | 102.1 | (37.9) | 80.1 | 65.6 |
| Property, Plant & Equip | (30.8) | (52.0) | (51.8) | (12.8) |
| Payment for Subsidiary | - | - | - | - |
| Other | 5.8 | (1.5) | - | - |
| Cash From Investing | (25.0) | (53.5) | (51.8) | (12.8) |
| Issue of Shares | - | - | - | - |
| Net Borrowing | 11.1 | 24.6 | - | - |
| Dividends / Other | (15.8) | (12.3) | (15.7) | (21.0) |
| Cash From Financing | (4.7) | 12.4 | (15.7) | (21.0) |
| Net Cash Flow | 72.4 | (79.0) | 12.6 | 31.9 |
| Ending Cash | 224.3 | 150.5 | 163.1 | 195.0 |

| Balance Sheet (\$m) | FY16A | FY17A | FY18F | FY19F |
|-------------------------|---------|-------|-------|---------|
| Cash | 224.3 | 150.5 | 163.1 | 195.0 |
| Receivables | 128.3 | 100.4 | 132.5 | 145.5 |
| Inventory | 109.0 | 170.4 | 144.8 | 158.2 |
| Other | 8.5 | 10.4 | 4.3 | 4.3 |
| Current Assets | 470.1 | 431.7 | 444.6 | 503.0 |
| Property, Plant & Equip | 490.8 | 500.3 | 525.7 | 509.8 |
| Intangibles | 9.3 | 8.9 | 7.7 | 6.5 |
| Other NC Assets | 42.9 | 19.1 | 13.5 | 13.5 |
| Non-Current Assets | 543.0 | 528.3 | 546.8 | 529.7 |
| Total Assets | 1,013.1 | 960.0 | 991.5 | 1,032.8 |
| Payables | 229.8 | 154.9 | 181.0 | 197.7 |
| Progress Claims / Dep | 12.8 | 15.6 | - | - |
| Borrowings | 172.6 | 196.4 | 195.9 | 194.8 |
| Provisions | 43.3 | 49.5 | 49.5 | 49.5 |
| Other | 97.0 | 86.8 | 86.8 | 86.8 |
| Total Liabilities | 555.6 | 503.1 | 513.2 | 528.8 |
| Net Assets | 457.6 | 456.9 | 478.3 | 503.9 |
| Ordinary Equity | 114.7 | 116.4 | 116.4 | 116.4 |
| Reserves | 100.7 | 91.6 | 91.6 | 91.6 |
| Retained Earnings | 242.1 | 248.9 | 270.3 | 295.9 |
| Total Equity | 457.6 | 456.9 | 478.3 | 503.9 |

| Valuation | Calcs. | \$m | \$ps |
|---|--------|-------|------|
| DCF Valuation: | | | |
| Discount Rate / WACC (%) | 11.50% | | |
| PV Free Cash Flow (\$m) | 683.3 | | |
| Less Net Debt / Plus Cash (\$m) | (45.9) | | |
| Unpaid Capital (\$m) / Notional CCPB Debt | 65.2 | | |
| Equity Value (\$m) | | 702.6 | 2.01 |
| Multiple Valuation: | | | |
| FY18/FY19 blend EV/EBIT multiple | 10.0 | 692.4 | 1.98 |
| FY18/FY19 blend P/E multiple | 15.0 | 646.2 | 1.85 |
| Valuation (\$ per share) - blended DCF and multiple valuations | | | 1.96 |

| Profit and Loss (\$m)* | 1H16A | 2H16A | 1H17A | 2H17A |
|------------------------|--------|---------|--------|--------|
| Revenue | 747.1 | 747.8 | 648.5 | 660.0 |
| EBITDA | 41.8 | 23.2 | 46.5 | 43.7 |
| D&A | (12.7) | (17.2) | (15.2) | (16.3) |
| EBIT | 29.0 | 6.1 | 31.2 | 27.4 |
| PBT | 26.8 | 2.9 | 28.2 | 24.7 |
| NPAT | 16.8 | 8.2 | 18.6 | 14.1 |
| Reported EBIT | 29.0 | (149.9) | 18.1 | 27.6 |
| Reported NPAT | 16.8 | (101.0) | 9.3 | 6.0 |

*Normalised, unless otherwise stated

| Cash Flow (\$m) | 1H16A | 2H16A | 1H17A | 2H17A |
|-------------------------|---------|---------|---------|---------|
| Receipts | 815.6 | 720.8 | 627.2 | 629.0 |
| Payments | (744.4) | (681.0) | (671.5) | (631.2) |
| Other | (19.4) | 10.5 | 0.5 | 8.2 |
| Cash from Operations | 51.8 | 50.3 | (43.8) | 6.0 |
| Property, Plant & Equip | (11.1) | (19.8) | (32.5) | (19.4) |
| Payment for Subsidiary | - | - | (0.3) | 0.3 |
| Other | 8.6 | (2.8) | 0.0 | (1.6) |
| Cash From Investing | (2.4) | (22.6) | (32.8) | (20.7) |
| Issue of Shares | - | - | - | - |
| Net Borrowing | (12.3) | 23.4 | 7.2 | 17.4 |
| Dividends / Other | (9.9) | (5.9) | (5.9) | (6.4) |
| Cash From Financing | (22.2) | 17.5 | 1.3 | 11.0 |
| Net Cash Flow | 27.2 | 45.2 | (75.3) | (3.8) |
| Ending Cash | 181.5 | 224.3 | 153.5 | 150.5 |

| Financial Ratios | FY16A | FY17A | FY18F | FY19F |
|-----------------------------|--------|--------|-------|-------|
| Growth | | | | |
| Revenue growth (%) | -5.3% | -2.3% | 5.6% | 9.9% |
| NPAT growth (%) | -44.5% | 30.8% | 13.4% | 25.7% |
| Norm. EPS growth (%) | -45.0% | 30.7% | 12.9% | 25.7% |
| Profitability Ratios | | | | |
| EBITDA Margin (%) | 4.9% | 6.9% | 6.8% | 7.2% |
| EBIT Margin (%) | 2.4% | 4.5% | 4.4% | 4.9% |
| PBT Margin (%) | 2.0% | 4.0% | 3.9% | 4.5% |
| NPAT Margin (%) | 1.7% | 2.5% | 2.7% | 3.1% |
| Return on Assets (%) | 4.1% | 7.3% | 7.4% | 8.9% |
| Return on Equity (%) | 5.2% | 7.2% | 7.9% | 9.5% |
| ROIC (%) | 3.9% | 6.7% | 6.4% | 8.0% |
| Balance Sheet Ratios | | | | |
| Net Debt (ND) | (51.7) | 45.9 | 32.8 | (0.2) |
| Net Debt (ND) / Equity (%) | -11.3% | 10.0% | 6.9% | 0.0% |
| ND / ND + Equity (%) | -12.7% | 9.1% | 6.4% | 0.0% |
| Current Ratio (x) | 1.5 | 1.8 | 1.8 | 1.9 |
| Net Interest Cover (x) | -22.0 | 8.0 | 10.4 | 13.1 |
| Cash Flow Ratios | | | | |
| Free Cash Flow Yield (%) | 9.8% | -15.3% | 4.8% | 8.9% |
| Cash Conversion (x) | 1.6 | (0.4) | 0.9 | 0.6 |

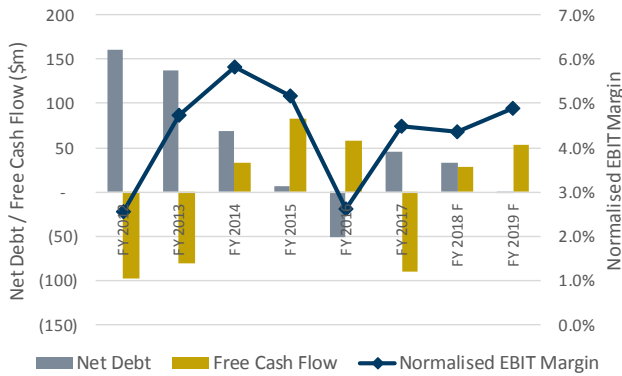


Austal

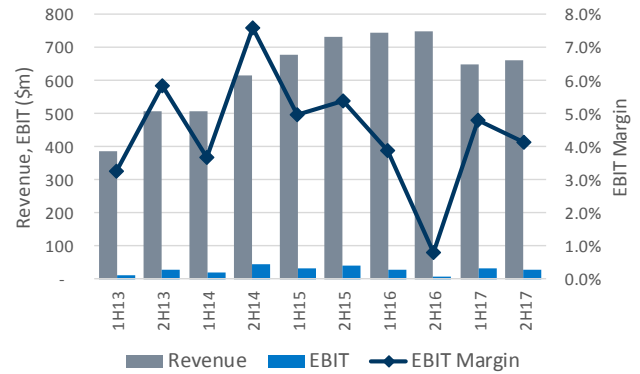
Key Charts

Equities Research

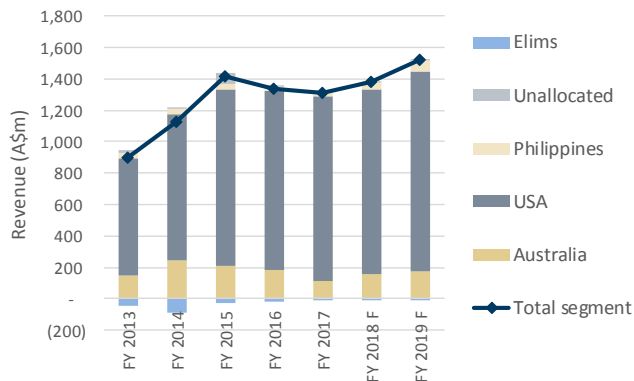
Key metrics



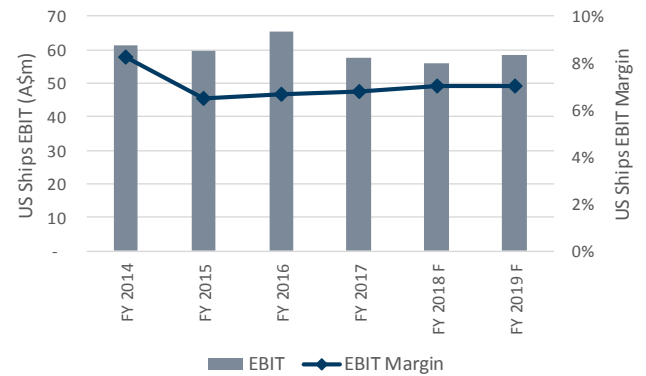
Half yearly performance - underlying



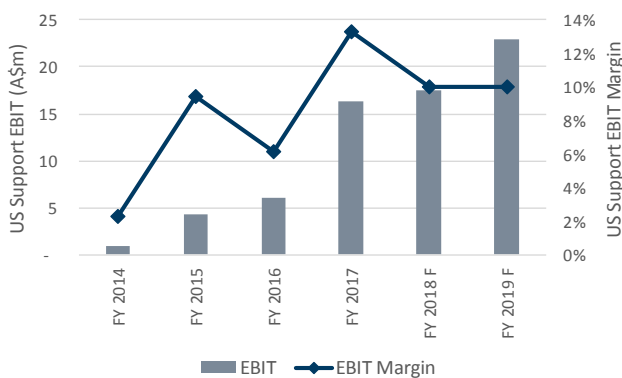
Revenue Reported - group



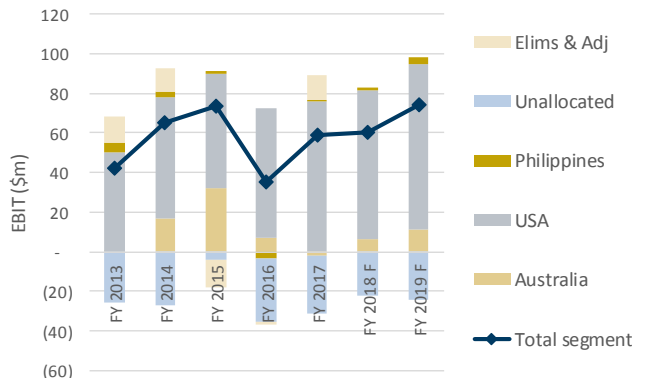
US Ships Construction Earnings



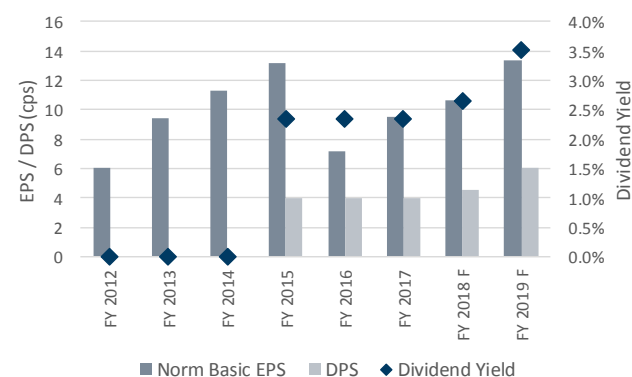
US Support Earnings



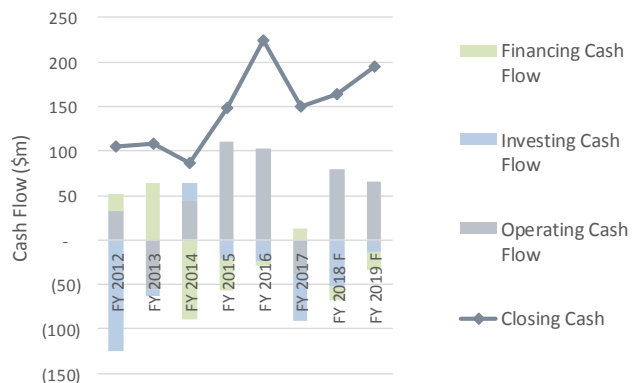
Segment EBIT



Dividends



Cash Flow



Adjustments to forecasts

Figure 1: Adjustments to forecasts

| Normalised | FY15 | FY16 | FY17 | FY18F | | | FY19F | | |
|-----------------|--------|--------|--------|-------|-------|--------|-------|-------|--------|
| | Actual | Actual | Actual | Old | New | Change | Old | New | Change |
| Revenue (\$m) | 1,414 | 1,495 | 1,309 | 1,383 | 1,382 | 0% | 1,559 | 1,518 | -3% |
| EBIT (\$m) | 73.2 | 35.1 | 58.7 | 60.0 | 60.4 | 1% | 74.5 | 74.3 | 0% |
| EBIT margin | 5.2% | 2.4% | 4.5% | 4.3% | 4.4% | 1% | 4.8% | 4.9% | 2% |
| PBT (\$m) | 69.1 | 29.6 | 52.9 | 54.3 | 54.5 | 0% | 68.9 | 68.6 | 0% |
| PBT margin | 4.9% | 2.0% | 4.0% | 3.9% | 3.9% | 0% | 4.4% | 4.5% | 2% |
| NPAT (\$m) | 45.0 | 25.0 | 32.7 | 36.9 | 37.1 | 0% | 46.9 | 46.6 | 0% |
| NPAT margin | 3.2% | 1.7% | 2.5% | 2.7% | 2.7% | 0% | 3.0% | 3.1% | 2% |
| Rep. EBIT (\$m) | 84.8 | -120.9 | 45.6 | 60.0 | 60.4 | 1% | 74.5 | 74.3 | 0% |
| Rep. NPAT (\$m) | 53.2 | -84.3 | 15.4 | 36.9 | 37.1 | 0% | 46.9 | 46.6 | 0% |
| EPS (cps) | 13.1 | 7.2 | 9.4 | 10.6 | 10.6 | 0% | 13.4 | 13.3 | -1% |

Source: Argonaut forecasts

RESEARCH:

Ian Christie | Director, Industrial Research
+61 8 9224 6872 ichtie@argonaut.com

Matthew Keane | Director, Metals & Mining Research
+61 8 9224 6869 mkeane@argonaut.com

James Wilson | Analyst, Metals & Mining Research
+61 8 9224 6835 jwilson@argonaut.com

Helen Lau | Analyst, Metals & Mining Research
+852 3557 4804 hlau@argonaut.com

Daniel Williamson | Analyst, Industrial Research
+61 8 9224 6831 dwilliamson@argonaut.com

INSTITUTIONAL SALES - PERTH:

Chris Wippl | Executive Director, Head of Sales & Research
+61 8 9224 6875 cwippl@argonaut.com

John Santul | Consultant, Sales & Research
+61 8 9224 6859 jsantul@argonaut.com

Damian Rooney | Director, Institutional Sales
+61 8 9224 6862 drooney@argonaut.com

Ben Willoughby | Institutional Dealer
+61 8 9224 6876 bwilloughby@argonaut.com

Phil Russo | Institutional Dealer
+61 8 9224 6813 prusso@argonaut.com

Josh Welch | Institutional Dealer
+61 8 9224 6868 jwelch@argonaut.com

George Ogilvie | Institutional Dealer
+61 8 9224 6871 golgovie@argonaut.com

INSTITUTIONAL SALES – HONG KONG:

Travis Smithson | Managing Director - Asia
+852 9832 0852 tsmithson@argonaut.com

CORPORATE AND PRIVATE CLIENT SALES:

Glen Colgan | Executive Director, Desk Manager
+61 8 9224 6874 gcolgan@argonaut.com

Kevin Johnson | Executive Director, Corporate Stockbroking
+61 8 9224 6880 kjohnson@argonaut.com

James McGlew | Executive Director, Corporate Stockbroking
+61 8 9224 6866 jmclew@argonaut.com

Ian Dorrington | Director, Corporate Stockbroking
+61 8 9224 6865 idorrington@argonaut.com

Geoff Barnesby-Johnson | Senior Dealer, Corporate Stockbroking
+61 8 9224 6854 bj@argonaut.com

Rob Healy | Dealer, Private Clients
+61 8 9224 6873, rhealy@argonaut.com

Cameron Prunster | Dealer, Private Clients
+61 8 9224 6853 cprunster@argonaut.com

James Massey | Dealer, Private Clients
+61 8 9224 6849 jmassey@argonaut.com

Chris Hill | Dealer, Private Clients
+61 8 9224 6830, chill@argonaut.com

Information Disclosure

Each research analyst of this material certifies that the views expressed in this research material accurately reflect the analyst's personal views about the subject securities and listed corporations. None of the listed corporations reviewed or any third party has provided or agreed to provide any compensation or other benefits in connection with this material to any of the analyst(s).

General Disclosure and Disclaimer

This research has been prepared by Argonaut Securities Pty Limited (ABN 72 108 330 650) ("ASPL") or by Argonaut Securities (Asia) Limited ("ASAL") for the use of the clients of ASPL, ASAL and other related bodies corporate (the "Argonaut Group") and must not be copied, either in whole or in part, or distributed to any other person. If you are not the intended recipient you must not use or disclose the information in this report in any way. ASPL is a holder of an Australian Financial Services License No. 274099 and is a Market Participant of the Australian Stock Exchange Limited. ASAL has a licence (AXO 052) to Deal and Advise in Securities and Advise on Corporate Finance in Hong Kong with its activities regulated by the Securities and Futures Ordinance ("SFO") administered by the Securities and Futures Commission ("SFC") of Hong Kong.

Nothing in this report should be construed as personal financial product advice for the purposes of Section 766B of the Corporations Act 2001 (Cth). This report does not consider any of your objectives, financial situation or needs. The report may contain general financial product advice and you should therefore consider the appropriateness of the advice having regard to your situation. We recommend you obtain financial, legal and taxation advice before making any financial investment decision.

This research is based on information obtained from sources believed to be reliable and ASPL and ASAL have made every effort to ensure the information in this report is accurate, but we do not make any representation or warranty that it is accurate, reliable, complete or up to date. The Argonaut Group accepts no obligation to correct or update the information or the opinions in it. Opinions expressed are subject to change without notice and accurately reflect the analyst(s)' personal views at the time of writing. No member of the Argonaut Group or its respective employees, agents or consultants accepts any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this research and/or further communication in relation to this research.

Nothing in this research shall be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from engaging in any transaction. The Argonaut Group and/or its associates, including ASPL, ASAL, officers or employees may have interests in the financial products or a relationship with the issuer of the financial products referred to in this report by acting in various roles including as investment banker, underwriter or dealer, holder of principal positions, broker, director or adviser. Further, they may buy or sell those securities as principal or agent, and as such may effect transactions which are not consistent with the recommendations (if any) in this research. The Argonaut Group and/or its associates, including ASPL and ASAL, may receive fees, brokerage or commissions for acting in those capacities and the reader should assume that this is the case.

There are risks involved in securities trading. The price of securities can and does fluctuate, and an individual security may even become valueless. International investors are reminded of the additional risks inherent in international investments, such as currency fluctuations and international stock market or economic conditions, which may adversely affect the value of the investment.

The analyst(s) principally responsible for the preparation of this research may receive compensation based on ASPL's and / or ASAL's overall revenues.

Hong Kong Distribution Disclosure

This material is being distributed in Hong Kong by Argonaut Securities (Asia) Limited which is licensed (AXO 052) and regulated by the Hong Kong Securities and Futures Commission. Further information on any of the securities mentioned in this material may be obtained on request, and for this purpose, persons in the Hong Kong office should be contacted at Argonaut Securities (Asia) Limited of Unit 701, 7/F, Henley Building, 5 Queen's Road Central, Hong Kong, telephone (852) 3557 48000.

Copyright

© 2017. All rights reserved. No part of this document may be reproduced or distributed in any manner without the written permission of Argonaut Securities Pty Limited and / or Argonaut Securities (Asia) Limited. Argonaut Securities Pty Limited and Argonaut Securities (Asia) Limited specifically prohibits the re-distribution of this document, via the internet or otherwise, and accepts no liability whatsoever for the actions of third parties in this respect.