WA Industrials: Marine Design & Construction

AUSTAL LIMITED (ASB)

ASB.asx
Neutral

6 Jul 2018

Share Price:	$1.87
Valuation:	$1.98
12mth price target:	$1.98

Brief Business Description:
Commercial and naval marine design and construction.

Hartleys Brief Investment Conclusion
Austal (ASB) generates the majority of its earnings from US naval contracts. Additional earnings are derived from commercial vessel construction and marine services

Chairman & CEO:
John Rothwell AO
David Singleton

Top Shareholders:

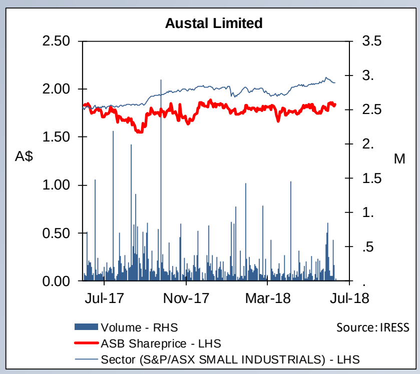
Allan Gray Australia Pty Ltd	18.6%
Renaissance Smaller Companies	5.0%
United Super Pty Ltd	5.0%

Company Address:
100 Clarence Beach Road
Henderson WA

Issued Capital:	349.4m
- fully diluted	359.9m
Market Cap:	$653.4m
- fully diluted	$653.4m
Net Debt (FY 18e)	-$10.6m

		FY16a	FY17a	FY18e
Op Cash Flw		102.1	-37.9	89.5
Free Cash Flw		77.1	-91.4	70.4
NPAT* (A$m)	**-**	**71.7**	**32.7**	**47.9**
EPS ($, bas)	-	20.5	9.3	13.7
P/E (basic)		-9.1x	20.0x	13.7x
P/E (diluted)		-9.4x	20.6x	14.1x
EV / EBITDA		-8.2x	7.1x	6.5x
DPS (cps)		4.0	4.0	4.0
Dividend Yield		2.1%	2.1%	2.1%
N.D. / equity		-11%	10%	-2%

Source: Hartleys Research. * normalised



Australian Future Frigates and US LCS

We have made two adjustments (one positive and one negative) to our Austal Limited (‘ASB’ or ‘Company’) model and valuation post some recent industry news. After the award of the Australian Navy’s Frigate contract to BAE we have downgraded our expectation of the percentage of work likely to come ASB’s way. On a more positive note we now believe the US Navy will order at least 6 more LCS vessels over the next two years, we expect ASB to secure four of them.

BAE awarded the Australian Future Frigate contract

BAE Systems offered an export variant of its Type 26. The Royal Navy has ordered eight of these vessels with the first vessel set to enter service in the early 2020s. The 9 BAE Hunter Class frigates will be built by ASC Shipbuilding at the Osborne Naval Shipyard in South Australia. BAE Systems expects the Australian industry content for the Hunter Class build will be 65-70 per cent. This $35 billion program is expected to create 4,000 jobs throughout Australia. Interestingly, ASC Shipbuilding, currently wholly owned by the Commonwealth, will become a subsidiary of BAE Systems. The Commonwealth government will retain a sovereign share in ASC Shipbuilding while BAE manages the program. At the end of the program the Commonwealth will resume complete ownership of ASC Shipbuilding. What this development means for ASB in terms of work share (we had assumed 25%) remains to be seen (ASB and ASC signed a teaming agreement to build the frigates). ASC now becoming a subsidiary of BAE may however suggest less work for third parties generally. It will likely take some time for the Frigate work programme to be allocated, but to be conservative we have downgraded our expectation of ASB’s share of the work to 10%.

Six more LCS vessels likely to be awarded

Recent industry and press reports in the US, post Congress passing its version of the 2019 Department of Defense Appropriations Act (which called for three new LCS contracts in the 2019 funding cycle), look positive for ASB. We now expect ASB to be awarded two further LCS contracts in this calendar year and two more in the second half of 2019. We have included these in our forecasts. Beyond 2019 we expect the LCS programme to be replaced by the FFG(X) programme. FFG(X) stands for fast frigate, guided, experimental and will effectively replace the Littoral Combat Ship shipbuilding program. Austal USA is one of the five finalists along with Lockheed Martin, General Dynamics Bath Iron Works, Fincantieri Marine and Huntington Ingalls Industries.

Maintain Neutral Recommendation

We have downgraded the % workshare from the Australian Future Frigate programme in our Group NPV but have partially filled this void with the expected award of four additional LCS vessels. The net result was an 24c reduction in our NPV10 (Net Present Value discounted at 10%) to $1.74per share (AUD/USD of US$76c per A$1). ASB is unique in that there are no other Naval contractors listed on the ASX. Based on the average multiple of the S&P/ASX 300 Industrials (ex-BIP and Tech) and our NPV10 we derive a 12-month forward target price of $1.98 per share (from $2.06).

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SUMMARY MODEL

Austal Limited (ASB)

Recommendation: Neutral

Company Information		
Date	6 Jul 2018	100 Clarence Beach Road
Share Price	$1.87	Henderson WA
52 Week High-Low	$1.97 - $1.495	Australia, 6166
Market Cap ($m)	$653.4	D: +61 8 6414 4010
Enterprise Value ($m)	$641.4	www.austal.com
Ordinary Shares	349.4	
Fully Diluted Shares	359.9	

Valuation	S&P/ASX Industrial: FY19 Multiple	ASX Comps	Target Multiple	Wgt.%	Tgt Price
EV/EBIT	9.3x	12.3x	10.8x	10%	2.12
EV/EBITDA	6.2x	8.0x	7.0x	25%	2.06
Earnings	14.8x	18.7x	16.5x	30%	2.14
Div Yield	2.7%	3.1%	2.7%	0%	1.83
NPV				35%	1.74
Valuation					**$1.98**
upside from current					*6%*
P / E (6/18F) at price target					14.9x
P / E (6/19F) at price target					*15.6x*
EV / EBITDA (6/18F) at price target					*7.4x*
EV / EBIT (6/18F) at price target					*11.6x*
Dividend Yield (6/18F) at price target					2.0%

Multiples (S/price at $1.87)	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
P / E (reported, basic weighted)	15.7x	12.2x	-7.7x	42.4x	13.7x	14.4x
P / E (normalised, dil. weighted)	15.5x	14.4x	-9.1x	20.0x	13.7x	14.4x
P / E (mkt cap / norm. NPAT)	15.7x	14.5x	-9.1x	20.0x	13.6x	14.3x
P / E (fully diluted mkt cap / norm. NF	16.2x	15.0x	-9.4x	20.6x	14.1x	14.8x
Dividend Yield	0.0%	2.1%	0.0x	2.1%	2.1%	2.7%
Group Free Cash Flow (f.c.f) / EV	8.5%	12.8%	0.1x	-14.0%	11.0%	4.3%
Equity f.c.f. / Mkt Cap	-5.4%	7.8%	0.1x	-10.0%	9.2%	2.7%
Norm f.c.f. / Mkt cap	-5.4%	7.8%	0.1x	-10.0%	9.2%	2.7%
Mkt cap / operating cash flow	15.7x	5.9x	6.4x	-17.2x	7.3x	9.8x
EV/EBITDA multiple	7.2x	6.6x	-8.2x	7.1x	6.5x	6.2x
EV/EBIT multiple	9.8x	8.8x	-5.9x	10.9x	10.2x	9.3x
Price / Book Value	1.6x	1.3x	1.5x	1.5x	1.4x	1.3x
Price / NTA	1.6x	1.3x	1.6x	1.5x	1.4x	1.3x
Price / FCF	11.9x	7.9x	10.7x	-7.3x	9.3x	23.8x

Ratios	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
Return period end Equity	7.4%	10.4%	-18.4%	3.4%	9.8%	8.7%
ROA	4.5%	4.5%	-6.9%	3.3%	4.9%	4.6%
ND / ND + Equity	15.8%	3.1%	-12.7%	9.1%	-2.2%	-4.8%
ND / Equity	18.7%	3.2%	-11.3%	10.0%	-2.2%	-4.6%
Net Interest Cover (EBIT)	7.8	17.8	-19.7	10.4	9.3	11.6
ROIC	6.4%	6.3%	-12.8%	5.0%	7.6%	7.0%

Free Cash Flow Analysis ($m)	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
Net Operating Cash Flow	41.6	110.4	102.1	-37.9	89.5	67.0
Capex (Reported)	12.7	-28.1	-40.9	-52.0	-19.1	-39.4
Group Free Cash Flow (rep'ted)	54.4	82.3	61.2	-89.9	70.4	27.6
Fixed Debt Repayments	-89.3	-31.1	11.1	24.6	-10.0	-10.0
Equity Free Cash Flow (rep'ted)	**-35.0**	**51.2**	**72.2**	**-65.2**	**60.4**	**17.6**
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow (normalised)	-35.0	51.2	72.2	-65.2	60.4	17.6
Capex (inc HP) / depreciation	-54%	116%	137%	165%	53%	114%

Share Data	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
Ord Issued shares (m)	346.5	346.9	349.4	349.5	350.5	351.5
growth	0.1%	0.2%	0.8%	0.7%	0.3%	0.6%
Weighted ave shares (m)	267.4	346.5	348.0	348.2	349.9	350.5
growth	0.8%	30.7%	30.1%	0.5%	0.6%	0.7%
Diluted shares wgted (m)	346.2	346.9	349.4	349.5	350.5	351.5
growth	87.8%	0.2%	0.9%	0.7%	0.3%	0.6%

Options & Rights

Year Expires	Number	% ord
28-Sep-17	1,925,000	0.5%
20-Oct-18	1,715,000	0.5%
Various	709,018	0.2%
5-Oct-18	1,418,036	0.4%
Perf. Rights	4,775,438	1.3%
TOTAL	**10,542,492**	**2.9%**

Directors & Senior Management	
John Rothwell AO	Non-Executive Chairman
David Singleton	Managing Director
Giles Everist	Independent Director
Jim McDowell	Independent Director

Substantial Shareholders	%
Allan Gray Australia Pty Ltd	18.6%

Profit & Loss ($m)	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
Australia - Divisional						
Revenue	153.9	211.8	187.0	113.7	191.7	251.5
EBIT	16.7	31.8	6.7	-2.1	2.9	4.2
EBIT Margin	10.8%	15.0%	3.6%	-1.8%	1.5%	1.7%
USA - Divisional						
Revenue	933.6	1119.7	1133.1	1172.1	1077.2	1159.4
EBIT	61.7	58.4	-90.6	78.5	73.5	79.9
EBIT Margin	6.6%	5.2%	-8.0%	6.7%	6.8%	6.9%
Philippines - Divisional						
Revenue	32.8	38.7	33.9	33.8	52.4	65.5
EBIT	2.7	1.0	-3.7	0.3	-1.3	-1.6
EBIT Margin	8.3%	2.6%	-10.9%	0.9%	-2.5%	-2.5%
Total Revenue	**1,122.8**	**1,414.9**	**1,340.0**	**1,308.6**	**1,308.0**	**1,463.2**
growth	*24.9%*	*26.0%*	-5.3%	*-2.3%*	*0.0%*	11.9%
Segment EBITDA	101.6	112.4	-60.8	106.3	108.7	115.0
Overhead	-12.5	-14.9	-17.6	-16.1	-10.4	-11.1
- % of sales	-1.1%	-1.1%	-1.3%	-1.2%	-0.8%	-0.8%
EBITDA	**89.1**	**97.5**	**-78.5**	**90.2**	**98.3**	**103.8**
margin	**7.9%**	**6.9%**	**-5.9%**	**6.9%**	**7.5%**	**7.1%**
Depreciation/Amortisation	-23.8	-24.3	-29.9	-31.5	-35.7	-34.5
EBIT	65.3	73.2	-108.4	58.7	62.6	69.3
EBIT / Sales	5.8%	5.2%	-8.1%	4.5%	4.8%	4.7%
Net Interest	-8.4	-4.1	-5.5	-5.7	-6.7	-6.0
Profit Before Tax	**56.9**	**69.1**	**-113.9**	**53.0**	**55.9**	**63.3**
- margin	**5.1%**	**4.9%**	**-8.5%**	**4.0%**	**4.3%**	**4.3%**
Normalised Tax	-15.3	-24.1	42.2	-20.3	-8.0	-17.7
Effective Tax Rate	26.9%	34.9%	37.0%	38.3%	14.3%	28.0%
NPAT Pre Minorities	41.6	45.0	-71.7	32.7	47.9	45.6
Minorities	0.0	0.0	0.0	0.0	1.0	2.0
Normalised NPAT to equity	**41.6**	**45.0**	**-71.7**	**32.7**	**47.9**	**45.6**
Normalised tax rate	-27%	-35%	-37%	-38%	-27%	-28%
Norm. Net Profit / Sales	**3.7%**	**3.2%**	**-5.3%**	**2.5%**	**3.7%**	**3.1%**
Abnormals / discontinued	-9.8	8.2	-12.6	-17.3	0.0	0.0
Reported Profit to equity	31.9	53.2	-84.3	15.4	47.9	45.6
Reported EPS (basic, w'ghted)	11.9	15.3	-24.2	4.4	13.7	13.0
Normalised EPS (dil, wghtd)	12.0	13.0	-20.5	9.3	13.7	13.0
Normalised EPS (full. diluted)	11.6	12.5	-19.9	9.1	13.3	12.7
EPS (full dil) Growth %	***16.5%***	***8.1%***	***-259.3%***	***-145.5%***	***46.7%***	***-4.8%***
DPS (cps)	**0.0**	**4.0**	**4.0**	**4.0**	**4.0**	**5.0**
Payout Ratio	0.0%	26.1%	-16.5%	90.7%	29.2%	38.4%

Cashflow Statement ($m)	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
EBITDA	89.1	97.5	-78.5	90.2	98.3	103.8
Working Capital Change	6.5	19.8	213.0	-108.4	5.9	-13.1
Net interest Paid	-4.1	-6.6	-5.7	-6.7	-6.0	-5.4
Tax Paid	-15.9	-18.5	42.2	-20.3	-8.0	-17.7
Other	-29.6	15.8	-68.1	6.2	0.0	0.0
Net Operating Cash Flow	**41.6**	**110.4**	**102.1**	**-37.9**	**89.5**	**67.0**
Capital Expenditure	12.7	-28.1	-40.9	-52.0	-19.1	-39.4
Asset Sales	0.0	6.3	0.0	0.0	1.0	2.0
Other (inc Investments)	6.2	0.0	15.9	-1.5	0.0	0.0
Net Investing Cash Flow	**19.0**	**-21.8**	**-25.0**	**-53.5**	**-19.1**	**-39.4**
Proceeds from Equity Issues	0.0	0.0	0.0	0.0	0.0	0.0
Net Change in Debt & Leases	-89.3	-31.1	11.1	24.6	-10.0	-10.0
Dividends Paid	0.0	-3.5	-15.8	-12.3	-14.0	-14.0
Net Financing Cash Flow	**-89.3**	**-34.6**	**-4.7**	**12.4**	**-24.0**	**-24.0**
Movement in Cash	-28.7	54.0	72.4	-79.0	46.4	3.5
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0	0.0

Balance Sheet ($m)	6/14A	6/15A	6/16A	6/17A	6/18F	6/19F
Cash	74.4	138.4	224.3	150.5	196.9	200.5
Receivables	95.8	104.3	128.3	100.4	93.2	104.2
Inventories	328.1	339.7	109.0	170.4	169.4	190.3
Other	19.2	16.5	8.5	10.4	10.4	10.4
Total Current Assets	**517.5**	**598.9**	**470.1**	**431.7**	**469.8**	**505.4**
Property, Plant & Equipment	366.5	442.5	490.8	500.3	483.7	488.5
Intangibles	9.0	9.0	35.0	5.6	5.6	5.6
Other	18.2	20.4	17.3	22.4	22.4	22.4
Total Non Current Assets	**393.8**	**471.9**	**543.0**	**528.3**	**511.6**	**516.5**
Total Assets	**911.3**	**1,070.9**	**1,013.1**	**960.0**	**981.5**	**1,021.9**
Accounts Payable	183.6	223.5	229.8	154.9	152.5	171.3
Interest Bearing Liabilities	13.2	146.9	2.5	9.9	9.9	9.9
Other	79.3	92.1	74.4	74.1	74.1	74.1
Total Current Liabilities	**276.0**	**462.5**	**306.8**	**238.9**	**236.5**	**255.3**
Interest Bearing Liabilities	142.3	7.7	170.1	186.5	176.5	166.5
Deferred Tax Liability	49.9	63.7	72.0	62.9	62.9	62.9
Other	9.9	24.6	6.8	14.8	14.8	14.8
Total Non Current Liabilities	**202.0**	**96.0**	**248.8**	**264.2**	**254.2**	**244.2**
Total Liabilities	**478.1**	**558.5**	**555.6**	**503.1**	**490.6**	**499.5**
Net Assets	**433.2**	**512.4**	**457.6**	**456.9**	**490.8**	**522.4**
Net Asset Value / Share ($)	1.20	1.42	1.27	1.27	1.36	1.45
NTA / Share ($)	1.18	1.40	1.17	1.25	1.35	1.44
Net Debt (net cash)	81.0	16.1	-51.7	45.9	-10.6	-24.1

Analyst: Aiden Bradley
Phone: +61 8 9268 2876

Last Earnings Estimate Changes:
06-July-2018

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

We have made two adjustments (one positive and one negative) to our ASB model and valuation post some recent industry news. After the award of the Australian Navy's Frigate contract to BAE we have downgraded our expectation of the percentage of work likely to come ASB's way. On a more positive note we now believe the US Navy will order at least 6 more LCS vessels over the next two years, we expect ASB to secure four of them.

BAE have been awarded the $35bn SEA 5000 Future Frigate contract

https://www.defenceconnect.com.au/maritime-antisub/2498-here-comes-the-hunter-bae-awarded-35b-sea-5000-future-frigate-contract

The nine BAE Hunter Class frigates will be built by ASC Shipbuilding at the Osborne Naval Shipyard in South Australia. BAE Systems expects the Australian industry content for the Hunter Class build will be 65-70 per cent. This $35 billion program is expected to create 4,000 jobs throughout Australia.

BAE Systems offered an export variant of its Type 26. The Royal Navy has ordered eight of these vessels with the first vessel set to enter service in the early 2020s.

Fig. 1: The Winning Design - BAE Systems Type 26

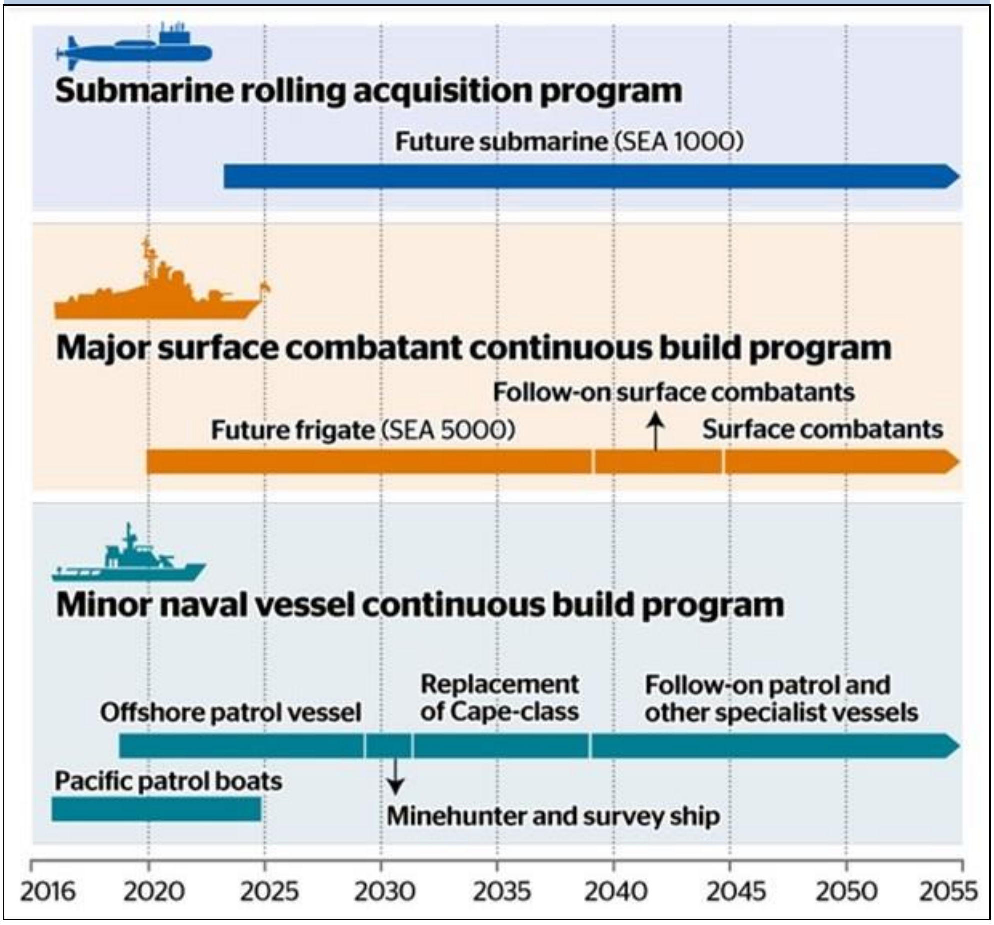
Source: BAE Systems

Interestingly, ASC Shipbuilding, currently wholly owned by the Commonwealth, will become a subsidiary of BAE Systems. The Commonwealth government will retain a sovereign share in ASC Shipbuilding while BAE manages the program. At the end of the program the Commonwealth will resume complete ownership of ASC Shipbuilding.

What this development means for ASB in terms of work share (we had assumed 25%) remains to be seen (ASB and ASC signed a teaming agreement to build the frigates). ASC now becoming a subsidiary of BAE may however suggest less work for third parties generally. It will likely take some time for the Frigate work programme to be allocated, but to be conservative we have downgraded our expectation of ASB's share of the work to 10%.

The SEA 5000 Future Frigates Program is worth around $35 billion (circa $15bn on construction of nine frigates and $20bn on ongoing sustainment).

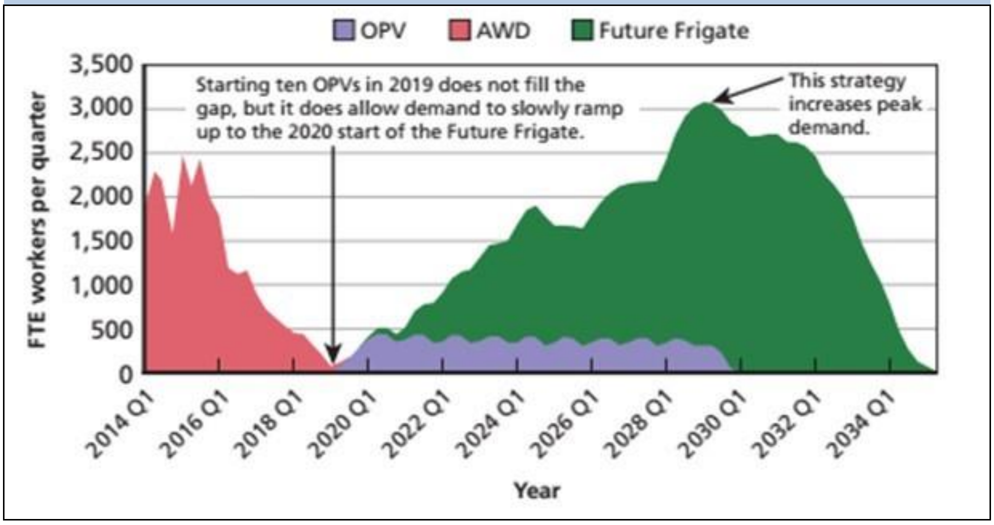
Fig. 2: Australian Navy $89bn investment programme



Source: Australian Defence Magazine. Indicative Dates for Commencement of Construction.

The Future Frigates, will be built in South Australia and will replace the Anzac fleet. Steel cutting is expected to begin in 2020. To maintain capacity in South Australia in the meantime the first two vessels of the $3bn OPV programme will be built in South Australia commencing in 2018 and the other 10 moving to Western Australia in 2020.

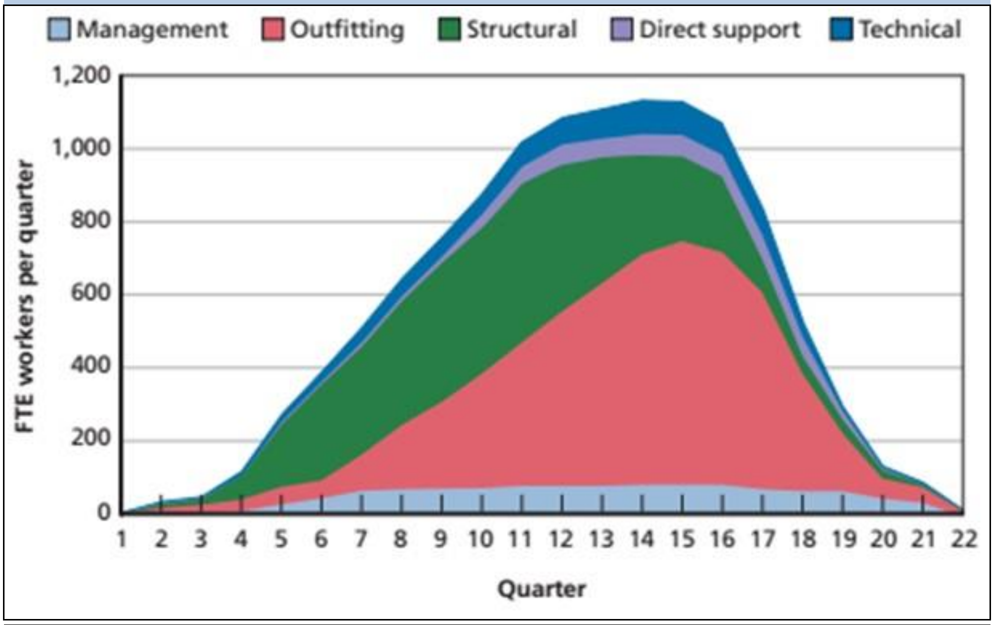
Fig. 3: Aggregate workforce profile for Building Offshore Patrol Vessels and Future Frigates Starting in 2019, One-Year Drumbeat



Source: RAND. This chart assumes both the OPV's and Frigates will be built at Osborne, SA. In fact, the latter 10 of 12 OPV's will now be built in WA. The figure assumes that the OPV's require 700,000 man-hours to produce.

Each Frigate is expected to take 22 Quarters to complete.

Fig. 4: Workforce Profile for First Follow-On Future Frigate (Full Capability Path)



Source: RAND

Looks likely another 6 LCS vessels will be ordered

Recent industry and press reports in the US, post Congress passing its version of the 2019 Department of Defense Appropriations Act (which called for three new LCS contracts in the 2019 funding cycle), look positive for ASB. (It should be noted that on June 18 the Senate passed a 2019 NDAA authorizing just one. A conference committee has been formed to reconcile these two different views).

https://www.al.com/news/index.ssf/2018/06/house_approves_3_more_littoral.html

Similar differences existed in 2017 (when three vessels were awarded, two to ASB) and again in 2018 when a bill signed by President Trump called for three.

The 2017 approvals were awarded between June and October 2018, with LCS-28 awarded to ASB in June and LCS-30 in October (LCS-27 was awarded to Lockheed Martin).

We now expect ASB to be awarded two further LCS contracts in this calendar year and two more in the second half of 2019. We have included these in our forecasts.

The net impact of both these changes to our valuation has been a modest downgrade of 8c per share in our target price to A$1.98 per share. We retain our Neutral rating.

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

Austal's achievements in establishing itself as a primary supplier to both the Australian Navy (and especially) and US Navy is quite simply a tremendous achievement.

However, it has not been without its teething problems and the volatility in the share price over the past five years reflects that (a low of 52c in late 2012 to a high of $2.43ps in late 2015).

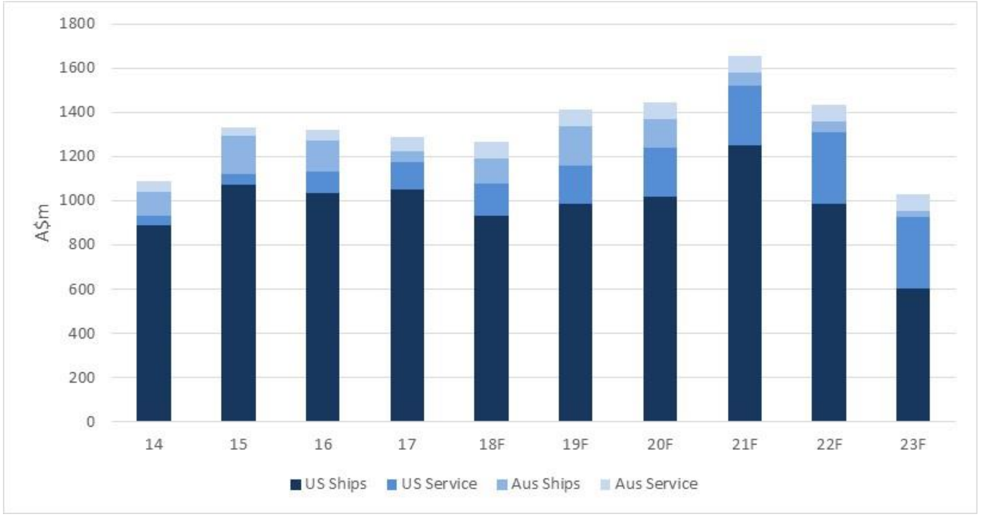
Having not been awarded the Australian OPV contract (see our research 'OPV work goes to Civmec vs. Commercial expansion' (15th May 2018)) we are now waiting to formally hear what impact the award of the Australia Futures Frigate contract to BAE will have on ASB's business.

Given these recent contract announcements in Australia, the US Navy's LCS/Frigate contracts have become even more important for the future of ASB. We now expect as outlined above the Company to be awarded a further four LCS contracts. Beyond 2019 we expect the LCS programme to be replaced by the FFG(X) programme. FFG(X) stands for fast frigate, guided, experimental and will effectively replace the Littoral Combat Ship shipbuilding program. Austal USA is one of the five finalists along with Lockheed Martin, General Dynamics Bath Iron Works, Fincantieri Marine and Huntington Ingalls Industries. The five finalists have all been awarded US$15 million each to hone their designs. The Navy will pick a winner in 2020 and order at least 20 ships. The ships are expected to cost approximately US$950 million each. This is therefore a crucial project for ASB to be part off, especially post the outcome of the two Australian Naval tenders.

In the near term the outlook for revenue and earnings is underpinned by continued strength in the commercial market and existing US Navy orders. Longer term, as outlined above the two Frigate contracts (US Navy LCS/frigate extension and the RAN's Future Frigate programme) are key to determining the level of workload in the US and Australia respectively. At the moment, we assume 50% is awarded to ASB from the former and now 10% (down from 25%) from the latter.

ASB to maintain utilisation of their existing three yards at close to capacity has to continue to secure additional contracts in the next 12-18 months as highlighted in the chart below.

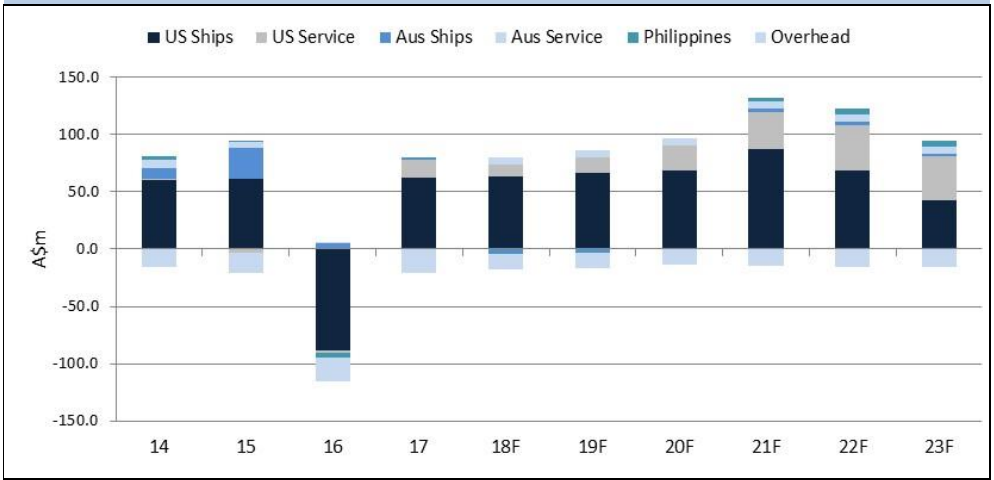
Fig. 5: Revenue Outlook – Existing Backlog



Source: Hartleys Research

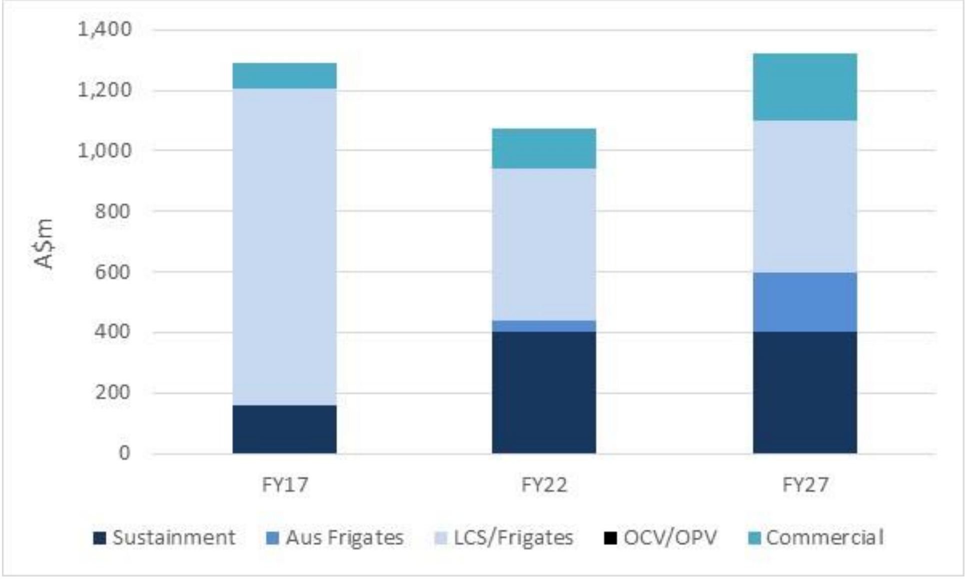
Sustainment revenue going forward will provide a significant high margin source of income both in the US and Australia and would naturally increase further as more Naval vessels are built. This is a significant change for ASB versus the past and will assist in smoothing out earnings going forward.

Fig. 6: EBIT Outlook – Existing Backlog



Source: Hartleys Research

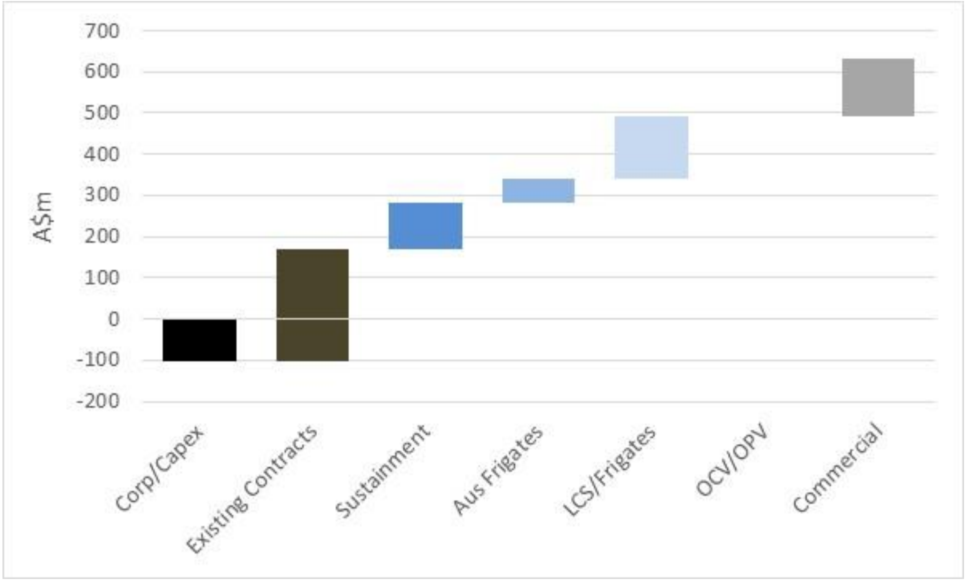
Fig. 7: Long Run Revenue



Source: Hartleys Research

We have downgraded the % of workshare from the Australian Future Frigate programme in our Group NPV but have partially filled this void with the expected award of four additional LCS vessels in the US. The net result was a 24c reduction in our NPV10 (Net Present Value discounted at 10%) to $1.74per share (on the basis of a long run AUD/USD exchange rate of US$76c per A$1).

Fig. 8: NPV10 – Base Case



Source: Hartleys Research

Again, the downside for the stock price if it does not win a significant portion of the Future Frigate and LCS/Frigate contracts would obviously be material. However, not as significant as suggested by simply removing these from our NPV10 analysis. We would expect a significant portion of the freed-up capacity to be filled over time with commercial contracts (where the market is improving) and we would expect the US Navy to also keep the Mobile yard at a reasonable level of capacity through further sustainment work and perhaps an extension to the successful Expeditionary Fast Transport programme (beyond the current 12 vessels).

ASB is unique in that there are no other Naval contractors listed on the ASX. So, we have selected the S&P/ASX 300 Industrials (ex-BIP and Tech) as the most relevant benchmark for investors. Based on the average multiple for this sector and our NPV10 we derive a 12-month forward target price of $1.98 per share (from $2.06).

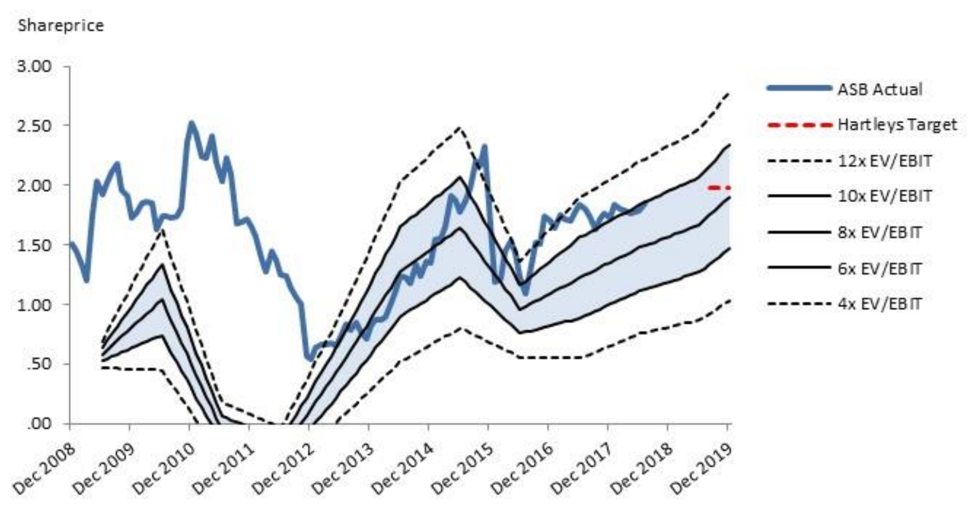
Fig. 9: Valuation - Target Multiples

Valuation					
S&P/ASX Industrial:	**FY19 Multiple**	**ASX Comps**	**Target Multiple**	**Wgt.%**	**Tgt Price**
EV/EBIT	9.3x	12.3x	10.8x	10%	2.12
EV/EBITDA	6.2x	8.0x	7.0x	25%	2.06
Earnings	14.8x	18.7x	16.5x	30%	2.14
Div Yield	2.7%	3.1%	2.7%	0%	1.83
NPV				35%	1.74
Valuation					**$1.98**

Source: Hartleys Research

As discussed, if the Company does win larger portions of the Future Frigates and LCS/frigate programmes than we currently assume then a premium to the Industrials Index may be warranted.

Fig. 10: EV/EBIT Band



Source: Hartleys Research

RISKS

A key risk for ASB, similar to other industrials, is the ability of management to replenish the order book. Capital intensive businesses, such as shipbuilding, require a relatively high level of plant capacity utilisation in order to generate an economic return. An inability to replenish the order book can lead to earnings disappointments. Such disappointments can be very difficult to predict and share price reactions can be severe and immediate upon disclosure by the company. Specific risks for ASB include cuts to the US and Australian naval budgets, failure to secure a portion of upcoming major contract awards and / or a sharp appreciation in the AUD / USD exchange rate.

SIMPLE S.W.O.T. TABLE

Strengths	Order book secures revenue through to FY21. Sustainment revenue: Contract with the US Navy should allow ASB to generate annuity service revenue from the LCS fleet once operational.
Weaknesses	Currently heavily reliant on a single customer (the US Navy). Capital intensive business that requires a relatively high level of yard utilisation to maintain margins.
Opportunities	Potential to win further orders from the US Navy, especially the LCS/frigate extension. Australian Governments' $89bn Naval replenishment programme, opportunity to secure a portion of work from the Future Frigates Program.
Threats	The majority of ASB's revenue is USD based. A strengthening of the AUD against the USD, therefore, could impact reported AUD earnings. Cuts to the US Navy's budget could have a long-term impact on ASB earnings.

Source: Hartleys Research

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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