

AUSTAL LIMITED (ASB)

FY18 Result and FY19 Outlook = Roughly in Line

ASB recently reported their FY18 result which was slightly ahead of our forecasts. Revenue was \$1.39bn vs \$1.31bn in FY17 and Hartleys \$1.31bn. Reported EBITDA was \$102m vs underlying EBITDA of \$90m in FY17 (they reported \$77m in FY17) and Hartleys \$98m. NPAT was \$39m vs Underlying \$32.7m in FY17 (reported \$15.3m) and Hartleys \$48m. Reported tax and interest were both ahead of our expectations.

Overall FY18 looks to be very marginally ahead of our forecast, US revenue and EBIT were better than we expected (overall EBIT margin of 7.1% vs Hartleys 6.8%), with Australia worse. Guidance for FY19 is for Group Revenue of \$1.3-1.4bn and USA shipbuilding margin of 7-8%. This compares to Hartleys prior revenue forecast of \$1.46bn. Cash generation is expected to be similar in FY19 to FY18.

As shown below, we have marginally lowered our FY19 US (assuming AUD/USD of 0.78c) and Australian revenue, while raising our Asian revenue on the back of increasing Commercial work in those yards. Overall, we have lowered our FY19 revenue by 4% to \$1.41bn, which is still at the top end of guidance. We have marginally increased our EBIT assumption for the US on a slightly better margin outlook, while lowering Australia to EBIT break even in FY19 (from an EBIT profit of \$4m previously).

Maintain Neutral Recommendation

Overall FY18 was a solid result for ASB roughly in line with our expectations and the outlook for FY19 again remains roughly in line. We recently published a more detailed note on the consequences of recent US and Australian Navy contract awards, see 'Australian Future Frigates and US LCS' (6th July 2018). Our valuation, post these results remains largely unchanged (up 6c, mainly on the rollover of our DCF) at \$2.04 per share and we continue to rate ASB a Neutral at that target level. 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 \$2.04 per share (from \$1.98).

Key Chart: Earnings Changes

A\$m	FY15 Act	FY17 Act	FY17 Act	FY18A			FY19E		
				Old	New	% diff	Old	New	% diff
Revenue	1,415	1,340	1,309	1,308	1,392	6%	1,472	1,406	-4%
USA	1,120	1,133	1,172	1,077	1,163	8%	1,168	1,131	-3%
Australia	212	187	114	192	199	4%	252	200	-21%
Asia	31	34	34	52	58	11%	65	96	46%
Other	45	-14	-11	-13	-27	-107%	-13	-21	-55%
EBITDA - Divisional	97	-78	90	98	102	4%	104	112	7%
USA	77	-66	105	104	112	8%	110	112	2%
Australia	33	8	-1	5	1	-78%	6	8	39%
Asia	2	-2	2	0	0	-140%	0	2	22750%
Other	-15	-18	-16	-10	-10	1%	-11	-11	3%
EBIT - Divisional	73.2	-108	59	63	65	4%	70	71	2%
USA	58	-91	79	74	86	17%	80	84	4%
Australia	32	7	-2	3	-7	-325%	4	0	-102%
Asia	1	-4	0	-1	-2	-22%	-2	0	129%
Other	-18	-21	-18	-13	-13	-1%	-13	-13	-1%
NPAT	45.0	-72	32.7	47.9	39.0	-19%	46.0	44.9	-2%

Source: Hartleys Research

Share Price:	\$1.90
Valuation:	\$2.04
12mth price target:	\$2.04

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:

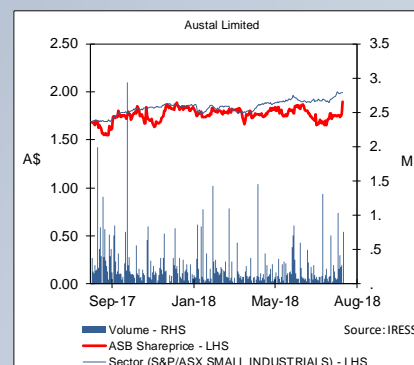
100 Clarence Beach Road
Henderson WA

Issued Capital:	349.4m
- fully diluted	359.9m
Market Cap:	\$663.8m
- fully diluted	\$663.8m
Net Debt (FY 19e)	\$9.6m

	FY17a	FY18a	FY19e
Op Cash Flw	-37.9	65.6	69.6
Free Cash Flw	-91.4	31.7	31.1
NPAT* (A\$m)	32.7	39.0	44.9
EPS (\$, bas)	9.3	11.2	12.8
P/E (basic)	20.3x	17.0x	14.8x
P/E (diluted)	20.9x	17.5x	15.2x
EV / EBITDA	7.0x	6.1x	5.6x
DPS (cps)	4.0	5.0	5.0

Dividend Yield	2.1%	2.6%	2.6%
N.D. / equity	10%	4%	2%

Source: Hartleys Research. * normalised



Authors:
Aiden Bradley
Energy & Industrials Analyst
Ph: +61 8 9268 2876
E: aiden.bradley@hartleys.com.au

SUMMARY MODEL

Austal Limited (ASB)						
Company Information						
Date	3 Sep 2018	100 Clarence Beach Road				
Share Price	\$1.90	Henderson WA				
52 Week High-Low	\$1.97 - \$1.495	Australia, 6166				
Market Cap (\$m)	\$663.8	D: +61 8 6414 4010				
Enterprise Value (\$m)	\$629.2	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	8.9x	12.3x	10.8x	16%	2.23	
EV/EBITDA	5.6x	8.0x	7.0x	16%	2.28	
Earnings	15.2x	18.7x	16.5x	16%	2.11	
Div Yield	2.6%	3.1%	2.7%	16%	1.83	
NPV				35%	1.91	
Valuation						
upside from current 8%						
P / E (6/19F) at price target	16.4x					
P / E (6/20F) at price target	14.2x					
EV / EBITDA (6/19F) at price target	6.1x					
EV / EBIT (6/19F) at price target	9.6x					
Dividend Yield (6/19F) at price target	2.4%					
Multiples (\$/price at \$1.90)						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
P / E (reported, basic weighted)	9.6x	-7.8x	43.1x	17.0x	14.8x	12.8x
P / E (normalised, dil. weighted)	14.6x	-9.2x	20.3x	17.0x	14.8x	12.9x
P/E (mkt cap / norm. NPAT)	14.8x	-9.3x	20.3x	17.0x	14.8x	12.8x
P / E (fully diluted mkt cap / norm. NP)	15.2x	-9.5x	20.9x	17.5x	15.2x	13.2x
Dividend Yield	2.1%	2.1%	0.0x	2.6%	2.6%	2.6%
Group Free Cash Flow (f.c.f) / EV	13.1%	9.7%	-0.1x	5.2%	4.9%	12.8%
Equity f.c.f. / Mkt Cap	7.7%	10.9%	-0.1x	3.6%	3.2%	9.1%
Norm f.c.f. / Mkt cap	7.7%	10.9%	-0.1x	3.6%	3.2%	9.1%
Mkt cap / operating cash flow	6.0x	6.5x	-17.5x	10.1x	9.5x	5.3x
EV/EBITDA multiple	6.5x	-8.0x	7.0x	6.1x	5.6x	5.2x
EV/EBIT multiple	8.6x	-5.8x	10.7x	9.7x	8.9x	7.8x
Price / Book Value	1.3x	1.5x	1.5x	1.2x	1.2x	1.1x
Price / NTA	1.4x	1.6x	1.5x	1.3x	1.2x	1.1x
Price / FCF	8.0x	10.8x	-7.4x	20.2x	21.4x	8.3x
Ratios						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Return period end Equity	10.4%	-18.4%	3.4%	7.1%	7.8%	8.5%
ROA	4.5%	-6.9%	3.3%	3.7%	3.9%	4.5%
ND / ND + Equity	3.1%	-12.7%	9.1%	4.1%	1.6%	-9.6%
ND / Equity	3.2%	-11.3%	10.0%	4.2%	1.7%	-8.8%
Net Interest Cover (EBIT)	17.8	-19.7	10.4	7.9	10.2	12.7
ROIC	6.3%	-12.8%	5.0%	4.8%	5.5%	6.5%
Free Cash Flow Analysis (\$m)						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Net Operating Cash Flow	110.4	102.1	-37.9	65.6	69.6	125.6
Capex (Reported)	-28.1	-40.9	-52.0	-32.8	-38.5	-44.9
Group Free Cash Flow (rep'ted)	82.3	61.2	-89.9	32.9	31.1	80.7
Fixed Debt Repayments	-31.1	11.1	24.6	-9.2	-10.0	-20.0
Equity Free Cash Flow (rep'ted)	51.2	72.2	-65.2	23.6	21.1	60.7
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow (normalised)	51.2	72.2	-65.2	23.6	21.1	60.7
Capex (inc HP) / depreciation	116%	137%	165%	88%	95%	111%
Share Data						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
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			Substantial Shareholders		%
David Singleton	Managing Director			Allan Gray Australia Pty Ltd		18.6%
Giles Everist	Independent Director					
Jim McDowell	Independent Director					
Recommendation: Neutral						
Profit & Loss (\$m)						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Australia - Divisional						
Revenue	211.8	187.0	113.7	198.5	199.8	219.0
EBIT	31.8	6.7	-2.1	-6.6	-0.1	0.4
EBIT Margin	15.0%	3.6%	-1.8%	-3.3%	0.0%	0.2%
USA - Divisional						
Revenue	1119.7	1133.1	1172.1	1162.7	1131.2	1207.3
EBIT	58.4	-90.6	78.5	86.0	84.0	91.6
EBIT Margin	5.2%	-8.0%	6.7%	7.4%	7.4%	7.6%
Philippines - Divisional						
Revenue	38.7	33.9	33.8	57.9	95.5	119.4
EBIT	1.0	-3.7	0.3	-1.6	0.5	2.4
EBIT Margin	2.6%	-10.9%	0.9%	-2.8%	0.5%	2.0%
Total Revenue	1,414.9	1,340.0	1,308.6	1,391.7	1,406.0	1,161.0
growth	57.4%	-5.3%	-2.3%	6.4%	1.0%	-17.4%
Segment EBITDA	112.4	-60.8	106.3	112.8	122.3	132.2
Overhead	-14.9	-17.6	-16.1	-10.4	-10.8	-11.5
- % of sales	-1.1%	-1.3%	-1.2%	-0.7%	-0.8%	-1.0%
EBITDA	97.5	-78.5	90.2	102.4	111.5	120.7
margin	6.9%	-5.9%	6.9%	7.4%	7.9%	10.4%
Depreciation/Amortisation	-24.3	-29.9	-31.5	-37.3	-40.4	-40.3
EBIT	73.2	-108.4	58.7	65.1	71.1	80.4
EBIT / Sales	5.2%	-8.1%	4.5%	4.7%	5.1%	6.9%
Net Interest	-4.1	-5.5	-5.7	-8.2	-7.0	-6.3
Profit Before Tax	69.1	-113.9	53.0	56.8	64.1	74.1
- margin	4.9%	-8.5%	4.0%	4.1%	4.6%	6.4%
Normalised Tax	-24.1	42.2	-20.3	-17.8	-19.2	-22.2
Effective Tax Rate	34.9%	37.0%	38.3%	31.3%	30.0%	30.0%
NPAT Pre Minorities	45.0	-71.7	32.7	39.0	44.9	51.9
Minorities	0.0	1.0	2.0	3.0	4.0	5.0
Normalised NPAT to equity	45.0	-71.7	32.7	39.0	44.9	51.9
Normalised tax rate	-27%	-35%	-37%	-38%	-31%	-30%
Norm. Net Profit / Sales	3.2%	-5.3%	2.5%	2.8%	3.2%	4.5%
Abnormals / discontinued	8.2	-12.6	-17.3	0.0	0.0	0.0
Reported Profit to equity	53.2	-84.3	15.4	39.0	44.9	51.9
Reported EPS (basic, wghted)	19.9	-24.3	4.4	11.2	12.8	14.8
Normalised EPS (dil. wghtd)	13.0	-20.7	9.3	11.2	12.8	14.8
Normalised EPS (full. diluted)	12.5	-19.9	9.1	10.8	12.5	14.4
EPS (full dil) Growth %	26%	-259%	-146%	20%	15%	16%
DPS (cps)	4.0	4.0	4.0	5.0	5.0	5.0
Cashflow Statement (\$m)						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
EBITDA	97.5	-78.5	90.2	102.4	111.5	120.7
Working Capital Change	19.8	213.0	-108.4	-50.1	-15.7	33.5
Net interest Paid	-4.1	-6.6	-5.7	-8.2	-7.0	-6.3
Tax Paid	-18.5	42.2	-20.3	-17.8	-19.2	-22.2
Other	15.8	-68.1	6.2	39.2	0.0	0.0
Net Operating Cash Flow	110.4	102.1	-37.9	65.6	69.6	125.6
Capital Expenditure	-28.1	-40.9	-52.0	-32.8	-38.5	-44.9
Asset Sales	6.3	15.9	-1.5	-1.1	0.0	0.0
Other (inc Investments)	6.3	15.9	-1.5	-1.1	0.0	0.0
Net Investing Cash Flow	-21.8	-25.0	-53.5	-33.9	-38.5	-44.9
Proceeds from Equity Issues	0.0	0.0	0.0	0.0	0.0	0.0
Net Change in Debt & Leases	-31.1	11.1	24.6	-9.2	-10.0	-20.0
Dividends Paid	-3.5	-15.8	-12.3	-12.8	-17.5	-17.6
Net Financing Cash Flow	-34.6	-4.7	12.4	-22.0	-27.5	-37.6
Movement in Cash	54.0	72.4	-79.0	9.7	3.6	43.2
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0	0.0
Balance Sheet (\$m)						
	6/15A	6/16A	6/17A	6/18A	6/19F	6/20F
Cash	138.4	224.3	150.5	162.0	165.6	208.8
Receivables	104.3	128.3	100.4	97.3	100.2	82.7
Inventories	339.7	109.0	170.4	246.5	258.9	208.1
Other	16.5	8.5	10.4	13.7	13.7	13.7
Total Current Assets	598.9	470.1	431.7	519.6	538.4	513.2
Property, Plant & Equipment	442.5	490.8	500.3	565.8	563.8	568.4
Intangibles	9.0	35.0	5.6	7.8	7.8	7.8
Other	20.4	17.3	22.4	55.6	55.6	55.6
Total Non Current Assets	471.9	543.0	528.3	629.2	627.3	631.9
Total Assets	1,070.9	1,013.1	960.0	1,148.8	1,165.6	1,145.1
Accounts Payable	223.5	229.8	154.9	177.8	177.3	142.5
Interest Bearing Liabilities	146.9	2.5	9.9	72.8	72.8	72.8
Other	92.1	74.4	74.1	138.3	138.3	138.3
Total Current Liabilities	462.5	306.8	238.9	388.9	388.4	353.6
Interest Bearing Liabilities	7.7	170.1	186.5	112.5	102.5	82.5
Deferred Tax Liability	63.7	72.0	62.9	58.1	58.1	58.1
Other	24.6	6.8	14.8	40.3	40.3	40.3
Total Non Current Liabilities	96.0	248.8	264.2	210.9	200.9	180.9
Total Liabilities	558.5	555.6	503.1	599.8	589.3	534.5
Net Assets	512.4	457.6	456.9	549.0	576.3	610.6
Net Asset Value / Share (\$)	1.42	1.27	1.27	1.53	1.60	1.70
NTA / Share (\$)	1.40	1.17	1.25	1.50	1.58	1.67
Net Debt (net cash)	16.1	-51.7	45.9	23.3	9.6	-53.5
Analyst: Aiden Bradley						
Phone: +61 8 9268 2876						
Sources: IRESS, Company Information, Hartleys Research						
Last Earnings Estimate Changes: 03-September-2018						

HIGHLIGHTS

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Reported EBITDA was \$102m vs underlying EBITDA of \$90m in FY17 (they reported \$77m in FY17) and Hartleys \$98m.

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Overall FY18 looks to be very marginally ahead of our forecast – US revenue and EBIT was better than we expected (overall EBIT margin of 7.1% vs Hartleys 6.8%), with Australia worse.

Guidance for FY19 is for Group Revenue of \$1.3-1.4bn and USA shipbuilding margin of 7-8%. This compares to Hartleys prior revenue forecast of \$1.46bn. Cash generation is expected to be similar in FY19 to FY18.

As shown in Figure 1, we have marginally lowered our FY19 US (assuming AUD/USD of 0.78c) and Australian revenue, while raising our Asian revenue on the back of increasing Commercial work in those yards. Overall, we have lowered our FY19 revenue by 4% to \$1.41bn, which is still at the top end of guidance. We have marginally increased our EBIT assumption for the US on a slightly better margin outlook, while lowering Australia to EBIT break even in FY19 (from an EBIT profit of \$4m previously).

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Source: Hartleys Research

Overall FY18 was a solid result for ASB roughly in line with our expectations and the outlook for FY19 again remains roughly in line with us. We recently published a more detailed note on the consequences of recent US and Australian Navy contract awards, see 'Australian Future Frigates and US LCS' (6th July 2018). Our valuation remains largely unchanged (up 6c, mainly on the rollover of our DCF), at \$2.04 per share and we continue to rate ASB a Neutral at that target level.

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).

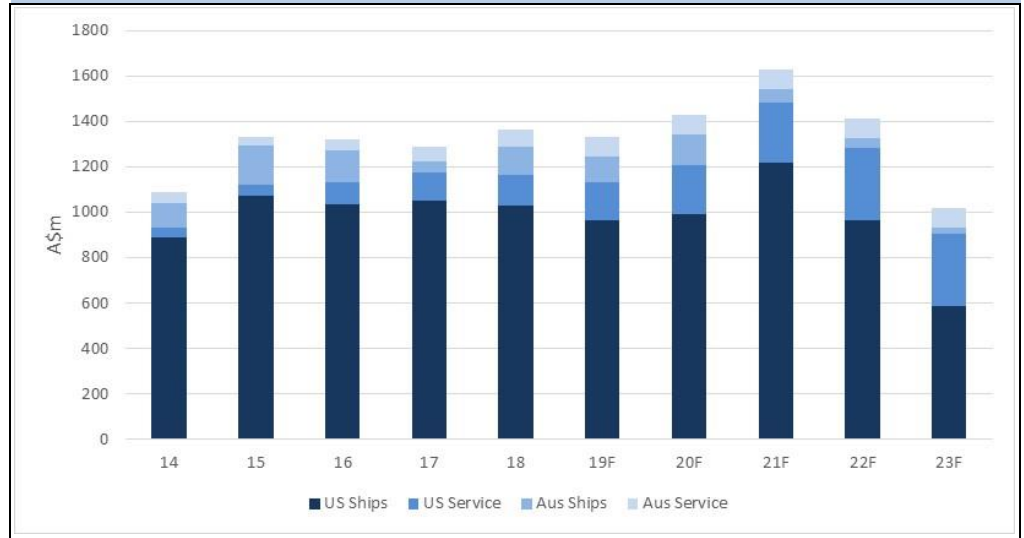
Having not been awarded the Australian OPV contract (see our research 'OPV work goes to Cvmec vs. Commercial expansion' (15th May 2018)) we are now waiting to formally hear what impact the award of the Australia Futures Frigate contract to BAE will have on ASB's business.

Given 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 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 of, 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 10% 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.

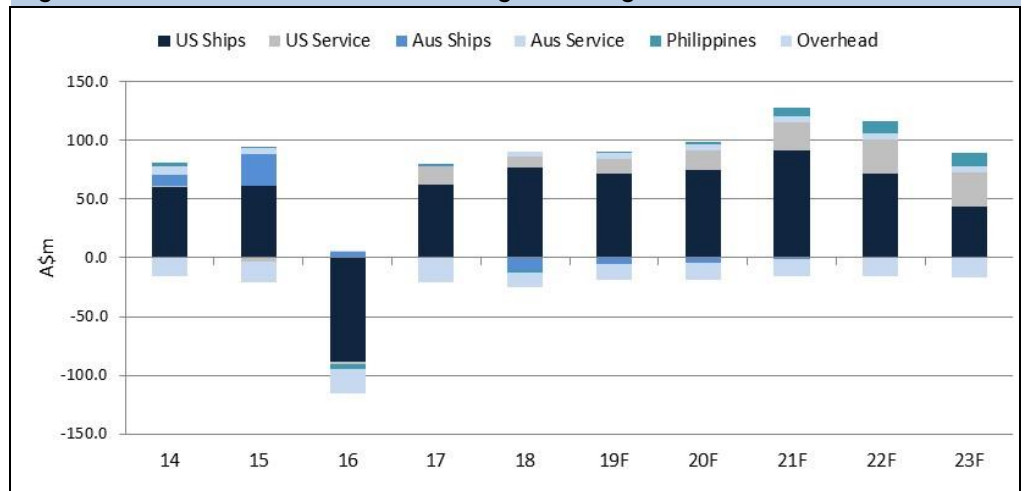
Fig. 2: Revenue Outlook – Existing Backlog



Source: Hartleys Research

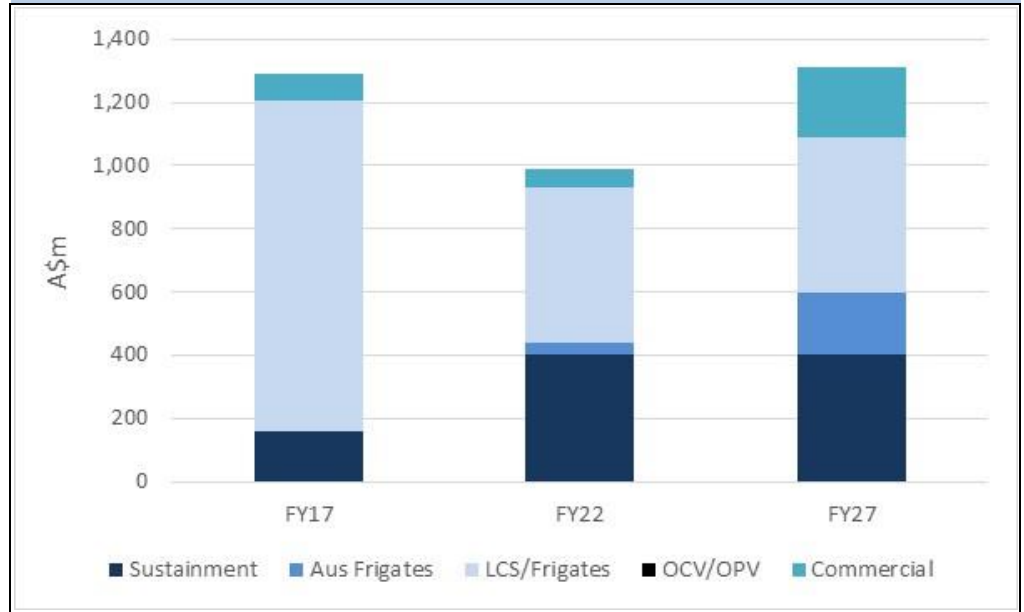
Sustainment revenue going forward will provide a significant high margin source of income both in the US and Australia and would naturally increase further as more Naval vessels are built. This is a significant change for ASB versus the past and will assist in smoothing out earnings going forward.

Fig. 3: EBIT Outlook – Existing Backlog



Source: Hartleys Research

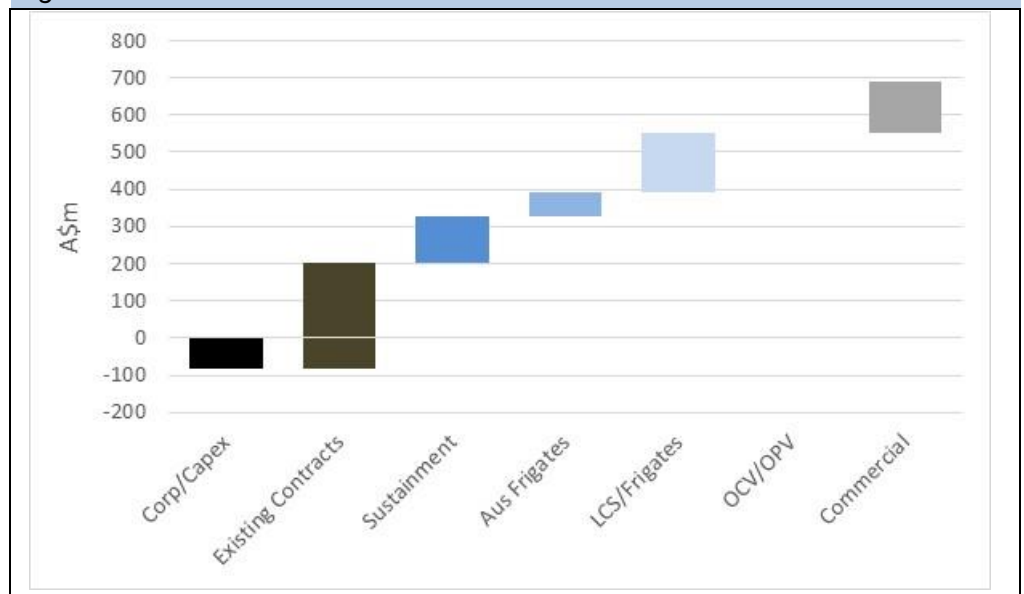
Fig. 4: Long Run Revenue



Source: Hartleys Research

In our recent note, 'Australian Future Frigates and US LCS' (6th July 2018) we downgraded the % of workshare from the Australian Future Frigate programme in our Group NPV but partially filled this void with the expected award of four additional LCS vessels in the US.

Fig. 5: 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 \$2.04 per share (from \$1.98).

Fig. 6: Valuation - Target Multiples

Valuation						
	S&P/ASX Industrial: FY19 Multiple	ASX Comps	Target Multiple	Wgt.%	Tgt Price	
EV/EBIT	8.9x	12.3x	10.8x	16%	2.23	
EV/EBITDA	5.6x	8.0x	7.0x	16%	2.28	
Earnings	15.2x	18.7x	16.5x	16%	2.11	
Div Yield	2.6%	3.1%	2.7%	16%	1.83	
NPV				35%	1.91	
Valuation					\$2.04	

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.

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.

HARTLEYS CORPORATE DIRECTORY

Research

Trent Barnett	Head of Research	+61 8 9268 3052
Mike Millikan	Resources Analyst	+61 8 9268 2805
John Macdonald	Resources Analyst	+61 8 9268 3020
Paul Howard	Resources Analyst	+61 8 9268 3045
Aiden Bradley	Research Analyst	+61 8 9268 2876
Oliver Stevens	Research Analyst	+61 8 9268 2879
Michael Scantlebury	Junior Analyst	+61 8 9268 2837
Janine Bell	Research Assistant	+61 8 9268 2831

Corporate Finance

Dale Bryan	Director & Head of Corp Fin.	+61 8 9268 2829
Richard Simpson	Director	+61 8 9268 2824
Ben Crossing	Director	+61 8 9268 3047
Ben Wale	Director	+61 8 9268 3055
Stephen Kite	Director	+61 8 9268 3050
Scott Weir	Director	+61 8 9268 2821
Scott Stephens	Associate Director	+61 8 9268 2819
Rhys Simpson	Associate Director	+61 8 9268 2851

Registered Office

Level 6, 141 St Georges Tce Postal Address:

Perth WA 6000	GPO Box 2777
Australia	Perth WA 6001
PH:+61 8 9268 2888	FX: +61 8 9268 2800
www.hartleys.com.au	info@hartleys.com.au

Note: personal email addresses of company employees are structured in the following manner: firstname.lastname@hartleys.com.au

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.

Institutional Sales

Carrick Ryan	+61 8 9268 2864
Justin Stewart	+61 8 9268 3062
Simon van den Berg	+61 8 9268 2867
Digby Gilmour	+61 8 9268 2814
Jayne Walsh	+61 8 9268 2828
Veronika Tkacova	+61 8 9268 3053

Wealth Management

Nicola Bond	+61 8 9268 2840
Bradley Booth	+61 8 9268 2873
Adrian Brant	+61 8 9268 3065
Nathan Bray	+61 8 9268 2874
Sven Burrell	+61 8 9268 2847
Simon Casey	+61 8 9268 2875
Tony Chien	+61 8 9268 2850
Tim Cottee	+61 8 9268 3064
David Cross	+61 8 9268 2860
Nicholas Draper	+61 8 9268 2883
John Featherby	+61 8 9268 2811
Ben Fleay	+61 8 9268 2844
James Gatti	+61 8 9268 3025
John Goodlad	+61 8 9268 2890
Andrew Gribble	+61 8 9268 2842
David Hainsworth	+61 8 9268 3040
Murray Jacob	+61 8 9268 2892
Gavin Lehmann	+61 8 9268 2895
Shane Lehmann	+61 8 9268 2897
Steven Loxley	+61 8 9268 2857
Andrew Macnaughtan	+61 8 9268 2898
Scott Metcalf	+61 8 9268 2807
David Michael	+61 8 9268 2835
Jamie Moullin	+61 8 9268 2856
Chris Munro	+61 8 9268 2858
Michael Munro	+61 8 9268 2820
Ian Parker	+61 8 9268 2810
Matthew Parker	+61 8 9268 2826
Charlie Ransom	+61 8 9268 2868
David Smyth	+61 8 9268 2839
Greg Soudure	+61 8 9268 2834
Sonya Soudure	+61 8 9268 2865
Dirk Vanderstruyf	+61 8 9268 2855
Samuel Williams	+61 8 9268 3041

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