

Austal Ltd

(ASB \$1.83) Buy

EUROZ

Analyst	Date	Price Target
Ben Laird	27 th February 2018	\$2.27/sh

Half year result

Investment case

ASB is continuing to deliver on two key themes that support our positive view on the stock. The first theme and biggest driver of earnings in the near term is the continued improvement in productivity of the US operations. ASB delivered a US shipbuilding margin of 7.6% which was towards the upper end of the guided range and was the key driver of profitability for the half.

Importantly after a recent surge in large ferry orders (\$380m of orders were won during the half) ASB can now also point to a significant increase in throughput in the next few years in their Australian and Phillipine operations. This lift in throughput from a very low base will underpin significant earnings growth as the operational leverage in these ship yards from current levels is large. Commentary around the OPV contract status was muted with management stating it is not included in their bullish outlook statements for the Australian operations. As the company is currently in sensitive negotiations this is to be expected in our view.

OPV aside we note that our valuation and earnings forecasts are very sensitive to US boat building margins which we forecast to continue to trend upwards. A resurgent large ferry market and a growing support business will also drive future growth in our view.

We maintain our BUY recommendation with a price target of \$2.27/sh.

Key points

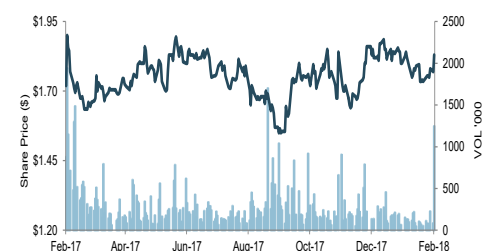
Numbers

- ASB's 1H is broadly in line with our previous assumptions.
- ASB have reported 1H FY'18 revenue of \$653.0m vs \$649.2m pcp.
- EBIT was \$29.2m vs \$18.1m pcp (FY'17 1H included one off costs relating to a legal settlement).
- With the Australian and Phillipine operations effectively posting a break even EBIT result the key driver of the business for the period was the US operations.
- NPAT was \$25.6m vs \$9.3m pcp (1H FY'18 included a one off non cash positive impact from the treatment of a deferred tax liability).
- That said management commented that the new, lower US corporate tax rate will deliver ASB -A\$5mpa additional NPAT going forward.
- Core net debt end Dec 2017 was a comfortably manageable \$10.8m not including the accounting treatment of residual buyback guarantee the Cape Class Boat 8&9 leasing program.
- ASB declared a 2cps unfranked dividend for the period.
- ASB's order book currently stands at A\$3.4b across all operations.
- ASB provided guidance that FY'18 revenue will be \$1.3-1.4B with an underlying US shipbuilding margin of 6-8%.
- We have made no changes to our FY'18 forecasts and some minor immaterial changes to our FY'19 forecasts in response to this result.

Austal Ltd	Year End 30 June	
Share Price	1.83	A\$/sh
Price Target	2.27	A\$/sh
Valuation	2.35	A\$/sh
WACC	10%	
Terminal Growth	3.0%	
Shares on issue	348.4	m, diluted
Market Capitalisation	599.2	A\$m
Enterprise Value	645.1	A\$m
Debt FY'17	196.4	A\$m
Cash FY'17	150.5	A\$m

Key Financials	2017a	2018f	2019f
Revenue (A\$m)	1310.1	1364.9	1332.2
EBITDA (A\$m)	90.2	90.5	106.9
EBIT (A\$m)	58.7	59.8	75.3
Reported NPAT (A\$m)	15.3	34.2	44.1
Normalised NPAT (A\$m)	32.7	34.2	44.1
Gross Cashflow (A\$m)	-37.4	71.8	75.5
Capex (A\$m)	-10.0	-68.0	-30.0
Op. Free Cashflow (A\$m)	-47.4	3.8	45.5
Revenue Growth (%)	-2%	4%	-2%
EBITDA Growth (%)	39%	0%	18%
Norm. NPAT Growth (%)	31%	5%	29%
Normalised EPS (Ac)	9.4	9.9	12.7
Norm. EPS growth (%)	31%	5%	29%
PER (x)	19.4	18.5	14.4
EV:EBITDA (x)	7.2	7.1	6.0
EV:EBIT (x)	11.0	10.8	8.6
DPS (Ac)	4.3	4.4	5.7
Dividend Yield (%)	2.4%	2.4%	3.1%
Net Debt (A\$m)	45.9	59.8	34.4
Net Debt:Equity (%)	10%	13%	7%
Interest Cover (x)	15.8	14.4	16.7

Share Price Chart



Euroz Securities Limited

All information and advice is confidential and for the private information of the person to whom it is provided and is provided without any responsibility or liability on any account whatsoever on the part of Euroz Securities Limited or any member or employee thereof. Refer to full disclaimer at the end of this document.

Austal Ltd

(ASB \$1.83) Buy

Operations

US

- Gains in productivity in the US operations mitigating a lower throughput, were a highlight of the update. A US shipbuilding margin of 7.6% was achieved vs the guided range of 6-8%. We forecast 7.3% for FY'18 and choose to leave this unchanged for now. Our long term forecast is for 8.5%.
- Rhetoric around the long term future of the US business was bullish. A significant increase in defence expenditure has been tabled in congress and this is expected to drive appropriation of more vessels as the Navy seeks to reach the target of 355 ships.
- ASB expect further LCS orders in CY'18.
- A key signal of the US Navy's intent is the recent \$15m award of a conceptual design contract for the FFG(X) frigate. This program is expected to commence in 2020 and is effectively an "upgunned" LCS vessel.

Australia/Philippines

- ASB's ultimate role in the OPV is still being negotiated. ASB expect a result in "a few more months". This is broadly in line with the previously targeted end March Q date.
- The first vessels are expected to be built in WA from 2021.
- ASB were very bullish on the prospects for the commercial ferry market with \$380m orders received in the half from a diverse base of clients.
- ASB expect commercial revenue to be up 50% in FY'19 driven by a doubling of throughput in the Philippines and a 20% uplift at the Henderson operations.
- ASB's still plans to spend US\$30m in expanding capacity in Asia
- Chinese JV has 6 vessels in next 18mths. One already delivered. Good from low base.

Euroz Securities Limited

All information and advice is confidential and for the private information of the person to whom it is provided and is provided without any responsibility or liability on any account whatsoever on the part of Euroz Securities Limited or any member or employee thereof. Refer to full disclaimer at the end of this document.

Austal Ltd

(ASB \$1.83) Buy

Analysis

Forecasts

We have made some minor immaterial changes to our forecasts post the 1H FY'18 result.

The table below breaks down our long term forecasts for ASB out to FY'21.

Austal Group Forecasts to EBIT level						
US operations	FY16a	FY17a	FY18 f/cast	FY19 f/cast	FY20 f/cast	FY21 f/cast
	A\$m	A\$m	A\$m	A\$m	A\$m	A\$m
Revenue	1133.1	1172.1	1163.0	1017.0	794.3	863.8
EBIT	-90.6	76.1	66.8	63.6	54.9	56.7
EBIT Margin%	-8.0%	6.5%	5.7%	6.3%	6.9%	6.6%
Australian operations	FY16a	FY17a	FY18	FY19	FY20	FY21
Revenue	187.0	113.7	150.6	212.7	285.5	335.5
EBIT	7.7	-2.1	6.3	19.7	26.8	31.8
EBIT Margin%	4.1%	-1.8%	4.2%	9.3%	9.4%	9.5%
Philippines operations	FY16a	FY17a	FY18	FY19	FY20	FY21
Revenue	33.9	33.8	51.3	102.6	153.8	153.8
EBIT	-3.7	0.3	2.6	8.2	15.4	15.4
EBIT Margin%	-10.9%	0.9%	5.0%	8.0%	10.0%	10.0%
Corporate EBIT*	-30.0	-15.6	-15.9	-16.2	-16.6	-16.9
Group EBIT	-116.6	58.7	59.8	75.3	80.5	87.0
Group EBIT Margin	na	4.4%	4.4%	5.7%	6.5%	6.4%

Key Features:

- We forecast US shipbuilding margins to continue to improve before plateauing out at 8.5% in FY'20.
- The decline in US revenue from FY'18 to FY'20 depicts a roll off of the pace of LCS production and the EPF program. The subsequent uptick in FY'21 assumes ASB build one FFG(X) Frigate per annum.
- It is evident that the Australian operations are forecast to grow revenue significantly from a low base of \$113m in FY'17 to \$385m in FY'21.
- We note the recent \$380m of contract wins and the very strong tender pipeline for commercial ferries. If more contract wins occur in the medium term we see upside to our forecasts.
- In reality the split of these revenues between the Philippine ship yard could vary but we forecast the EBIT contribution to be a similar margin.
- If the OPV outcome is as we expect, ASB's Henderson operations have the current pipeline of work with ferry orders and Australian defence work to support A\$300mpa of shipbuilding revenue for the long term (FY'21 and beyond).
- Aside from US margin expansion ASB's largest leverage in the medium to long term is the potential to win a role in the RAN's Future Frigate program. This could dwarf the impact of the OPV program for ASB. There is a lot of water to pass under the bridge in terms of who builds what portion (if any) in Australia. We do not factor this into our forecasts at this stage.

Euroz Securities Limited

All information and advice is confidential and for the private information of the person to whom it is provided and is provided without any responsibility or liability on any account whatsoever on the part of Euroz Securities Limited or any member or employee thereof. Refer to full disclaimer at the end of this document.

Austal Ltd

(ASB \$1.83) Buy

Valuation

We maintain our Buy recommendation with a PT 2.27/sh.

We use a blended FY'18/19 EV/EBIT and NPV valuation methodology to determine our price target.

Our methodology is outlined in the table below:

Blended Valuation								
Method	Blended FY'18/19 Earnings	Implied EV 12x	Net Debt	Implied Mkt cap	SOI	Implied Share Price	Weighting	Valuation
	\$m	\$m	FY'17 act	\$m	m	\$/sh	%	\$/sh
EV/EBIT	67.5	810.4	45.9	764.5	349	2.19	50%	1.10
NPV		866.9	45.9	821.0	349	2.35	50%	1.17
Price Target								2.27

*NPV is calculated on a WACC of 10%

EV/EBIT Methodology:

- We use a blended FY'18/19 EBIT on a multiple of 12x to calculate a target EV for ASB.
- We use a blended FY'18/19 as this reflects a portion of the growth we expect in FY'19 as US margin continues to improve along with utilisation at Henderson.
- 12x EV/EBIT is a discount to the larger defence contracting sector which trades at -16x forward EBIT (see previous research 30/11/18 for comps table)

	Units	2018	2019
EBIT	\$m	60	75
Target Multiple	x	12	12
EV	\$m	717	903
Net cash (FY'17a)	\$m	-46	-46
Implied Market Cap	\$m	672	857
SOI	m	349	349
Value	\$/sh	1.92	2.46
Price target	\$/sh	2.19	

Euroz Securities Limited

All information and advice is confidential and for the private information of the person to whom it is provided and is provided without any responsibility or liability on any account whatsoever on the part of Euroz Securities Limited or any member or employee thereof. Refer to full disclaimer at the end of this document.

Austal Ltd

(ASB \$1.83) Buy

Financial Statements	2016a	2017a	2018f	2019f	Performance Ratios	2016a	2017a	2018f	2019f
Revenue	1340.0	1310.1	1364.9	1332.2	Growth & Margins				
Operating Expenses	-1275.0	-1193.0	-1274.4	-1225.3	Revenue Growth	-5%	-2%	4%	-2%
EBITDA	65.0	90.2	90.5	106.9	EBITDA Growth	-33%	39%	0%	18%
Depreciation	-28.5	-30.4	-30.7	-31.6	EBIT Growth	-52%	67%	2%	26%
Other Non cash	0.0	0.0	0.0	0.0	Normalized Net Profit Growth	-44%	31%	5%	29%
EBITA	36.5	59.8	59.8	75.3	EBITDA margin	5%	7%	7%	8%
Amortisation	-1.4	-1.1	0.0	0.0	EBIT margin	3%	4%	4%	6%
EBIT	35.1	58.7	59.8	75.3	Normalized net profit margin	2%	2%	3%	3%
one off adjustments	-154.9	-13.2	0.0	0.0	Effective tax rate	33%	62%	36%	36%
Net interest expense	-6.6	-5.7	-6.3	-6.4	Liquidity				
NBPT	-126.4	39.8	53.5	68.9	Capex/depreciation (x)	1.6	0.3	2.2	0.9
Tax (expense)/ credit	42.2	-24.5	-19.3	-24.8	Current ratio (x)	1.5	1.8	1.6	1.7
NPAT	-84.2	15.3	34.2	44.1	Quick ratio (x)	1.1	1.1	1.0	1.1
Significant items after tax	0.0	0.0	0.0	0.0	Receivable days	32	32	30	33
Minorities	0.1	0.0	0.0	0.0	Inventory days	-64	-43	-50	-52
Reported NPAT	-84.1	15.3	34.2	44.1	Payable days	-65	-59	-50	-56
Analyst adj: g/w & amortisation	0.0	0.0	0.0	0.0	Risk Measures				
Analyst adj: significant items (a/t)	109.1	17.4	0.0	0.0	Dividend Cover (x)	1.6	2.7	1.9	2.2
Normalised NPAT	25.0	32.7	34.2	44.1	Payout ratio (%)	-17%	98%	45%	45%
					Net interest cover (x)	10	16	14	17
					Net debt/equity (%)	-11%	10%	13%	7%
					Returns				
Cash flow (A\$m)	2016a	2017a	2018f	2019f	Return on average capital employed (%)	3%	6%	6%	7%
EBITDA	65.0	90.2	90.5	106.9	WACC (%)	10.3%	10.3%	10.3%	10.3%
Tax paid	-4.8	12.2	-19.3	-24.8	ROA %	-9%	1%	3%	4%
Net interest	-4.0	-3.5	-6.3	-6.4	Return on average equity (%)	-21%	3%	7%	9%
Change in net working capital	45.7	-108.4	6.8	-0.2					
Other	0.0	-27.9	0.0	0.0	Share Data/Valuation	2016a	2017a	2018f	2019f
Operating Cashflow	101.8	-37.4	71.8	75.5	Share Data				
Capex PP& E	-44.1	-10.0	-68.0	-30.0	Issued shares (m)	348	349	349	349
Operating Free Cashflow	57.7	-47.4	3.8	45.5	Weighted ave shares (m)	347	349	349	349
Acquisitions	-1.0	0.0	0.0	0.0	Fully diluted shares (m)	348	349	349	349
Asset Sales	2.5	0.1	0.0	0.0	Basic EPS (c)	-24.2	4.4	9.8	12.6
Debt drawdowns (repayments)	11.1	-13.5	10.0	0.0	YoY change (%)	-258%	-118%	124%	29%
Equity contributions (net)	0.0	0.0	0.0	0.0	Fully diluted EPS (c)	-24.1	4.4	9.8	12.6
Dividends	-15.8	-12.3	-17.7	-20.2	YoY change (%)	-257%	-118%	124%	29%
Other	17.9	-0.8	0.0	0.0	Fully diluted normalised EPS (c)	7.2	9.4	9.9	12.7
Net cashflow	72.4	-73.8	-3.9	25.3	YoY change (%)	-44%	31%	5%	29%
					Dividend/share (c)	4	4	4	5.7
					Franking (%)	100%	100%	100%	100%
					Gross cashflow/share (c)	29.4	-10.7	20.5	21.6
					NBV/share (c)	131.3	130.7	135.5	142.3
					NTA/Share (c)	128.7	128.2	132.9	139.8
					Valuation				
Balance Sheet (\$m)	2016a	2017a	2018f	2019f	PER (Basic) (x)	-8	42	19	15
Cash	224.3	150.5	146.6	171.9	PER (Fully diluted) (x)	-8	42	19	15
Receivables	128.3	100.4	122.8	119.9	PER (Fully diluted, normalized) (x)	25	19	19	14
Inventories	109.0	170.4	177.4	173.2	P/CFPS (x)	6	-17	9	8
Other financial assets	5.6	9.7	1.7	1.7	Price/NBV (x)	1.4	1.4	1.4	1.3
Other	2.9	0.7	0.7	0.7	Price/NTA (x)	1.4	1.4	1.4	1.3
Total Current Assets	470.1	431.7	449.3	467.4	Dividend Yield (%)	2.2%	2.4%	2.4%	3.1%
Investments	7.6	9.6	9.6	9.6	Fully diluted normalized 3 yr EPS Cagr (%)	-18%	-6%	-9%	21%
Receivables	0.0	0.0	0.0	0.0	PEG ratio (x)	-1.4	-3.3	-2.1	0.7
Property, plant & equipment	490.8	500.3	537.6	536.0	EV/EBITDA (x)	9.9	7.2	7.1	6.0
Deferred Tax	35.0	5.6	5.6	5.6	EV/EBIT (x)	18.4	11.0	10.8	8.6
Intangible assets	9.3	8.9	8.9	8.9	EV/Revenue (x)	0.5	0.5	0.5	0.5
Other	0.4	3.8	3.2	3.2	NPV (\$/sh)	2.35			
Total Non Current Assets	543.0	528.3	565.0	563.4	WACC (%)	10%			
Total Assets	1013.1	960.0	1014.3	1030.8					
Creditors	229.8	154.9	191.2	183.8	Other Information				
Tax provision	0.1	0.0	0.0	0.0	Major Shareholders:				
Borrowings	2.5	9.9	9.9	9.9	Allan Gray				18.6%
Provisions	42.3	46.6	46.6	46.6	John Rothwell				9.12%
Other	32.0	27.5	27.1	27.1					
Current Liabilities	306.8	238.9	274.8	267.4	12-mth High/Low (A\$/sh)				1.94/0.93
Borrowings	170.1	186.5	196.5	196.5	Average daily volume (A\$m)				2.5
Deferred tax	0.0	10.9	0.0	0.0	ASX Code				ASB
Provisions	1.1	2.9	2.7	2.7	Next result				Aug'18
Other	77.7	64.0	66.9	66.9					
Total Non Current Liabilities	248.8	264.2	266.0	266.0	Company Description				
Total Liabilities	555.6	503.1	540.8	533.4	Austal is a West Australian based shipbuilder. The company has operations in Henderson, WA and Mobile, USA. Austal builds vessels for various military and paramilitary customers as well as commercial and international ferry operators.				
NET ASSETS	457.6	456.9	473.5	497.4					
Share capital	114.7	116.4	116.4	116.4					
Foreign currency translation/Reserves	100.7	91.6	91.6	91.6					
Retained profits/(losses)	242.1	248.9	265.4	289.3					
Shareholders' funds	457.6	456.9	473.5	497.4					
Minority Interest	0.0	0.0	0.0	0.0					
Total Shareholders' Equity	457.6	456.9	473.5	497.4					

Euroz Securities Limited

All information and advice is confidential and for the private information of the person to whom it is provided and is provided without any responsibility or liability on any account whatsoever on the part of Euroz Securities Limited or any member or employee thereof. Refer to full disclaimer at the end of this document.

Disclaimer

Copyright & Distribution

The material contained in this communication (and all attachments) is prepared for the exclusive use of clients of Euroz Securities Ltd (ACN 089 314 983) ("Euroz") only. Euroz is the holder of an Australian Financial Services Licence (AFSL 243302) issued by the Australian Securities and Investments Commission ("ASIC") and is a participant of the Australian Securities Exchange Group ("ASX Group").

The information contained herein is confidential and may be legally privileged. If you are not the intended recipient no confidentiality is lost nor privilege waived by your receipt of it. Please delete and destroy all copies, and contact Euroz on (+618) 9488 1400. You should not use, copy, disclose or distribute this information without the express written authority of Euroz.

Disclaimer & Disclosure

Euroz and its associates declare that they deal in securities as part of their securities business and consequently may have a relevant interest in the securities recommended herein (if any). This may include providing equity capital market services to their issuing company, hold a position in the securities, acting as principal or agent, or make a market therein and as such may effect transactions not consistent with the recommendation (if any) in this report.

Euroz declares that it may have acted as an underwriter, arranger, co-arranger or advisor in equity capital raisings, and will have received a fee for its services, for any company mentioned within this report during the last 12 months.

You should not act on any recommendation issued by Euroz without first consulting your investment advisor in order to ascertain whether the recommendation (if any) is appropriate, having regard to your investment objectives, financial situation and particular needs. Nothing in this report shall be construed as a solicitation to buy or sell a security, or to engage in or refrain from engaging in any transaction.

Euroz believes that the information and advice contained herein is correct at the time of compilation, however we make no representation or warranty that it is accurate, complete, reliable or up to date, nor do we accept any obligation to correct or update the opinions in it. The opinions expressed are subject to change without notice. No member of Euroz accepts any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this material.

We cannot guarantee that the integrity of this communication has been maintained, is free from errors, virus interception or interference.

Contact Details

Euroz Securities Limited +61 8 9488 1400

International Toll Free

(If calling to Euroz from the following Countries)

Germany	0800 1800 554
Switzerland	0800 835 385
Hong Kong	800 900 936
Malaysia	1800 805 002
Singapore	800 6161 759
New Zealand	0800 441 271
USA	18 772 804 390
United Kingdom	08 000 929 851

Research Analysts

Jon Bishop - Head of Research	+61 8 9488 1481
Andrew Clayton - Resources Analyst	+61 8 9488 1427
Michael Emery - Resources Analyst	+61 8 9488 1430
Ben Laird - Industrials Director	+61 8 9488 1429
Gavin Allen - Industrials Analyst	+61 8 9488 1413
Jerome Paz - Associate Research Analyst	+61 8 9488 1414

Institutional Sales

Andrew McKenzie - Executive Chairman	+61 8 9488 1407
Rob Black - Managing Director	+61 8 9488 1423
Jay Hughes - Executive Director	+61 8 9488 1406
Russell Kane - Executive Director	+61 8 9488 1426
Simon Yeo - Executive Director	+61 8 9488 1404
Timothy Bunney - Executive Director	+61 8 9488 1461
Peter Schwarzbach - Executive Director	+61 8 9488 1492
Stacy Kitsantas - Institutional Adviser	+61 8 9488 1486
Blair Spaulding - Institutional Adviser	+61 8 9488 1418

Private Client Advisers

Chris Webster - Head of Private Clients	+61 8 9488 1412
Ben Statham - Executive Director	+61 8 9488 1417
Brian Bates - Executive Director	+61 8 9346 0314
Cameron Murray - Executive Director	+61 8 9488 1440
James Mackie - Executive Director	+61 8 9488 1416
Lucas Robinson - Executive Director	+61 8 9488 1424
Ryan Stewart - Executive Director	+61 8 9488 1441
Tim Lyons - Executive Director	+61 8 9346 0324
Brett Stapleton - Associate Director	+61 8 9488 1435
Duncan Relf - Associate Director	+61 8 9346 0322
Giles McCaw - Associate Director	+61 8 9488 1462
Michael Bowden - Associate Director	+61 8 9346 0307
Richard Gardner - Associate Director	+61 8 9488 1444
Paul Berson - Associate Director	+61 8 9346 0314
Paul Cooper - Associate Director	+61 8 9346 0316
Phil Grant - Associate Director	+61 8 9346 0306
Lauren Walker - Investment Adviser	+61 8 9488 1495
Michael Bartley - Investment Adviser	+61 8 9346 0352
Steve Wood - Investment Adviser	+61 8 9346 0305
Tom Kenny - Associate Adviser	+61 8 9488 1431

Euroz Securities Limited

All information and advice is confidential and for the private information of the person to whom it is provided and is provided without any responsibility or liability on any account whatsoever on the part of Euroz Securities Limited or any member or employee thereof. Refer to full disclaimer at the end of this document.