

# Austal Limited

## (ASB \$1.76) Buy

EUROZ

Analyst	Date	Price Target
Ben Laird	30 <sup>th</sup> August 2018	\$2.31/sh

### FY'18 Result – very strong performance from the US

#### Investment case

ASB has produced a strong FY'18 result that comfortably beat our forecasts and was significantly up on the previous financial year. The biggest driver of earnings outperformance was the continued improvement in productivity of the US operations. ASB delivered a US shipbuilding margin of 8.5% in FY'18 (vs 7.6% in 1H FY'18) which exceeded the upper end of the guided range of 6-8%. We have made upward adjustments to our forecasts and price target to reflect ASB's strong operational performance in the US.

After a surge in large ferry and defence orders over the past 12-18mths ASB expect a significant increase in throughput in the next few years in their Australian and Asian operations. This lift in throughput from a very low base will underpin revenue and margin growth for the next few years in our view.

Earnings aside we see leverage in ASB from current prices in terms of a possible multiple rerating should they be successful in their efforts to win a material share of work under prime contractor BAE, for the Australian Navy's 9 "Hunter Class" anti-submarine warfare frigates (Future Frigates). We also note recent commentary surrounding the potential to supply 6 OPVs to the Philippine Government.

**We maintain our BUY recommendation with a new price target of \$2.31 (prev. \$1.94)**

#### Key points

##### Result ahead of our forecasts

- ASB delivered Revenue of \$1.39b vs EZL forecasts of \$1.36b and EBIT of \$65.0m vs EZL forecasts \$59.8m. NPAT was \$39.0m vs EZL forecasts of \$34.2m.
- Operating cashflow was strong at \$65.6m and the company finished the period with net cash of \$33.9m (excluding the impact of the Cape Class Patrol Boat 9 & 10 leasing program).
- ASB declared a final dividend of 3cps, making a full year total of 5cps (vs EZL forecasts of 4cps).
- ASB's current orderbook stands at \$3b across the US, Australia, Philippines, Vietnam and China.

##### Operations & Guidance – better US shipbuilding margins going forward

- ASB's US shipbuilding margin was a very strong 8.5% vs previous management guidance of 6-8% and also ahead of our forecasts of 7.3%.
- Management have guided \$1.3b-1.4b group revenue for FY'19 but with a US shipbuilding margin of 8-9%. We had previously forecast a US shipbuilding of 7.8% in FY'19 peaking at 8.5% in FY'20.
- US shipbuilding margin is one of the major drivers of value with ASB and we now view our forecasts with an upward bias.
- The US operation contributed a very strong \$83m EBIT in the period.
- ASB secured \$420m of commercial ferry contracts in the period.
- The Australian operations made a small EBIT loss of \$6.7m vs our forecast of \$6.3m profit. Management attribute this to profit recognition of the GCPB 1 vessel (expected to be realised in FY'19), low margin on the Mols ferry and tender costs associated with the OPV program.
- It is anticipated that with volume uptick in FY'19 Australian profitability should improve.
- The Asian operations (incl Philippines, Vietnam and China) operations which are still in the ramp up mode made a small EBIT loss of \$1.6m.

Austal Ltd	Year End 30 June	
Share Price	1.76	A\$/sh
Price Target	2.31	A\$/sh
Valuation	2.71	A\$/sh
WACC	10%	
Terminal Growth	1.0%	
Shares on issue	348.4	m, diluted
Market Capitalisation	599.2	A\$m
Enterprise Value	645.1	A\$m
Debt FY'18	185.3	A\$m
Cash FY'18	162.0	A\$m

Key Financials	2018a	2019f	2020f
Revenue (A\$m)	1392.0	1354.5	1222.4
EBITDA (A\$m)	102.3	114.8	114.7
EBIT (A\$m)	65.0	77.0	77.6
Reported NPAT (A\$m)	39.0	48.9	49.7
Normalised NPAT (A\$m)	39.0	48.9	48.9

Gross Cashflow (A\$m)	74.2	75.4	96.5
Capex (A\$m)	-27.1	-35.0	-20.0
Op. Free Cashflow (A\$m)	47.1	40.4	76.5

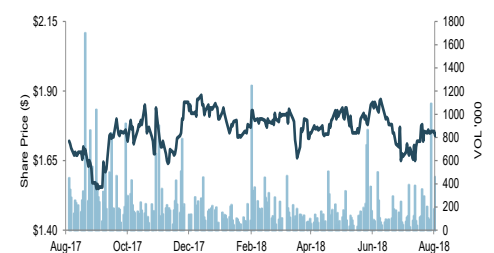
Revenue Growth (%)	6%	-3%	-10%
EBITDA Growth (%)	13%	12%	0%
Norm. NPAT Growth (%)	19%	25%	2%

Normalised EPS (Ac)	11.1	13.9	14.2
Norm. EPS growth (%)	19%	25%	2%
PER (x)	15.8	12.6	12.4
EV:EBITDA (x)	6.3	5.6	5.6
EV:EBIT (x)	9.9	8.4	8.3

DPS (Ac)	5.0	6.4	6.4
Dividend Yield (%)	2.8%	3.6%	0.0%

Net Debt (A\$m)	23.3	-48.8	-34.8
Net Debt:Equity (%)	4%	-8%	-6%
Interest Cover (x)	12.0	18.6	20.8

#### Share Price Chart



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# Austal Limited

## (ASB \$1.76) Buy

### Analysis

The table below depicts our new forecasts to an EBIT level for ASB's Australian operations to a divisional level and our forecasts for the US and Asian operations.

Austal Group Forecasts to EBIT level					
US operations	FY16a	FY17a	FY18a	FY19f	FY20f
	A\$m	A\$m	A\$m	A\$m	A\$m
Revenue	1133.1	1172.1	1162.7	1051.8	794.3
EBIT	-90.6	76.1	83.0	74.8	58.6
Divisional EBIT Margin%	-8.0%	6.5%	7.1%	7.1%	7.4%
<b>Australian operations</b>					
Revenue	187.0	113.7	198.5	197.5	274.3
EBIT	7.7	-2.1	-6.7	11.9	21.9
Divisional EBIT Margin%	4.1%	-1.8%	-3.4%	6.0%	8.0%
<b>Asian operations</b>					
Revenue	33.9	33.8	57.9	105.3	153.8
EBIT	-3.7	0.3	-1.6	5.3	12.3
Divisional EBIT Margin%	-10.9%	0.9%	-2.8%	5.0%	8.0%
<b>Corporate EBIT*</b>	<b>-30.0</b>	<b>-15.6</b>	<b>-9.7</b>	<b>-15.0</b>	<b>-15.3</b>
<b>Group Revenue</b>	<b>1354.0</b>	<b>1319.6</b>	<b>1419.1</b>	<b>1354.5</b>	<b>1222.4</b>
<b>Group EBIT</b>	<b>-116.6</b>	<b>58.7</b>	<b>65.0</b>	<b>77.0</b>	<b>77.6</b>
<b>Group EBIT Margin</b>	<b>-8.6%</b>	<b>4.4%</b>	<b>4.6%</b>	<b>5.7%</b>	<b>6.3%</b>
*US Ship building + Support margin	-8.6%	5.9%	7.5%	7.4%	7.7%

### Key Features:

- We forecast US shipbuilding margins to continue to improve before plateauing at 9.0% in FY'20 (prev 8.5%).
- We note ASB will now report a combined US shipbuilding and support margin and have guided 7-8% going forward. This compares to our forecasts of 7.4% & 7.7% in FY'18 & 19 respectively.
- The decline in US revenue from FY'18 to FY'20 depicts a roll off of the pace of LCS EPF programs to 1.5 LCS and 1 EPF per annum in FY'19 before stepping down to 1 LCS per annum beyond FY'21. We view these as conservative assumptions.
- At the group level the increase in Australian and Asian divisional revenue offsets the forecast decline in the US.
- As per management guidance we see Australian operations margin improvement in FY'19 followed by revenue and margin growth in FY'20.
- Asian operations are forecasts to double revenue in FY'19 as per management guidance.
- 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. We do not currently factor this into our forecasts.

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# Austal Limited

**(ASB \$1.76) Buy**

## Valuation

We maintain our Buy recommendation with a new price target of \$2.31 (prev. \$1.94/sh).

This increase has been driven by an increase in our assumed long run US ship building margin and a roll forward of our EV/EBIT from blended FY'18/19 to FY'19.

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

Our methodology is outlined in the table below:

Blended Valuation								
Method	FY'19 Earnings	Implied EV	Net Debt	Implied Mkt cap	SOI	Implied Share Price	Weighting	Valuation
		9x						
	\$m	\$m	FY'18a	\$m	m	\$/sh	%	\$/sh
EV/EBIT	77.0	693.0	25.1	667.9	351	1.90	50%	0.95
NPV		975.6	25.1	950.5	351	2.71	50%	1.35
<b>Price Target</b>								<b>2.31</b>

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Financial Statements	2017a	2018f	2019f	2020f	Performance Ratios	2017a	2018f	2019f	2020f
<b>Revenue</b>	<b>1310.1</b>	<b>1392.0</b>	<b>1354.5</b>	<b>1222.4</b>	<b>Growth &amp; Margins</b>				
Operating Expenses	-1193.0	-1289.7	-1239.7	-1107.7	Revenue Growth	-2%	6%	-3%	-10%
<b>EBITDA</b>	<b>90.2</b>	<b>102.3</b>	<b>114.8</b>	<b>114.7</b>	EBITDA Growth	39%	13%	12%	0%
Depreciation	-30.4	-35.7	-37.8	-37.1	EBIT Growth	67%	11%	18%	1%
Other Non cash	0.0	0.0	0.0	0.0	Normalized Net Profit Growth	31%	19%	25%	2%
<b>EBITA</b>	<b>59.8</b>	<b>66.6</b>	<b>77.0</b>	<b>77.6</b>	EBITDA margin	7%	7%	8%	9%
Amortisation	-1.1	-1.6	0.0	0.0	EBIT margin	4%	5%	6%	6%
<b>EBIT</b>	<b>58.7</b>	<b>65.0</b>	<b>77.0</b>	<b>77.6</b>	Normalized net profit margin	2%	3%	4%	4%
one off adjustments	-13.2	0.3	0.0	0.0	Effective tax rate	62%	31%	31%	31%
Net interest expense	-5.7	-8.5	-6.2	-5.5	<b>Liquidity</b>				
<b>NBPT</b>	<b>39.8</b>	<b>56.8</b>	<b>70.8</b>	<b>72.0</b>	Capex/depreciation (x)	0.3	0.8	0.9	0.5
Tax (expense)/ credit	-24.5	-17.8	-22.0	-22.3	Current ratio (x)	1.8	1.3	1.6	-1.8
<b>NPAT</b>	<b>15.3</b>	<b>39.0</b>	<b>48.9</b>	<b>49.7</b>	Quick ratio (x)	1.1	0.7	0.9	1.1
Significant items after tax	0.0	0.0	0.0	0.0	Receivable days	32	26	28	32
Minorities	0.0	0.0	0.0	0.0	Inventory days	-43	-59	-72	-75
<b>Reported NPAT</b>	<b>15.3</b>	<b>39.0</b>	<b>48.9</b>	<b>49.7</b>	Payable days	-59	-47	-51	-53
Analyst adj: g/w & amortisation	0.0	0.0	0.0	0.0	<b>Risk Measures</b>				
Analyst adj: significant items (a/t)	17.4	0.0	0.0	0.0	Dividend Cover (x)	2.7	3.0	2.1	1.9
<b>Normalised NPAT</b>	<b>32.7</b>	<b>39.0</b>	<b>48.9</b>	<b>49.7</b>	Payout ratio (%)	121%	45%	46%	45%
					Net interest cover (x)	16	12	19	21
					Net debt/equity (%)	10%	4%	-8%	-6%
<b>Cash flow (A\$m)</b>	<b>2017a</b>	<b>2018f</b>	<b>2019f</b>	<b>2020f</b>	<b>Returns</b>				
EBITDA	90.2	102.3	114.8	114.7	Return on average capital employed (%)	6%	6%	7%	7%
Tax paid	12.2	-7.1	-22.0	-22.3	WACC (%)	10.3%	10.3%	10.3%	12.1%
Net interest	-3.5	-4.6	-6.2	-5.5	ROA %	1%	3%	4%	4%
Change in net working capital	-108.4	-50.1	-11.3	9.6	Return on average equity (%)	3%	8%	9%	11%
Other	-27.9	33.6	0.0	0.0					
<b>Operating Cashflow</b>	<b>-37.4</b>	<b>74.2</b>	<b>75.4</b>	<b>96.5</b>	<b>Share Data/Valuation</b>	<b>2017a</b>	<b>2018f</b>	<b>2019f</b>	<b>2020f</b>
Capex PP& E	-10.0	-27.1	-35.0	-20.0	<b>Share Data</b>				
<b>Operating Free Cashflow</b>	<b>-47.4</b>	<b>47.1</b>	<b>40.4</b>	<b>76.5</b>	Issued shares (m)	349	351	351	351
Acquisitions	0.0	-13.5	0.0	0.0	Weighted ave shares (m)	349	350	351	351
Asset Sales	0.1	0.0	0.0	0.0	Fully diluted shares (m)	349	351	351	351
Debt drawdowns (repayments)	-13.5	-11.1	0.0	0.0	Basic EPS (c)	4.4	11.1	13.9	14.2
Equity contributions (net)	0.0	0.0	0.0	0.0	YoY change (%)	-118%	154%	25%	2%
Dividends	-12.3	-12.8	-22.8	-26.1	Fully diluted EPS (c)	4.4	11.1	13.9	14.2
Other	-0.8	0.0	0.0	0.0	YoY change (%)	-118%	154%	25%	2%
<b>Net cashflow</b>	<b>-73.8</b>	<b>9.7</b>	<b>13.9</b>	<b>46.0</b>	Fully diluted normalised EPS (c)	9.4	11.1	13.9	14.2
					YoY change (%)	30%	19%	25%	2%
					Dividend/share (c)	5	5	6.4	6.4
					Franking (%)	100%	100%	50%	50%
					Gross cashflow/share (c)	-10.7	21.2	21.5	27.5
					NBV/share (c)	130.7	156.5	163.9	170.6
					NTA/Share (c)	128.2	150.5	158.0	164.7
<b>Balance Sheet (\$m)</b>	<b>2017a</b>	<b>2018f</b>	<b>2019f</b>	<b>2020f</b>	<b>Valuation</b>				
Cash	150.5	162.0	174.1	220.1	PER (Basic) (x)	40	16	13	12
Receivables	100.4	97.3	108.4	103.9	PER (Fully diluted) (x)	40	16	13	12
Inventories	170.4	246.5	239.9	216.5	PER (Fully diluted, normalized) (x)	19	16	13	12
Other financial assets	9.7	7.6	1.7	1.7	P/CFPS (x)	-16	8	8	6
Other	0.7	6.1	6.1	6.1	Price/NBV (x)	1.3	1.1	1.1	1.0
<b>Total Current Assets</b>	<b>431.7</b>	<b>519.6</b>	<b>530.2</b>	<b>548.4</b>	Price/NTA (x)	1.4	1.2	1.1	1.1
Investments	9.6	13.0	13.0	13.0	Dividend Yield (%)	3.0%	2.8%	3.6%	0.0%
Receivables	0.0	0.0	0.0	0.0	Fully diluted normalized 3 yr EPS Cagr (%)	-6%	-5%	25%	15%
Property, plant & equipment	500.3	565.8	563.0	545.8	PEG ratio (x)	-3.1	-3.2	0.5	0.8
Deferred Tax	5.6	7.8	7.8	7.8	EV/EBITDA (x)	7.2	6.3	5.6	5.6
Intangible assets	8.9	20.8	20.8	20.8	EV/EBIT (x)	11.0	9.9	8.4	8.3
Other	3.8	21.8	21.8	21.8	EV/Revenue (x)	0.5	0.5	0.5	0.5
<b>Total Non Current Assets</b>	<b>528.3</b>	<b>629.2</b>	<b>626.4</b>	<b>609.3</b>	NPV (\$/sh)	2.71			
<b>Total Assets</b>	<b>960.0</b>	<b>1148.8</b>	<b>1156.6</b>	<b>1157.6</b>	WACC (%)	10%			
Creditors	154.9	177.8	171.0	152.8	<b>Other Information</b>				
Tax provision	0.0	0.0	0.0	0.0	Major Shareholders:				
Borrowings	9.9	72.8	12.8	12.8	Allan Gray				18.6%
Provisions	46.6	70.1	70.1	70.1	John Rothwell				9.12%
Other	27.5	68.3	68.3	68.3					
<b>Current Liabilities</b>	<b>238.9</b>	<b>388.9</b>	<b>322.0</b>	<b>303.8</b>	12-mth High/Low (A\$/sh)				1.94/0.93
Borrowings	186.5	112.5	112.5	172.5	Average daily volume (A\$m)				2.5
Deferred tax	10.9	32.5	32.5	32.5	ASX Code				ASB
Provisions	2.9	1.5	1.5	1.6	Next result				Feb'19
Other	64.0	64.3	64.3	48.4	<b>Company Description</b>				
<b>Total Non Current Liabilities</b>	<b>264.2</b>	<b>210.9</b>	<b>259.6</b>	<b>255.1</b>	Austal is a West Australian based shipbuilder. The company has operations in Australia, USA, Philippines, Vietnam and China. Austal builds vessels for various military and paramilitary customers as well as commercial and international ferry operators.				
<b>Total Liabilities</b>	<b>503.1</b>	<b>599.8</b>	<b>581.6</b>	<b>558.9</b>					
<b>NET ASSETS</b>	<b>456.9</b>	<b>549.0</b>	<b>575.0</b>	<b>598.7</b>					
Share capital	116.4	118.3	118.3	118.3					
Foreign currency translation/Reserves	91.6	156.7	156.7	156.7					
Retained profits/(losses)	248.9	273.9	300.0	323.6					
Shareholders' funds	456.9	549.0	575.0	598.7					
Minority Interest	0.0	0.0	0.0	0.0					
<b>Total Shareholders' Equity</b>	<b>456.9</b>	<b>549.0</b>	<b>575.0</b>	<b>598.7</b>					

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