

8 Mar 2019

AUSTAL LIMITED (ASB)

Great Result

Austal Limited ('ASB' or 'The Company') recently reported a good first half result as expected (the Company had provided updated guidance at the start of February). Business activity is strong and the weaker AUD provided a boost (with 80% of revenue generated in the US).

The Company now reports its Australian and Asian businesses as a combined unit, and it was a positive to see this combined business return a small EBIT profit of \$4.15m vs a loss of \$1.12m in 1H18. Cash at bank was up strongly, \$233.3m at the end of December versus \$162m at the end of June. However, in a historical context inventory now sits at one of the lowest levels versus sales and we would expect working capital requirements to increase in FY20. The Company announced an Interim Dividend increase to 3c (we had forecast 2c).

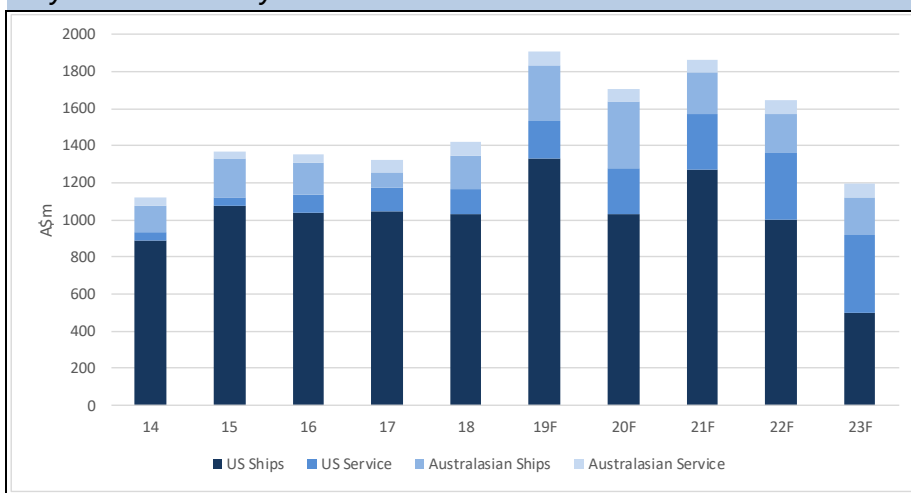
We have upgraded our FY19-20 margins for the now combined Australasian business to reflect a quicker return to (aggregated) profitability in those regions than we had expected. We had expected a combined EBIT profit of \$0.7m for the Full Year.

Our estimated fall in revenue in FY20 is due to an expected recovery in the USD/AUD exchange rate to 75c and the timing of revenue recognition on the LCS programme in the US (which is hard to predict). Our FY21 revenue shows an increase again on the basis of our ship by ship modelling of the LCS contracts.

Great performance – largely priced in.

ASB remains a WA success story and the level of success it has achieved with the US Navy we believe still deserves more recognition locally. We have modestly upgraded our near-term Divisional earnings on the back of a faster return to profitability in Australasia than expected. Looking forward we set our 12-month target price at \$2.25 (from \$2.12 per share, assumes AUD of 0.75) due to higher current net cash and hence we maintain our Neutral rating.

Key Chart: Hartleys Revenue Forecasts



Source: Hartleys Research

| | |
|---------------------|--------|
| Share Price: | \$2.30 |
| Valuation: | \$2.25 |
| 12mth price target: | \$2.25 |

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:

| | |
|-----------------------------|-------|
| Orbis Investment Management | 18.6% |
| enX Group Limited | 9.3% |
| Pendal Group Limited | 5.1% |

Company Address:

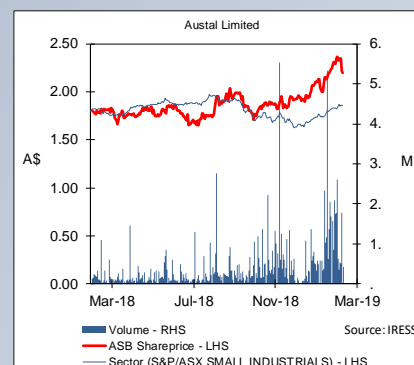
100 Clarence Beach Road
Henderson WA

| | |
|-------------------|----------|
| Issued Capital: | 352.0m |
| - fully diluted | 360.8m |
| Market Cap: | \$809.6m |
| - fully diluted | \$809.6m |
| Net Debt (FY 19e) | -\$45.1m |

| | FY17a | FY18a | FY19e |
|---------------|-------|-------|-------|
| Op Cash Flw | -37.9 | 65.6 | 131.0 |
| Free Cash Flw | -91.4 | 31.7 | 89.3 |
| NPAT* (A\$m) | 32.7 | 39.0 | 50.2 |
| EPS (\$, bas) | 9.3 | 11.2 | 14.3 |
| P/E (basic) | 24.6x | 20.6x | 16.1x |
| P/E (diluted) | 25.4x | 21.3x | 16.5x |
| EV / EBITDA | 8.6x | 7.6x | 6.2x |
| DPS (cps) | 4.0 | 5.0 | 6.0 |

| | | | |
|----------------|------|------|------|
| Dividend Yield | 1.7% | 2.2% | 2.6% |
| N.D. / equity | 10% | 4% | -8% |

Source: Hartleys Research. * normalised



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SUMMARY MODEL

Austal Limited (ASB)

| Company Information | | |
|------------------------|------------------|--|
| Date | 8 Mar 2019 | 100 Clarence Beach Road |
| Share Price | \$2.30 | Henderson WA |
| 52 Week High-Low | \$2.43 - \$1.495 | Australia, 6166 |
| Market Cap (\$m) | \$809.6 | D: +61 8 6414 4010 |
| Enterprise Value (\$m) | \$775.0 | www.austal.com |
| Ordinary Shares | 352.0 | |
| Fully Diluted Shares | 360.8 | |

| Valuation | | | | | |
|-----------------------------------|-------|-----------|-----------------|-------|-----------|
| S&P/ASX Industrial: FY19 Multiple | | ASX Comps | Target Multiple | Wgt.% | Tgt Price |
| EV/EBIT | 9.2x | 12.3x | 9.8x | 15% | 2.59 |
| EV/EBITDA | 6.2x | 8.0x | 6.4x | 15% | 2.50 |
| Earnings | 16.5x | 18.7x | 15.0x | 15% | 2.15 |
| Div Yield | 2.6% | 3.1% | 2.5% | 15% | 2.42 |
| NPV | | | | 40% | 2.01 |

| Valuation | | \$2.25 |
|--|--|--------|
| Upside from current | | -2% |
| P / E (6/19F) at price target | | 16.2x |
| P / E (6/20F) at price target | | 16.0x |
| EV / EBITDA (6/19F) at price target | | 6.1x |
| EV / EBIT (6/19F) at price target | | 9.0x |
| Dividend Yield (6/19F) at price target | | 2.7% |

| Multiples (\$/price at \$2.30) | 6/15A | 6/16A | 6/17A | 6/18A | 6/19F | 6/20F |
|--|-------|--------|--------|-------|-------|-------|
| P / E (reported, basic weighted) | 11.6x | -9.5x | 52.1x | 20.5x | 16.0x | 15.9x |
| P / E (normalised, dil. weighted) | 17.7x | -11.1x | 24.6x | 20.6x | 16.1x | 15.9x |
| P / E (mkt cap / norm. NPAT) | 18.0x | -11.3x | 24.8x | 20.7x | 16.1x | 15.9x |
| P / E (fully diluted mkt cap / norm. NP) | 18.4x | -11.6x | 25.4x | 21.3x | 16.5x | 16.3x |
| Dividend Yield | 1.7% | 1.7% | 0.0x | 2.2% | 2.6% | 2.8% |
| Group Free Cash Flow (f.c.f.) / EV | 10.6% | 7.9% | -0.1x | 4.2% | 11.5% | 5.1% |
| Equity f.c.f. / Mkt Cap | 6.3% | 8.9% | -0.1x | 2.9% | 8.6% | 2.4% |
| Norm f.c.f. / Mkt cap | 6.3% | 8.9% | -0.1x | 2.9% | 8.6% | 2.4% |
| Mkt cap / operating cash flow | 7.3x | 7.9x | -21.4x | 12.3x | 6.2x | 9.4x |
| EV/EBITDA multiple | 8.0x | -9.9x | 8.6x | 7.6x | 6.2x | 6.2x |
| EV/EBIT multiple | 10.6x | -7.2x | 13.2x | 11.9x | 9.2x | 9.2x |
| Price / Book Value | 1.6x | 1.8x | 1.8x | 1.5x | 1.4x | 1.4x |
| Price / NTA | 1.6x | 2.0x | 1.8x | 1.5x | 1.5x | 1.4x |
| Price / FCF | 9.7x | 13.0x | -8.9x | 24.5x | 9.0x | 20.4x |

| 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% | 8.7% | 8.4% |
| ROA | 4.5% | -6.9% | 3.3% | 3.7% | 4.4% | 4.4% |
| ND / ND + Equity | 3.1% | -12.7% | 9.1% | 4.1% | -8.5% | -11.7% |
| ND / Equity | 3.2% | -11.3% | 10.0% | 4.2% | -7.8% | -10.5% |
| Net Interest Cover (EBIT) | 17.8 | -19.7 | 10.4 | 7.9 | 10.0 | 11.5 |
| ROIC | 6.3% | -12.8% | 5.0% | 4.8% | 6.4% | 6.3% |

| 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 | 131.0 | 86.4 |
| Capex (Reported) | -28.1 | -40.9 | -52.0 | -32.8 | -41.7 | -46.7 |
| Group Free Cash Flow (rep'd) | 82.3 | 61.2 | -89.9 | 32.9 | 89.3 | 39.7 |
| Fixed Debt Repayments | -31.1 | 11.1 | 24.6 | -9.2 | -20.0 | -20.0 |
| Equity Free Cash Flow (rep'd) | 51.2 | 72.2 | -65.2 | 23.6 | 69.3 | 19.7 |
| 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 | 69.3 | 19.7 |
| Capex (inc HP) / depreciation | 116% | 137% | 165% | 88% | 103% | 115% |

| 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 |
| Various | 2,402,098 | 0.7% |
| Perf. Rights | 6,370,288 | 1.8% |
| TOTAL | 8,772,386 | 2.4% |

| Directors & Senior Management | | Substantial Shareholders | | % |
|-------------------------------|------------------------|-----------------------------|--|-------|
| John Rothwell AO | Non-Executive Chairman | Orbis Investment Management | | 18.6% |
| David Singleton | Managing Director | enX Group Limited | | 9.3% |
| Giles Everist | Independent Director | Pendal Group Limited | | 5.1% |
| Jim McDowell | Independent Director | Renaissance Small Companies | | 4.9% |
| Chris Indermaur | Non-Executive 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 | 373.9 | 428.0 |
| EBIT | 31.8 | 6.7 | -2.1 | -6.6 | 8.4 | 13.9 |
| EBIT Margin | 15.0% | 3.6% | -1.8% | -3.3% | 2.3% | 3.3% |
| USA - Divisional | | | | | | |
| Revenue | 1119.7 | 1133.1 | 1172.1 | 1162.7 | 1530.0 | 1276.6 |
| EBIT | 58.4 | -90.6 | 78.5 | 86.0 | 95.1 | 89.4 |
| EBIT Margin | 5.2% | -8.0% | 6.7% | 7.4% | 6.2% | 7.0% |
| Asia - Divisional | | | | | | |
| Revenue | 38.7 | 33.9 | 33.8 | 57.9 | | |
| EBIT | 1.0 | -3.7 | 0.3 | -1.6 | | |
| EBIT Margin | 2.6% | -10.9% | 0.9% | -2.8% | | |
| 2019+ Australasia | | | | | | |
| Total Revenue | 1,414.9 | 1,340.0 | 1,308.6 | 1,391.7 | 1,893.9 | 1,694.6 |
| growth | 57.4% | -5.3% | -2.3% | 6.4% | 36.1% | -10.5% |
| Segment EBITDA | 112.4 | -60.8 | 106.3 | 112.8 | 141.5 | 141.3 |
| Overhead | -14.9 | -17.6 | -16.1 | -10.4 | -16.5 | -16.5 |
| % of sales | -1.1% | -1.3% | -1.2% | -0.7% | -0.9% | -1.0% |
| EBITDA | 97.5 | -78.5 | 90.2 | 102.4 | 124.9 | 124.8 |
| margin | 6.9% | -5.9% | 6.9% | 7.4% | 6.6% | 7.4% |
| Depreciation/Amortisation | -24.3 | -29.9 | -31.5 | -37.3 | -40.4 | -40.5 |
| EBIT | 73.2 | -108.4 | 58.7 | 65.1 | 84.5 | 84.3 |
| EBIT / Sales | 5.2% | -8.1% | 4.5% | 4.7% | 4.5% | 5.0% |
| Net Interest | -4.1 | -5.5 | -5.7 | -8.2 | -8.4 | -7.3 |
| Profit Before Tax | 69.1 | -113.9 | 53.0 | 56.8 | 76.1 | 76.9 |
| - margin | 4.9% | -8.5% | 4.0% | 4.1% | 4.0% | 4.5% |
| Normalised Tax | -24.1 | 42.2 | -20.3 | -17.8 | -25.9 | -26.2 |
| Effective Tax Rate | 34.9% | 37.0% | 38.3% | 31.3% | 34.0% | 34.0% |
| NPAT Pre Minorities | 45.0 | -71.7 | 32.7 | 39.0 | 50.2 | 50.8 |
| 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 | 50.2 | 50.8 |
| Normalised tax rate | -35% | -37% | -38% | -31% | -34% | -34% |
| Norm. Net Profit / Sales | 3.2% | -5.3% | 2.5% | 2.8% | 2.7% | 3.0% |
| 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 | 50.2 | 50.8 |
| Reported EPS (basic, w'ghted) | 19.9 | -24.3 | 4.4 | 11.2 | 14.4 | 14.5 |
| Normalised EPS (dil, w'ghtd) | 13.0 | -20.7 | 9.3 | 11.2 | 14.3 | 14.4 |
| Normalised EPS (full, diluted) | 12.5 | -19.9 | 9.1 | 10.8 | 13.9 | 14.1 |
| EPS (full dil) Growth % | 26% | -259% | -146% | 20% | 29% | 1% |
| DPS (cps) | 4.0 | 4.0 | 4.0 | 5.0 | 6.0 | 6.0 |

| Payout Ratio | 20.1% | -16.4% | 90.7% | 44.6% | 41.8% | 41.4% |
|-----------------------------|-------|--------|--------|-------|-------|-------|
| Cashflow Statement (\$m) | | | | | | |
| EBITDA | 97.5 | -78.5 | 90.2 | 102.4 | 124.9 | 124.8 |
| Working Capital Change | 19.8 | 213.0 | -108.4 | -50.1 | 21.9 | -12.4 |
| Net interest Paid | -4.1 | -6.6 | -5.7 | -8.2 | -8.4 | -7.3 |
| Tax Paid | -18.5 | 42.2 | -20.3 | -17.8 | -7.4 | -18.7 |
| 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 | 131.0 | 86.4 |
| Capital Expenditure | -28.1 | -40.9 | -52.0 | -32.8 | -41.7 | -46.7 |
| 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 | -41.7 | -46.7 |
| 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 | -20.0 | -20.0 |
| Dividends Paid | -3.5 | -15.8 | -12.3 | -12.8 | -21.0 | -21.1 |
| Net Financing Cash Flow | -34.6 | -4.7 | 12.4 | -22.0 | -41.0 | -41.1 |
| Movement in Cash | 54.0 | 72.4 | -79.0 | 9.7 | 48.3 | -1.4 |
| 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 | 210.3 | 208.9 |
| Receivables | 104.3 | 128.3 | 100.4 | 97.3 | 103.8 | 120.7 |
| Inventories | 339.7 | 109.0 | 170.4 | 246.5 | 185.7 | 164.8 |
| Other | 16.5 | 8.5 | 10.4 | 13.7 | 13.7 | 13.7 |
| Total Current Assets | 598.9 | 470.1 | 431.7 | 519.6 | 513.5 | 508.2 |
| Property, Plant & Equipment | 442.5 | 490.8 | 500.3 | 565.8 | 567.0 | 573.2 |
| 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 | 630.5 | 636.6 |
| Total Assets | 1,070.9 | 1,013.1 | 960.0 | 1,148.8 | 1,144.0 | 1,144.8 |
| Accounts Payable | 223.5 | 229.8 | 154.9 | 177.8 | 145.4 | 129.0 |
| Interest Bearing Liabilities | 146.9 | 2.5 | 9.9 | 72.8 | 12.8 | 12.8 |
| Other | 92.1 | 74.4 | 74.1 | 138.3 | 156.8 | 164.3 |
| Total Current Liabilities | 462.5 | 306.8 | 238.9 | 388.9 | 314.9 | 306.1 |
| Interest Bearing Liabilities | 7.7 | 170.1 | 186.5 | 112.5 | 152.5 | 132.5 |
| 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 | 250.9 | 230.9 |
| Total Liabilities | 558.5 | 555.6 | 503.1 | 599.8 | 565.9 | 537.0 |
| Net Assets | 512.4 | 457.6 | 456.9 | 549.0 | 578.2 | 607.8 |
| Net Asset Value / Share (\$) | 1.42 | 1.27 | 1.27 | 1.52 | 1.60 | 1.68 |
| NTA / Share (\$) | 1.40 | 1.17 | 1.25 | 1.50 | 1.58 | 1.66 |
| Net Debt (net cash) | 16.1 | -51.7 | 45.9 | 23.3 | -45.1 | -63.7 |

Analyst: Aiden Bradley
Phone: +61 8 9268 2876

Last Earnings Estimate Changes:
08-March-2019

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

ASB recently reported a good first half result as expected (the Company had provided updated guidance at the start of February). Business activity is strong and the weaker AUD provided a boost (with 80% of revenue generated in the US).

The Company now reports its Australian and Asian businesses as a combined unit, and it was a positive to see this combined business return a small EBIT profit of \$4.15m vs a loss of \$1.12m in 1H18.

Fig. 1: Half Year Summary

| A\$ m | FY16 | | | FY17 | | | FY18 | | | FY19 F | | | Current Period | |
|------------------|-------|---------|--------|-------|-------|-------|-------|-------|-------|--------|-------|-------|----------------|----------|
| | 1H | 2H | FY | 1H | 2H | FY | 1H | 2H | FY | 1Ha | 2He | FYe | HoH | YoY |
| Revenue | 747 | 593 | 1,340 | 649 | 659 | 1,309 | 653 | 739 | 1,392 | 852 | 1,042 | 1,894 | 15.3% | 30.4% |
| EBITDA | 42 | (120) | (78) | 47 | 44 | 90 | 46 | 56 | 102 | 65 | 60 | 125 | 16.6% | 40.3% |
| Margin % | 5.6% | -20.3% | -5.9% | 7.2% | 6.6% | 6.9% | 7.1% | 7.6% | 7.4% | 7.7% | 5.7% | 6.6% | 9 bps | 54 bps |
| D&A | (13) | (17) | (30) | (15) | (16) | (32) | (17) | (20) | (37) | (20) | (20) | (40) | 1.2% | 17.5% |
| EBIT | 29 | (137) | (108) | 31 | 28 | 59 | 29 | 36 | 65 | 40 | 44 | 85 | 12.6% | 38.2% |
| Margin % | 3.88% | -23.18% | -8.09% | 4.80% | 4.18% | 4.49% | 4.48% | 4.86% | 4.68% | 4.74% | 4.23% | 4.46% | -11 bps | 27 bps |
| Interest Expense | (3) | (4) | (7) | (3) | (3) | (6) | (4) | (4) | (8) | (4) | (4) | (8) | 0.1% | -2.2% |
| PBT | 27 | (141) | (114) | 28 | 25 | 53 | 25 | 32 | 57 | 36 | 40 | 76 | 14.5% | 44.8% |
| Tax | (10) | 52 | 42 | (10) | (11) | (20) | 1 | (18) | (18) | (13) | (13) | (26) | -31.0% | -2605.8% |
| Tax rate % | 37.2% | 37.1% | 37.0% | 33.8% | 43.4% | 38.3% | -2.0% | 57.6% | 31.3% | 34.7% | 33.3% | 34.0% | -2285 bps | 3672 bps |
| NPAT | 17 | (101) | (84) | 19 | 14 | 33 | 26 | 13 | 39 | 24 | 27 | 50 | 76.1% | -7.3% |

Source: ASB and Hartleys Research

Cash at bank was up strongly, \$233.3m at the end of December versus \$162m at the end of June. However, in a historical context inventory now sits at one of the lowest levels versus sales and we would expect working capital requirements to increase in FY20. The Company announced an Interim Dividend increase to 3c (we had forecast 2c).

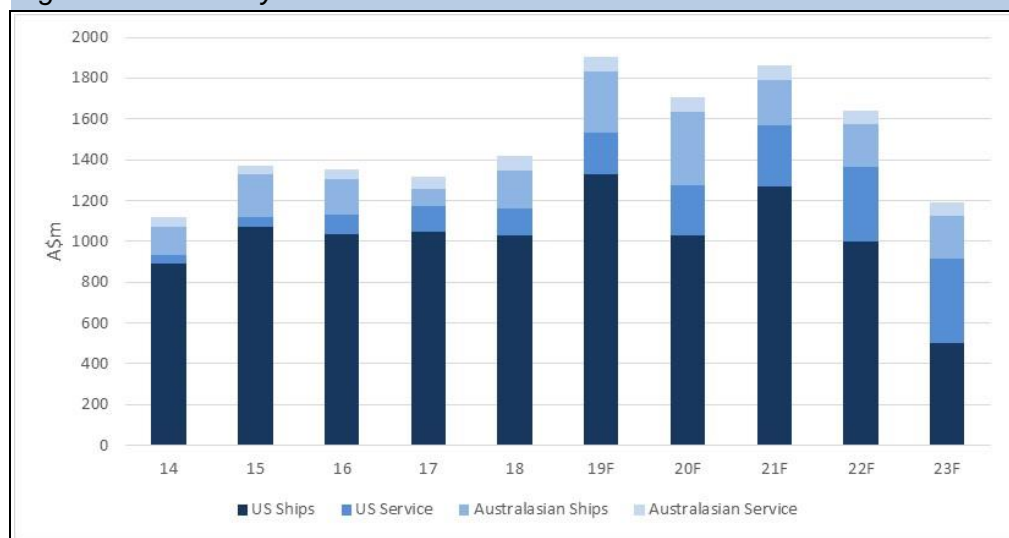
We have upgraded our FY19-20 margins for the now combined Australasian business to reflect a quicker return to (aggregated) profitability in those regions than we had expected. We had expected a combined EBIT profit of \$0.7m for the Full Year.

Fig. 2: Hartleys Earnings Changes

| A\$ m | FY16 | FY17 | FY18 | FY19E | | | FY20E | | |
|---------|-------|-------|-------|-------|-------|--------|-------|-------|--------|
| | Act | Act | Act | Old | New | % diff | Old | New | % diff |
| Revenue | 1,340 | 1,309 | 1,392 | 1,895 | 1,894 | 0% | 1,658 | 1,695 | 2% |
| EBITDA | -78 | 90 | 102 | 122 | 125 | 3% | 124 | 125 | 0% |
| EBIT | -108 | 59 | 65 | 81 | 85 | 4% | 84 | 84 | 0% |
| NPAT | -72 | 33 | 39 | 52.1 | 50.2 | -4% | 54.2 | 50.8 | -6% |

Source: ASB and Hartleys Research

Our estimated fall in revenue in FY20 is due to an expected recovery in the USD/AUD exchange rate to 75c and the timing of revenue recognition on the LCS programme in the US (which is hard to predict). Our FY21 revenue shows an increase again on the basis of our ship by ship modelling of the LCS contracts.

Fig. 3: Hartleys Revenue Forecasts*

Source: ASB and Hartleys Research. * Revenue is from existing contracts only.

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

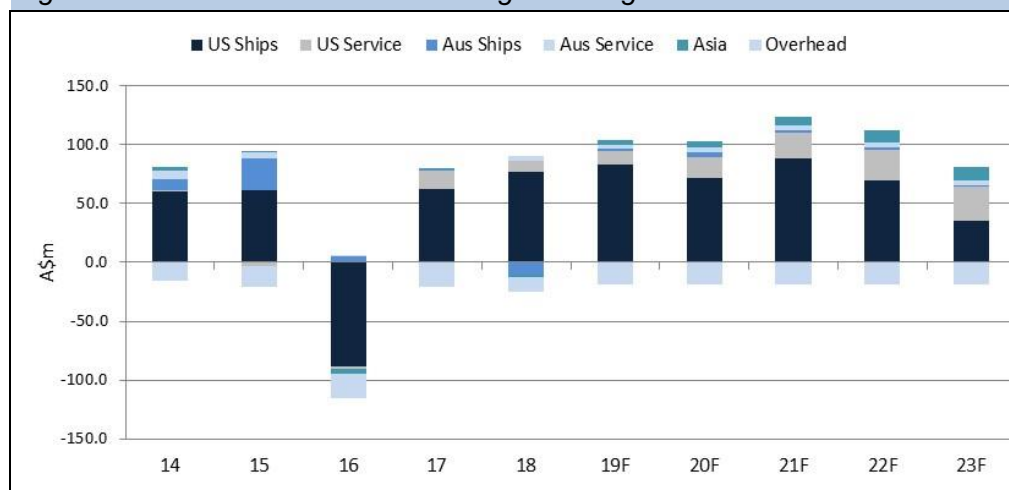
Austal's achievements in establishing itself as a primary supplier to both the Australian Navy (and especially) and US Navy is quite simply a tremendous achievement. However, it has not been without its teething problems and the volatility in the share price over the past five years reflects that (a 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 still waiting to formally hear what impact the award of the Australia Futures Frigate contract to BAE will have on ASB's business (although expectations are not high).

Given recent contract announcements in Australia, the US Navy's LCS/Frigate contracts have become even more important for the future of ASB. 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 US Navy will pick a winner in 2020 and order at least 20 ships. This is therefore a crucial project for ASB to be part off, especially post the outcome of the two Australian Naval tenders.

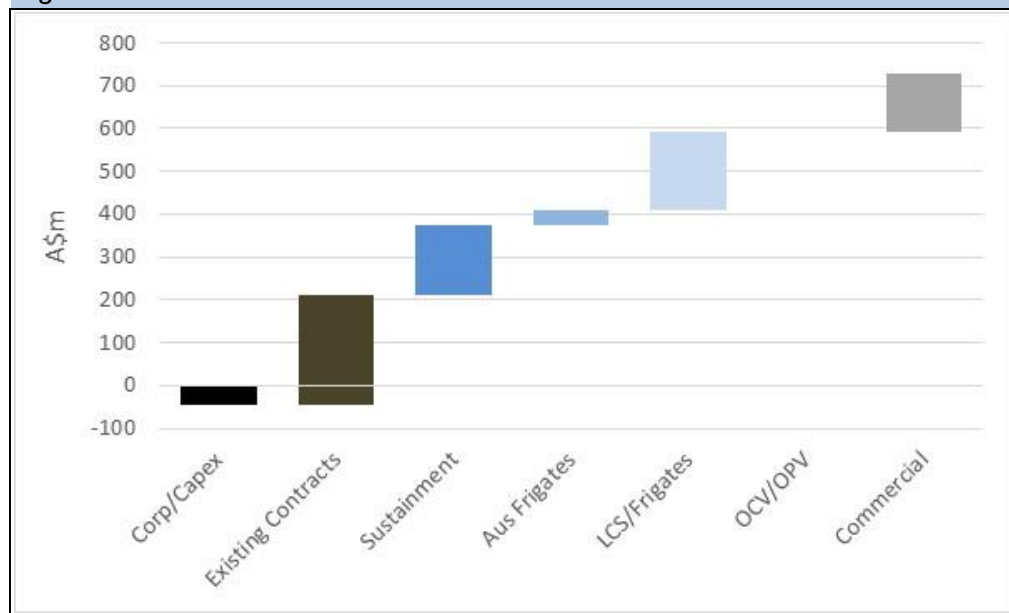
In the near term the outlook for revenue and earnings is underpinned by continued strength in the commercial market and existing US Navy orders. Longer term, the US Navy LCS/Frigate extension will be key to determining the level of workload in the US. At the moment, we assume 50% is awarded to ASB. ASB 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.

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. 4: EBIT Outlook – Existing Backlog

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 continues to improve) 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).

Fig. 5: NPV10 – Base Case

Source: Hartleys Research

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 current relative multiple to this sector and our NPV10 we derive a 12-month forward target price of \$2.25 per share (up from \$2.12).

Fig. 6: Valuation - Target Multiples

| Valuation | | | | | |
|---|-----------|-----------------|-------|-----------|---------------|
| S&P/ASX Industrial: FY19 Multiple | ASX Comps | Target Multiple | Wgt.% | Tgt Price | |
| EV/EBIT | 9.2x | 12.3x | 9.8x | 15% | 2.59 |
| EV/EBITDA | 6.2x | 8.0x | 6.4x | 15% | 2.50 |
| Earnings | 16.5x | 18.7x | 15.0x | 15% | 2.15 |
| Div Yield | 2.6% | 3.1% | 2.5% | 15% | 2.42 |
| NPV | | | | 40% | 2.01 |
| Valuation | | | | | \$2.25 |
| <i>upside from current</i> | | | | | -2% |
| <i>P / E (6/19F) at price target</i> | | | | | 16.2x |
| <i>P / E (6/20F) at price target</i> | | | | | 16.0x |
| <i>EV / EBITDA (6/19F) at price target</i> | | | | | 6.1x |
| <i>EV / EBIT (6/19F) at price target</i> | | | | | 9.0x |
| <i>Dividend Yield (6/19F) at price target</i> | | | | | 2.7% |

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.

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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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