

24 April 2018

Electro Optic Systems (EOS)

Buy

Share Price: A\$3.03

Strong 1Q18 update

Target Price:

A\$4.05

EOS issued a strong 1Q18 update yesterday ahead of its AGM this morning. The key takeaway of the update was that production of its market leading R400S-Mk2 is on track to achieve FY18 guidance. In addition, the group announced small incremental contracts of A\$12m from existing and new customers. With industry leading technology, large order book and deep customer relationships, EOS is extremely well positioned to capture what we estimate may be a A\$5bn market in the near term. We reiterate our A\$4.05 target price and Buy recommendation.

Production targets achieved

- 1Q18 production target, achieved.
- On track to meet FY18F target of 240 units.
- Product quality in-line or ahead of customer expectations with no defects reported.

Small new contract win

- During the quarter EOS received additional orders for A\$12m of remote weapon systems (RWS) from one existing and one new customer.
- In addition, the US defence budget has released funds for several programs that may require EOS.
- EOS expects these contracts will be awarded from 4Q18.

Product Development

- EOS has developed a remote weapon system that can mount all small arms and crew-served weapons at lower costs than legacy product.
- This product, known as R-150, provides significant cost and weight savings over its predecessors.
- The R-150 is expected to be qualified for production later in 2018.
- In its Space division, following the completion of an extensive period of testing with one customer, a wide range of missions were successfully completed.

Forecasts and Valuation

- We have taken a conservative valuation approach and have only included announced contracts for existing products in our forecasts and valuation methodology.
- This implies strong potential for significant upward revisions from an RWS replacement cycle and new product verticals, particularly in relation to space surveillance data and remote turrets systems.
- We reiterate our Buy recommendation and a A\$4.05 target price.

Company Data

| | |
|--------------------------------|---------------------|
| Shares – ordinary (M) | 80.3 |
| Dilution (M) | 0.0 |
| Total (fully diluted) (M) | 80.3 |
| Market capitalisation (\$M) | 228.8 |
| 12 month low/high (\$) | 1.73/3.40 |
| Average monthly turnover (\$M) | 4.0 |
| Index | ASX 300 |
| GICS Industry | Aerospace & Defence |

Financial Summary (fully diluted/normalised)

| Year end Dec | 2016A | 2017A | 2018F | 2019F | 2020F |
|------------------------|-------|-------|-------|--------|--------|
| Revenue (\$M) | 25.8 | 23.3 | 96.0 | 208.0 | 218.8 |
| Costs (\$M) | -28.0 | -35.2 | -89.8 | -189.6 | -198.9 |
| EBITDA (\$M) | -2.2 | -11.9 | 6.2 | 18.4 | 19.9 |
| NPAT (\$M) | -0.9 | -9.4 | 5.3 | 17.5 | 13.3 |
| EPS (¢ps) | -1.6 | -15.1 | 6.6 | 19.0 | 14.4 |
| EPS Growth (%) | n/m | n/m | n/m | 188% | -24% |
| PER (x) | n/m | n/m | 45.9 | 16.0 | 21.0 |
| Free Cashflow (\$M) | -3.1 | -27.1 | 1.1 | 5.4 | 17.1 |
| FCFPS (¢ps) | -3.8 | -33.7 | 1.3 | 6.7 | 21.3 |
| PFCFPS (x) | n/m | n/m | 224.8 | 45.2 | 14.2 |
| Enterprise Value (\$M) | 234.4 | 233.3 | 170.4 | 165.1 | 148.0 |
| EV / EBITDA (x) | n/m | n/m | n/m | 9.0 | 7.4 |
| Payout ratio (%) | n/m | n/m | n/m | n/m | n/m |
| Dividends (¢ps) | n/m | n/m | n/m | n/m | n/m |
| Yield (%) | n/m | n/m | n/m | n/m | n/m |

EOS – performance over one year



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Analysis

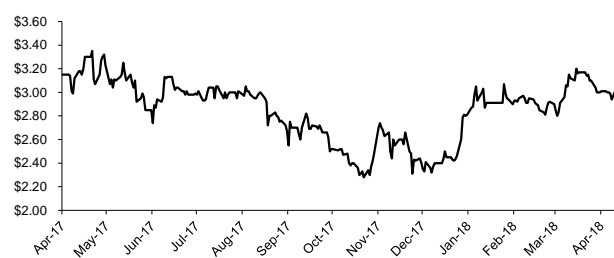
Electro Optic Systems Holdings Limited

Year end 31 December

MARKET DATA

| | | |
|---------------------------|-----|-----------|
| Recommendation | | Buy |
| Price | \$ | 3.03 |
| Target price (12-month) | \$ | 4.05 |
| 52 week low / high | | 1.73/3.40 |
| Market capitalisation | \$m | 243.3 |
| Shares on issue (basic) | no. | 80.3 |
| Options / rights | no. | 0.0 |
| Other equity | no. | 0.0 |
| Shares on issue (diluted) | no. | 80.3 |

12-MONTH SHARE PRICE PERFORMANCE



INVESTMENT FUNDAMENTALS

| | FY16A | FY17A | FY18F | FY19F | FY20F |
|-----------------------------------|-----------|--------|-------|-------|-------|
| Reported NPAT | \$m (0.9) | (9.4) | 5.3 | 17.5 | 13.3 |
| NPAT normalised | \$m (0.9) | (9.4) | 5.3 | 17.5 | 13.3 |
| Reported EPS (undiluted) | ¢ (1.6) | (15.1) | 5.9 | 19.0 | 14.4 |
| EPS normalised (undiluted) | ¢ (1.6) | (15.1) | 6.6 | 19.0 | 14.4 |
|Growth | % n/m | n/m | n/m | 188% | -24% |
| PER normalised | x n/m | n/m | 45.9 | 16.0 | 21.0 |
| Operating cash flow per share | ¢ (3.3) | (32.3) | 2.6 | 7.9 | 22.5 |
| Free cash flow per share | ¢ (3.8) | (33.7) | 1.3 | 6.7 | 21.3 |
| Price to free cash flow per share | x n/m | n/m | 224.8 | 45.2 | 14.2 |
| FCF yield | % (1.3) | (11.1) | 0.4 | 2.2 | 7.0 |

| | | | | | |
|----------|-------|-----|-----|-----|-----|
| Dividend | ¢ 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payout | % 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Yield | % 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Franking | % n/a | n/a | n/a | n/a | n/a |

| | | | | | |
|---------------------|-----------|-------|-------|-------|-------|
| Enterprise value | \$m 234.4 | 233.3 | 170.4 | 165.1 | 148.0 |
| EV/EBITDA | x n/m | n/m | n/m | 9.0 | 7.4 |
| EV/EBIT | x n/m | n/m | n/m | n/m | 7.5 |
| Price to book (NAV) | x 60.1 | 10.3 | 2.8 | 2.3 | 1.9 |
| Price to NTA | x 14.2 | 5.1 | 1.5 | 0.9 | 0.8 |

KEY RATIOS

| | FY16A | FY17A | FY18F | FY19F | FY20F |
|--------------------------------------|-----------|--------|--------|--------|--------|
| EBITDA margin | % (8.7) | (51.3) | 6.5 | 8.8 | 9.1 |
| EBIT margin | % (9.1) | (52.2) | 6.4 | 8.8 | 9.1 |
| NPAT margin | % (3.4) | (40.4) | 5.5 | 8.4 | 6.1 |
| ROE | % (21.9) | (39.9) | 6.0 | 16.6 | 10.7 |
| ROA | % (5.2) | (19.7) | 3.3 | 6.5 | 4.5 |
| Net debt / (cash) | \$m (8.9) | (10.0) | (72.8) | (78.2) | (95.3) |
| Interest cover (EBIT / net interest) | x 4.0 | (4.4) | 7.6 | 22.9 | 24.8 |
| Gearing (net debt / EBITDA) | x 4.0 | 0.8 | (11.7) | (4.3) | (4.8) |
| Leverage (ND / (ND+E)) | % 184% | n/m | n/m | n/m | n/m |

DUPONT ANALYSIS

| | FY16A | FY17A | FY18F | FY19F | FY20F |
|--------------------|----------|--------|-------|-------|-------|
| Net Profit Margin | % (3.4) | (40.4) | 5.5 | 8.4 | 6.1 |
| Asset Turnover | x 1.5 | 0.5 | 0.6 | 0.8 | 0.7 |
| Return on Assets | % (5.2) | (19.7) | 3.3 | 6.5 | 4.5 |
| Financial Leverage | x 4.2 | 2.0 | 1.8 | 2.5 | 2.4 |
| Return on Equity | % (21.9) | (39.9) | 6.0 | 16.6 | 10.7 |

PROFIT AND LOSS (PRO FORMA)

| | FY16A | FY17A | FY18F | FY19F | FY20F |
|-----------------------------|-----------|--------|-------|-------|-------|
| Total revenue | \$m 25.8 | 23.3 | 96.0 | 208.0 | 218.8 |
| EBITDA | \$m (2.2) | (11.9) | 6.2 | 18.4 | 19.9 |
| Depreciation & amortisation | \$m 0.1 | 0.2 | 0.1 | 0.1 | 0.1 |
| EBIT | \$m (2.3) | (12.1) | 6.1 | 18.3 | 19.8 |
| Net interest | \$m 0.6 | (2.7) | (0.8) | (0.8) | (0.8) |
| Non-operating income | \$m 0.0 | 0.0 | 0.0 | 0.0 | 1.0 |
| Pretax Profit | \$m (2.9) | (9.4) | 5.3 | 17.5 | 19.0 |
| Tax expense | \$m 2.0 | 0.0 | 0.0 | 0.0 | (5.7) |
| Minorities | \$m 0.0 | 0.0 | 0.0 | 0.0 | 1.0 |
| Operating NPAT | \$m (0.9) | (9.4) | 5.3 | 17.5 | 13.3 |
| Significant items | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported NPAT | \$m (0.9) | (9.4) | 5.3 | 17.5 | 13.3 |

BALANCE SHEET

| | FY16A | FY17A | FY18F | FY19F | FY20F |
|----------------------|----------|-------|-------|-------|-------|
| Cash | \$m 8.9 | 10.0 | 72.8 | 78.2 | 95.3 |
| Receivables | \$m 3.8 | 11.7 | 50.6 | 109.7 | 115.4 |
| Inventory | \$m 3.5 | 13.8 | 35.2 | 74.3 | 77.9 |
| Other | \$m 0.5 | 2.4 | 2.5 | 2.6 | 2.8 |
| Current | \$m 16.6 | 37.8 | 161.2 | 264.9 | 291.4 |
| Prop, plant & equip | \$m 0.5 | 1.4 | 1.6 | 2.5 | 3.5 |
| Intangibles | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$m 0.0 | 8.4 | 0.0 | 0.0 | 0.0 |
| Non current | \$m 0.5 | 9.8 | 1.6 | 2.5 | 3.5 |
| Total assets | \$m 17.1 | 47.6 | 162.8 | 267.4 | 294.9 |
| Accounts Payable | \$m 7.2 | 18.1 | 74.6 | 161.7 | 170.1 |
| Borrowings | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | \$m 5.9 | 6.0 | 0.0 | 0.0 | 0.0 |
| Total liabilities | \$m 13.0 | 24.0 | 74.6 | 161.7 | 170.1 |
| Shareholder's equity | \$m 4.0 | 23.6 | 88.1 | 105.7 | 124.8 |

CASH FLOW

| | FY16A | FY17A | FY18F | FY19F | FY20F |
|-------------------------------------|-----------|--------|-------|--------|-------|
| EBITDA | \$m (2.2) | (11.9) | 6.2 | 18.4 | 19.9 |
| D&A | \$m (0.1) | (0.2) | (0.1) | (0.1) | (0.1) |
| Interest | \$m 0.6 | (2.7) | (0.8) | (0.8) | (0.8) |
| Other | \$m (0.9) | (11.1) | (3.2) | (11.1) | (0.9) |
| Operating cash flow | \$m (2.7) | (25.9) | 2.1 | 6.4 | 18.1 |
| Capex | \$m (0.4) | (1.1) | (1.0) | (1.0) | (1.0) |
| Acquisitions | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Disposals | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Investing cash flow | \$m (0.4) | (1.1) | (1.0) | (1.0) | (1.0) |
| Equity | \$m 0.0 | 28.0 | 61.8 | 0.0 | 0.0 |
| Increase / (decrease) in borrowings | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividend/other | \$m 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Financing cash flow | \$m 0.0 | 28.0 | 61.8 | 0.0 | 0.0 |
| Free cash flow | \$m (3.1) | (27.1) | 1.1 | 5.4 | 17.1 |

Source: Petra Capital

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