

SPEC BUY

Current Price \$0.50
Valuation \$1.05

Fully Diluted Shares (m)*: 74.8
Market Cap (\$m)*: 37.4
Net Debt (\$m): 2.2
Enterprise Value (\$m): 39.6
** Assumes CN conversion into equity*

52 wk High/Low: 0.62 0.14
12m Av Daily Vol (m): 0.10

Key Metrics

	15F	16F
EV/EBITDA (x)	12.3	6.1
EV/EBIT (x)	30.3	9.9
P/E (x)	-106.4	19.9

Ratios

	14A	15F	16F
ND / Equity	13.9%	-9.4%	10.6%
EBITDA Mgn	-0.6%	3.5%	4.8%
RoA	-4.3%	2.6%	6.7%
RoE	-1.7%	-1.3%	5.9%

Financials:

	14A	15F	16F
Rep. Rev. (\$m)	22	16	43
Adj. Rev. (\$m)*	66	63	91
Rep. EBITDA (\$m)	-0.8	-1.9	2.3
Adj. EBITDA (\$m)*	-0.4	2.2	4.4
Rep. NPAT (\$m)	1.7	-0.3	1.8
Adj. NPAT (\$m)*	-0.3	-0.3	1.8

* Adj. reflects one-offs & OEC's share of assoc., subsid.

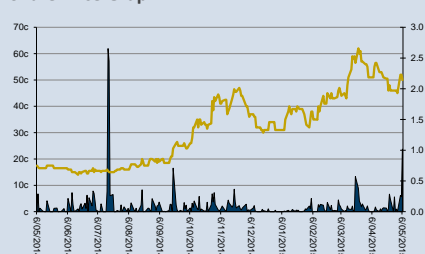
Net Assets (\$m) 21.0 29.9 32.4

Op CF (\$m) -1.9 0.2 -3.2

Per Share Data:

	14A	15F	16F
Adj. EPS (cps)	-0.7	-0.5	2.5
DPS (cps)	0.0	0.0	0.0
Div Yield	0.0%	0.0%	0.0%
NTAPS (cps)	42.5	52.4	59.0
CFPS (cps)	-3.9	0.3	-4.3

Share Price Graph



Wednesday, 6 May 2015

Orbital (OEC)

Opportunity-rich

Analyst | Ian Christie

Quick Read

Significant growth options are being presented to OEC by Boeing subsidiary Insitu (in the drone market), as well as in the Pilbara (REMSAFE and LNG technology). In our view OEC is a rejuvenated, opportunity-rich business, which has its downside limited by the investment in Synerject. Enhanced System Sales revenue visibility post the engine supply agreement with Insitu offsets the potential dilution from the issue of an additional \$3m Convertible Notes in April. Our valuation and recommendation are unchanged.

View | Positive

Significant UAV engine manufacturing opportunity: Boeing subsidiary Insitu has named OEC as the preferred supplier of engines and propulsion systems for the ScanEagle UAV programme. A commercial Production Contract is being negotiated, which is expected to result in initial engine production from OEC's Perth facilities, pending the establishment of new, higher volume facilities in the U.S.

Opportunity-rich: This positive news cements a relationship that has been nurtured for over two years, and gives us greater confidence in forecasts for the System Sales division. The UAV propulsion system market is sizeable and there is upside to our current forecasts (see detail on pages 4-5). In addition we have cause to be optimistic about the recently acquired REMSAFE business. Its high voltage remote isolation system improves safety and reduces costs – topics dear to the hearts of iron ore miners in the Pilbara. In similar vein, OEC's LNG technology also offers an attractive alternative to cost-focussed miners through the switch of large earthmoving fleets to natural gas.

Convertible Note issue recently completed: In December OEC announced its intention to raise up to \$10m via a CN offer, with the proceeds to be applied to the acquisition and funding of REMSAFE. After shareholder approval in January, \$7m worth of CN's were issued in February and a further \$3m in April to complete the offer. The 200 CN's issued have a face value of \$50,000 each, mature 2 years from the date of issue, pay interest at 10.0% p.a., and can convert at any time at \$0.40 per share.

Investment opportunity: As discussed in our recent initiation piece ([Game of Drones](#), March 2015) we believe OEC's fully diluted market cap is largely underpinned by a 30% stake with Continental AG in Synerject (which delivered US\$3.0m profit to OEC in FY14). In our view little value is being ascribed to the growth opportunities discussed above. Potential CN conversion and sale of shares may cap share price appreciation in the near term, but would provide an opportunity for new investors in our view.

Recommendation

The potential EPS dilution on conversion of the additional \$3m CN's issued in April has been offset by a reduction in earnings risk following the Insitu agreement. As a result we maintain our \$1.05 valuation (based on fully diluted shares). This provides considerable upside and we maintain our valuation and speculative buy recommendation.

Orbital Corporation

Equity Research

Ian Christie, CFA

Recommendation	SPEC BUY
Current Price (\$)	0.50
Valuation (\$)	1.05

Sector	Technical Engineering
Market Cap (\$m)	24.5
Date	6 May 2015

Trading Metrics	FY14A	FY15F	FY16F	FY17F
EV / EBITDA (x)	(63.0)	12.3	6.1	2.6
EV / EBIT (x)	(20.1)	30.3	9.9	3.0
P/E (x)	(71.9)	(106.4)	19.9	5.6
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%

Per Share Data	FY14A	FY15F	FY16F	FY17F
Reported EPS (cps)	3.4	-0.5	2.5	8.9
Adjusted EPS (cps)	-0.7	-0.5	2.5	8.9
Div. per share (cps)	0.0	0.0	0.0	0.0
NTA per share (cps)	42.5	52.4	59.0	60.4
CF per share (cps)	-3.9	0.3	-4.3	3.2

Profit and Loss (\$m)*	FY14A	FY15F	FY16F	FY17F
Revenue	65.9	62.8	90.7	118.1
EBITDA	(0.4)	2.2	4.4	10.3
D&A	(0.9)	(1.3)	(1.7)	(1.6)
EBIT	(1.3)	0.9	2.7	8.8
PBT	(1.7)	(0.0)	1.2	7.4
NPAT	(0.3)	(0.3)	1.8	6.5
Reported Revenue	22.5	16.4	43.3	78.6
Reported EBITDA	(0.8)	(1.9)	2.3	11.1
Reported NPAT	1.7	(0.3)	1.8	6.5

* Normalised to reflect one-offs and share of REMSAFE & Synerject at all lines, unless otherwise stated

Cash Flow (\$m)	FY14A	FY15F	FY16F	FY17F
Receipts	20.8	19.8	39.4	73.7
Payments	(22.8)	(18.7)	(41.0)	(67.5)
Other	0.1	(0.9)	(1.5)	(3.8)
Cash from Operations	(1.9)	0.2	(3.2)	2.4
Property, Plant & Equip	(0.4)	(0.8)	(4.6)	(1.2)
Payment for Subsidiary	-	(6.0)	-	-
Other	1.2	3.0	2.0	2.0
Cash From Investing	0.9	(3.8)	(2.6)	0.8
Issue of Shares	-	9.3	-	-
Net Borrowing	(0.4)	-	5.0	-
Dividends / Other	-	-	(0.5)	(1.3)
Cash From Financing	(0.4)	9.3	4.5	(1.3)
Net Cash Flow	(1.5)	5.7	(1.3)	1.9
Ending Cash	5.4	11.1	9.9	11.8

Balance Sheet (\$m)	FY14A	FY15F	FY16F	FY17F
Cash	5.4	11.1	9.9	11.8
Receivables	5.8	2.5	7.1	12.9
Inventories	3.3	2.5	5.6	9.2
Other	1.3	0.1	0.1	0.1
Current Assets	15.8	16.3	22.8	34.1
Property, Plant & Equip	2.8	3.9	7.2	6.9
Intangibles	-	4.5	4.0	4.0
Other NC Assets	19.0	20.8	22.8	24.8
Non-Current Assets	21.8	29.1	34.0	35.7
Total Assets	37.7	45.4	56.7	69.7
Payables	3.7	2.5	5.6	9.2
Progress Claims / Dep	0.3	0.4	1.1	2.0
Borrowings	8.3	8.3	13.3	13.3
Provisions	0.5	0.5	0.5	0.5
Other	3.8	3.8	3.8	3.8
Total Liabilities	16.6	15.5	24.3	28.8
Net Assets	21.0	29.9	32.4	40.9
Ordinary Equity	19.6	28.8	29.5	31.4
Reserves	(0.6)	(0.6)	(0.6)	(0.6)
Retained Earnings	2.0	1.7	3.5	10.1
Total Equity	21.0	29.9	32.4	40.9

Valuation	Calcs.	\$m	\$ps
DCF Valuation:			
Discount Rate / WACC (%)	12.57%		
PV Free Cash Flow (\$m)	86.0		
Less Net Debt / Plus Cash (\$m)	(2.2)		
Unpaid Capital (\$m)	-		
Equity Value (\$m)		83.8	1.12

PE Valuation:			
FY17 PE multiple	11.0	71.8	0.96
Valuation (\$ per share) - blend of DCF and PE			1.05

Profit and Loss (\$m)*	1H14A	2H14A	1H15A	2H15F
Revenue	35.7	30.2	35.8	26.9
EBITDA	(0.3)	(0.2)	(0.6)	2.8
D&A	(0.4)	(0.5)	(0.3)	(1.0)
EBIT	(0.7)	(0.6)	(1.0)	1.8
PBT	(0.9)	(0.8)	(1.2)	1.2
NPAT	(0.5)	0.2	(1.2)	0.9
Reported Revenue	11.7	10.7	9.1	7.3
Reported EBITDA	(2.4)	1.6	(2.4)	0.5
Reported NPAT	(0.5)	2.2	(1.2)	0.9

* Normalised to reflect one-offs and share of REMSAFE & Synerject at all lines, unless otherwise stated

Cash Flow (\$m)	1H14A	2H14A	1H15A	2H15F
Receipts	10.1	10.7	11.9	7.8
Payments	(12.5)	(10.3)	(12.1)	(6.6)
Other	0.0	0.1	(0.0)	(0.9)
Cash from Operations	(2.3)	0.4	(0.2)	0.4
Property, Plant & Equip	(0.1)	(0.3)	(0.1)	(0.7)
Payment for Subsidiary	-	-	-	(6.0)
Other	0.2	1.1	1.1	1.9
Cash From Investing	0.1	0.8	1.0	(4.8)
Issue of Shares	-	-	(0.8)	10.1
Net Borrowing	(0.0)	(0.4)	(0.0)	0.0
Dividends / Other	-	-	-	-
Cash From Financing	(0.0)	(0.4)	(0.8)	10.1
Net Cash Flow	(2.3)	0.8	0.1	5.7
Ending Cash	4.6	5.4	5.5	11.1

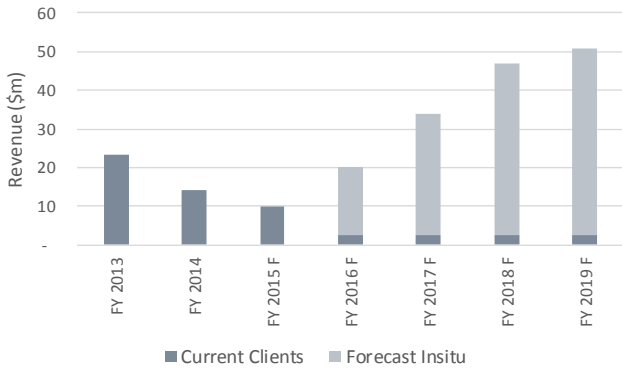
Financial Ratios	FY14A	FY15A	FY16F	FY17F
Growth				
Revenue growth (%)	-31.4%	-16.2%	184.6%	81.6%
NPAT growth (%)				
Norm. EPS growth (%)	-81.2%	-32.4%	-634.7%	255.0%
Profitability Ratios				
EBITDA Margin (%)	-0.6%	3.5%	4.8%	8.7%
EBIT Margin (%)	-2.0%	1.4%	3.0%	7.4%
PBT Margin (%)	-2.6%	0.0%	1.3%	6.3%
NPAT Margin (%)	-0.5%	-0.5%	2.0%	5.5%
Return on Assets (%)	-4.3%	2.6%	6.7%	16.7%
Return on Equity (%)	-1.7%	-1.3%	5.9%	17.8%
ROIC (%)	-4.3%	3.1%	6.0%	13.6%
Balance Sheet Ratios				
Net Debt (ND)	2.9	(2.8)	3.4	1.6
Net Debt (ND) / Equity (%)	13.9%	-9.4%	10.6%	3.9%
ND / ND + Equity (%)	12.2%	-10.4%	9.6%	3.7%
Current Ratio (x)	2.1	2.8	2.3	2.4
Net Interest Cover (x)	-4.8	-3.5	0.4	7.0
Cash Flow Ratios				
Free Cash Flow Yield (%)	-9.3%	-17.9%	-21.2%	3.1%
Cash Conversion (x)	4.5	0.1	(0.7)	0.2

Orbital Corporation

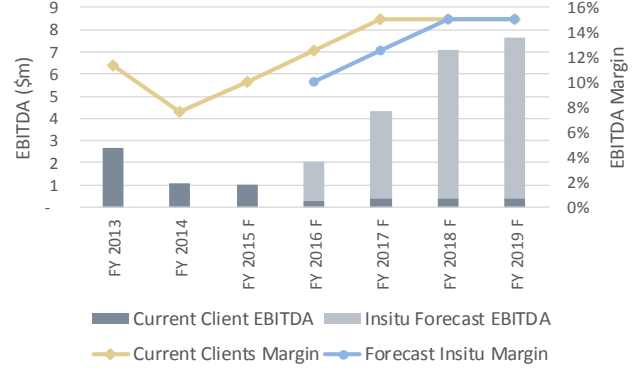
Key Charts

Equities Research

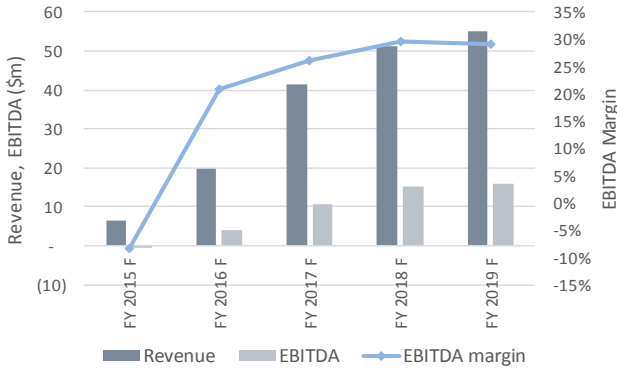
System Sales Revenue Forecasts



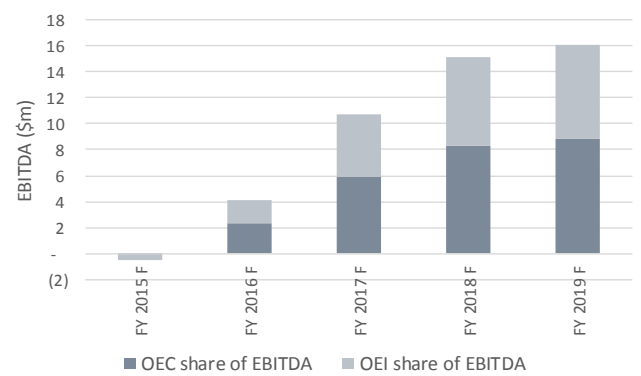
System Sales EBITDA Forecasts



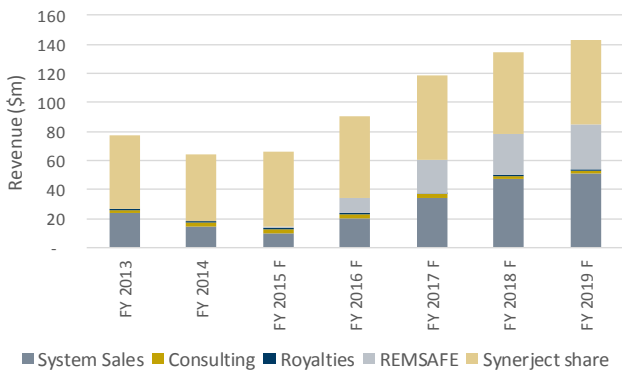
REMSAFE Earnings Forecasts (100%)



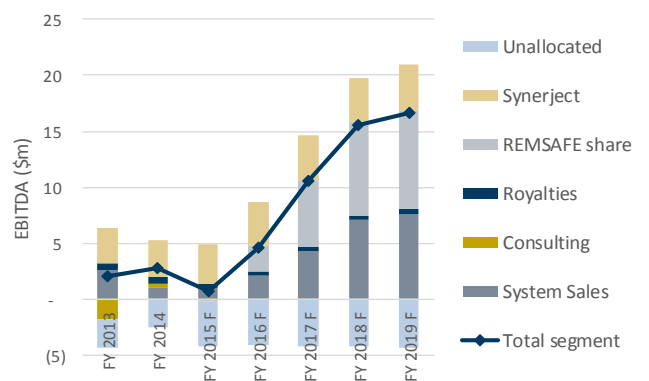
REMSAFE Forecast Share of Earnings



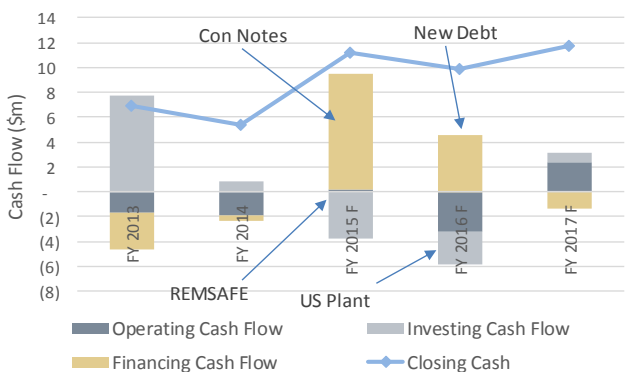
Segment Revenue Forecasts



Segment Earnings Forecasts



Cash Flow



Gearing

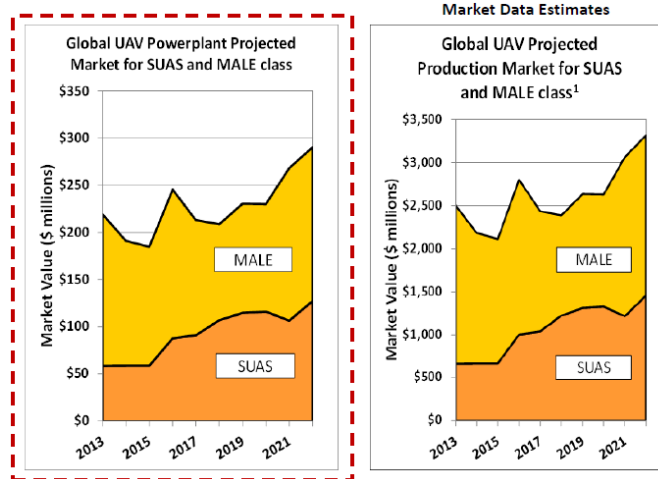


Insitu signals significant growth potential

Boeing subsidiary Insitu dominates the UAS market

Insitu, a division of Boeing, specialises in and dominates the unmanned aircraft systems (UAS) market. At the smaller end (Small Unmanned Aircraft Systems, or SUAS) the market is forecast to grow to ~US\$1b by 2016. As propulsion systems make up ~9% of the aircraft's content it implies a SUAS powerplant market approaching US\$100m within a couple of years (see chart at left in figure 1 below).

Figure 1: SUAS and MALE (Medium Altitude Long Endurance) market size



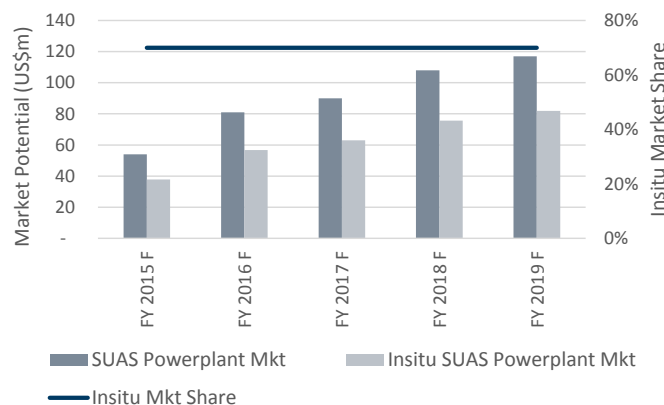
The SUAS powerplant market is expected to exceed US\$100m within a couple of years

Source: OEC, referenced from Company announcements and a Market and Markets report

What could a contract with Insitu be worth?

Using the data above, and assuming Insitu has a 70% share of the SUAS market, Insitu's SUAS powerplant market could approach US\$80m by the end of the decade.

Figure 2: Insitu potential powerplant market share



Insitu's SUAS powerplant market could approach US\$80m by the end of this decade

Source: Argonaut forecasts referenced from Market and Markets data

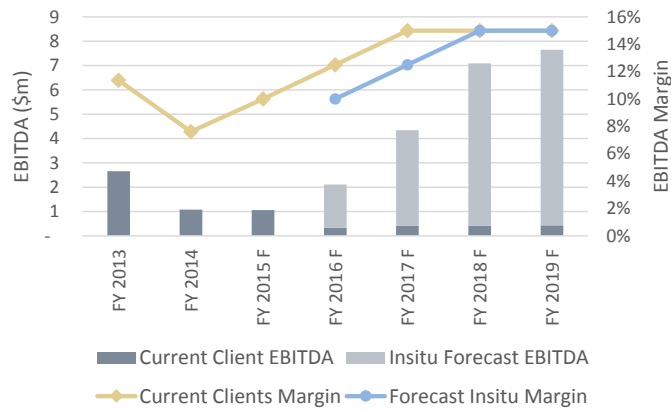
We conservatively assume OEC's sales equate to roughly 50% of Insitu's powerplant sales

It has now been confirmed that OEC is the preferred supplier of engines and propulsion systems for Insitu's ScanEagle UAV programme. However, we have assumed OEC sales to Insitu are ~50% of Insitu's total powerplant requirements as discussed above (noting that Insitu sells SUAS systems other than ScanEagle). On this basis, OEC sales to Insitu come close to US\$40m by FY18. As discussed previously, we believe this is conservative and that there is upside to these forecasts.

We assume OEC sees growth in System Sales EBITDA margins to ~15% over the next few years

We have also previously factored in the establishment of a US-based manufacturing facility and have pencilled in FY16 capex of US\$3m. Growing sales and the transition to US-based manufacturing should boost margins over time. For forecasting purposes we assume EBITDA margins increase from below 10% to 15% over a 3-4 year period. This sees EBITDA from the System Sales division growing significantly from the current ~A\$1m to ~\$7m in FY18.

Figure 3: Forecast System Sales EBITDA growth



Source: Argonaut forecasts, assuming sales to Insitu

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