



HOLD

Current Price \$0.67
Valuation \$0.75

Ticker: OEC.ASX
Sector: Technical Engineering

Shares in Issue (m): 77.3
Market Cap (\$m): 51.8
Net Debt / (Cash) (\$m): -9.8
Enterprise Value (\$m): 42.0

52 wk High/Low: 0.97 0.43
12m Av Daily Vol (m): 0.05

Key Metrics

	17F	18F
EV/EBITDA (x)	-8.0	51.8
EV/EBIT (x)	-7.2	370.3
P/E (x)	n/a	-104.8

Ratios

	16A	17F	18F
ND / Equity	-53.1%	-57.9%	-18.4%
EBITDA Mgn	-37.7%	-36.6%	3.7%
RoA	-15.2%	-27.1%	0.5%
RoE	-23.3%	-31.4%	-2.7%

Financials*:

	16A	17F	18F
Revenue (\$m)	11.6	14.3	22.0
EBITDA (\$m)	-4.4	-5.2	0.8
NPAT (\$m)	-5.9	-7.8	-0.5
Rep. NPAT (\$m)	1.5	-12.4	-0.5

* Underlying unless otherwise stated

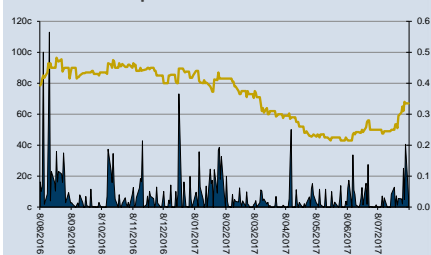
Net Assets (\$m) 31.3 18.7 18.2

Op CF (\$m) -5.1 -6.7 -1.4

Per Share Data:

	16A	17F	18F
Adj. EPS (cps)	-10.5	-10.1	-0.6
DPS (cps)	0.0	0.0	0.0
Div Yield	0.0%	0.0%	0.0%
NTAPS (cps)	46.4	24.5	23.6
CFPS (cps)	-9.0	-8.7	-1.9

Share Price Graph



Monday, 7 August 2017

Orbital (OEC)

Drones to provide the lift

Analysts | Ian Christie, CFA | Daniel Williamson

Quick Read

Preliminary FY17 results are disappointing and below expectations, although the value in the business relates to significant opportunity for growth in the UAVE segment. Earnings forecasts are strongly weighted to this sector. Gains have taken the share price closer to our revised valuation of \$0.75 (prior \$0.90). Forecasting risk is elevated and we reduce to hold (prior buy) in the near term as realisation of the UAVE potential will take time.

Event & Impact | Negative

Preliminary FY17 results: Unaudited numbers indicate operating revenue of \$14.3m, a GP margin ~41%, and EBITDA and NPAT losses of \$6.5m and \$12.4m respectively. Although we were forecasting losses, the outturn is well below our expectations. Reasons include a temporary revenue interruption in the UAVE segment and the very weak market conditions for REMSAFE. We have adjusted our FY17 numbers accordingly.

Implications for FY18: OEC also indicated revenue and GP margin expectations of \$22m and ~49% for this financial year. Fixed costs are expected to drop in FY18, and we have pencilled in \$10m for this item, resulting in an EBITDA forecast of \$0.8m. We expect a strong 2H weighting, and continued losses in the 1H. Despite guidance, we think there is considerable forecasting risk; it relates to the timing of an earnings pick-up in the UAVE segment and uncertainty regarding a return to profitability in the REMSAFE business. Further detail on assumptions, splits and adjustments are shown on pages 2-6.

UAVE outlook positive: The general market outlook for drones, together with a strong relationship and supply agreements with Boeing subsidiary Insitu, paint a strong picture for the UAVE segment. We expect the additional engineering work being undertaken for Insitu to lead to a ramp up in production and the establishment of a facility in the US. OEC is very well positioned for a sharp improvement in revenue and earnings from this segment, the only real question in our mind being that of timing.

Concerns for REMSAFE: This business on the other hand has exhibited a declining sales trend over recent periods and has limited visibility. The technology has been validated by major miners, but low volume, high revenue sales lead to unwelcome unpredictability. We have pared back our forecasts considerably for this segment; most of our assumed earnings growth in future periods is now driven by the UAVE business.

Recommendation

Following downgrades to REMSAFE forecasts, our blended valuation has fallen to \$0.75 (prior \$0.90), weighted to a DCF. While FY18 earnings forecasts do not support this, it is a more palatable 5.9x and 12.7x FY19's EBITDA and NPAT forecasts. The share price has gained >45% since we upgraded in May and is closer to our revised valuation. We reduce to hold pending evidence the UAVE segment can live up to longer term potential.

Orbital Corporation

Equity Research

Ian Christie, CFA

Recommendation	HOLD
Current Price (\$)	0.67
Valuation (\$)	0.75

Sector	Technical Engineering
Market Cap (\$m)	51.8
Date	7 August 2017

Trading Metrics	FY16A	FY17F	FY18F	FY19F
EV / EBITDA (x)	(9.5)	(8.0)	51.8	5.1
P/E (x)	(6.4)	(6.6)	(104.8)	11.3
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%

Per Share Data	FY16A	FY17F	FY18F	FY19F
Reported EPS (cps)	2.7	-16.0	-0.6	5.9
Adjusted EPS (cps)	-10.5	-10.1	-0.6	5.9
Div. per share (cps)	0.0	0.0	0.0	0.0
NTA per share (cps)	46.4	24.5	23.6	31.5
CF per share (cps)	-9.0	-8.7	-1.9	4.0

Profit and Loss (\$m)*	FY16A	FY17F	FY18F	FY19F
Operating Revenue	11.6	14.3	22.0	37.0
EBITDA	(4.4)	(5.2)	0.8	8.2
D&A	(0.6)	(0.6)	(0.7)	(0.9)
EBIT	(4.9)	(5.8)	0.1	7.3
PBT	(4.7)	(6.4)	(0.5)	6.7
NPAT	(5.9)	(7.8)	(0.5)	4.7
Reported Revenue	23.1	16.8	22.0	37.0
Reported EBITDA	3.0	(11.7)	0.8	8.2
Reported NPAT	1.5	(12.4)	(0.5)	4.7

* Continuing ops & normalised unless otherwise stated

Cash Flow (\$m)	FY16A	FY17F	FY18F	FY19F
Receipts	22.7	18.6	20.2	33.9
Payments	(27.6)	(24.8)	(21.0)	(28.1)
Other	(0.2)	(0.5)	(0.6)	(2.6)
Cash from Operations	(5.1)	(6.7)	(1.4)	3.2
Property, Plant & Equip	(0.3)	(0.6)	(6.1)	(0.7)
Payment for Subsidiary	-	-	-	-
Other	23.3	-	-	-
Cash From Investing	23.1	(0.6)	(6.1)	(0.7)
Issue of Shares	-	0.2	-	-
Net Borrowing	(0.6)	(0.2)	-	-
Dividends / Other	-	-	-	-
Cash From Financing	(0.6)	0.0	-	-
Net Cash Flow	17.4	(7.3)	(7.5)	2.5
Ending Cash	24.9	17.9	10.4	12.9

Balance Sheet (\$m)	FY16A	FY17F	FY18F	FY19F
Cash	24.9	17.9	10.4	12.9
Receivables	6.0	4.2	6.0	9.1
Inventory	4.2	6.3	3.5	3.2
Other	1.4	1.0	1.0	1.0
Current Assets	36.6	29.4	21.0	26.2
Property, Plant & Equip	1.9	1.6	7.0	6.8
Intangibles	5.2	-	-	-
Other NC Assets	5.5	5.5	5.5	5.5
Non-Current Assets	12.6	7.1	12.5	12.3
Total Assets	49.2	36.5	33.4	38.5
Payables	6.5	7.0	4.4	4.7
Progress Claims / Dep	-	-	-	-
Borrowings	8.3	8.1	8.1	8.1
Provisions	0.3	0.3	0.3	(1.5)
Other	2.9	2.5	2.5	2.5
Total Liabilities	17.9	17.8	15.2	13.9
Net Assets	31.3	18.7	18.2	24.6
Ordinary Equity	30.9	31.1	31.1	32.8
Reserves	1.4	1.0	1.0	1.0
Retained Earnings	(1.0)	(13.3)	(13.8)	(9.1)
Total Equity	31.3	18.7	18.2	24.6

Valuation	Calcs.	\$m	\$ps
DCF Valuation:			
Discount Rate / WACC (%)	12.5%		
PV Free Cash Flow (\$m)	67.1		
Less Net Debt / Plus Cash (\$m)	9.8		
Unpaid Capital (\$m)	-		
Equity Value (\$m)		76.9	0.99

EV/EBITDA Valuation:			
FY18 EV/EBITDA multiple	15.0	22.0	0.28
Valuation (\$ per share) - weighted blend of DCF and PE			0.75

Profit and Loss (\$m)*	1H17A	2H17F	1H18F	2H18F
Operating Revenue	9.2	5.1	6.8	15.2
EBITDA	(1.1)	(4.1)	(0.8)	1.6
D&A	(0.3)	(0.3)	(0.3)	(0.4)
EBIT	(1.4)	(4.4)	(1.1)	1.2
PBT	(1.7)	(4.7)	(1.4)	0.9
NPAT	(1.8)	(6.1)	(1.4)	0.9
Reported Revenue	11.2	5.6	6.8	15.2
Reported EBITDA	(1.1)	(10.6)	(0.8)	1.6
Reported NPAT	(1.8)	(10.6)	(1.4)	0.9

* Continuing ops & normalised unless otherwise stated

Cash Flow (\$m)	1H17A	2H17F	1H18F	2H18F
Receipts	11.6	7.0	6.0	14.2
Payments	(13.6)	(11.2)	(7.5)	(13.5)
Other	(0.1)	(0.4)	(0.3)	(0.3)
Cash from Operations	(2.1)	(4.6)	(1.8)	0.4
Property, Plant & Equip	(0.1)	(0.5)	(2.0)	(4.1)
Payment for Subsidiary	-	-	-	-
Other	0.4	(0.4)	-	-
Cash From Investing	0.4	(0.9)	(2.0)	(4.1)
Issue of Shares	-	0.2	-	-
Net Borrowing	-	(0.2)	-	-
Dividends / Other	-	-	-	-
Cash From Financing	-	0.0	-	-
Net Cash Flow	(1.8)	(5.5)	(3.8)	(3.7)
Ending Cash	23.4	17.9	14.1	10.4

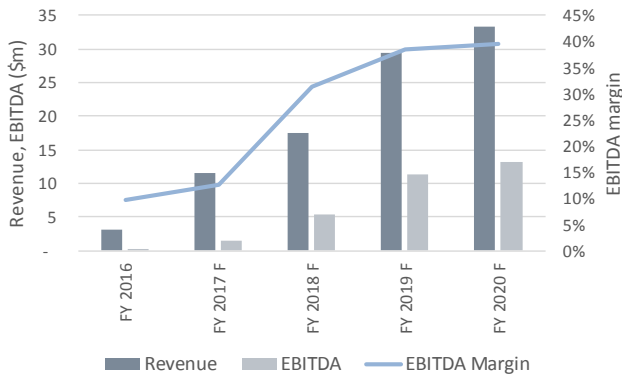
Financial Ratios	FY16A	FY17F	FY18F	FY19F
Growth				
Revenue growth (%)	21.8%	22.9%	54.0%	68.1%
NPAT growth (%)				
Norm. EPS growth (%)	494.5%	-3.0%	-93.7%	-1025.4%
Profitability Ratios				
EBITDA Margin (%)	-37.7%	-36.6%	3.7%	22.1%
EBIT Margin (%)	-42.5%	-40.7%	0.5%	19.7%
PBT Margin (%)	-40.5%	-45.0%	-2.2%	18.1%
NPAT Margin (%)	-53.3%	-54.8%	-2.2%	12.7%
Return on Assets (%)	-15.2%	-27.1%	0.5%	30.1%
Return on Equity (%)	-23.3%	-31.4%	-2.7%	21.9%
ROIC (%)	-18.2%	-27.6%	0.5%	25.9%
Balance Sheet Ratios				
Net Debt (excl. CN's) (ND)	(16.6)	(10.8)	(3.3)	(5.8)
Net Debt (ND) / Equity (%)	-53.1%	-57.9%	-18.4%	-23.7%
ND / ND + Equity (%)	-113.1%	-137.4%	-22.5%	-31.0%
Current Ratio (x)	3.8	3.2	3.2	3.8
Net Interest Cover (x)	1.9	-20.0	0.2	12.0
Cash Flow Ratios				
Free Cash Flow Yield (%)	-14.2%	-14.0%	-14.5%	4.7%
Cash Conversion (x)	1.2	1.3	(1.8)	0.4

Orbital Corporation

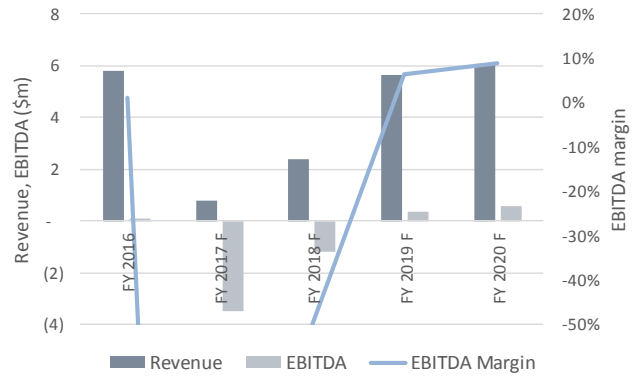
Key Charts

Equities Research

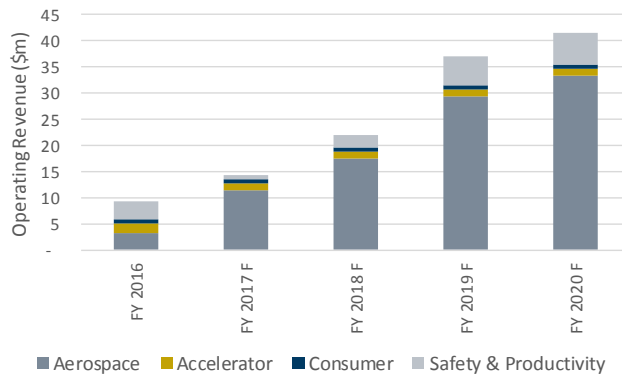
UAV's Forecasts (Aerospace)



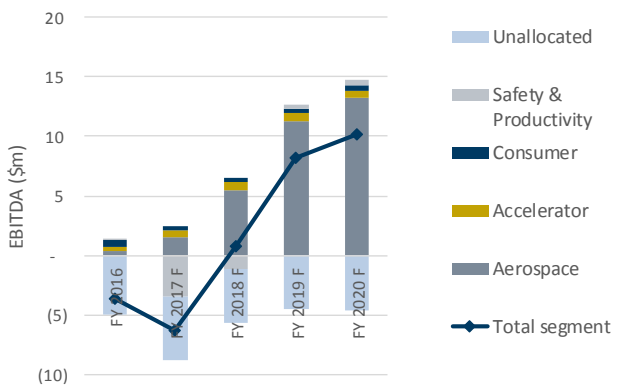
REMSAFE Forecasts (Safety & Productivity)



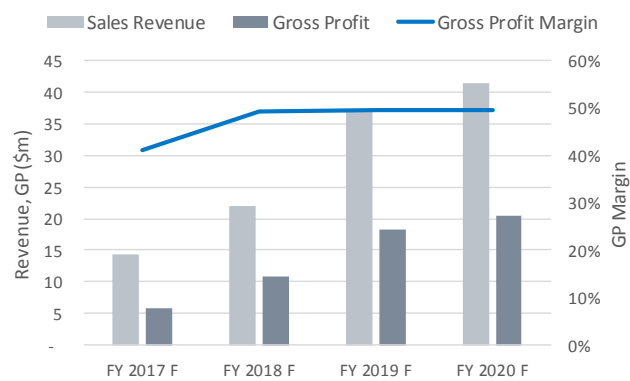
Segment Revenue Forecasts



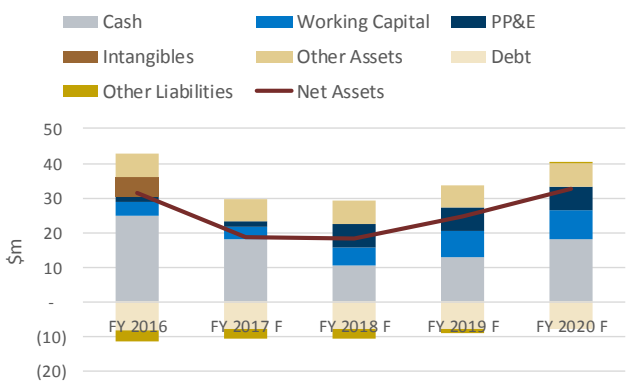
Segment Earnings Forecasts



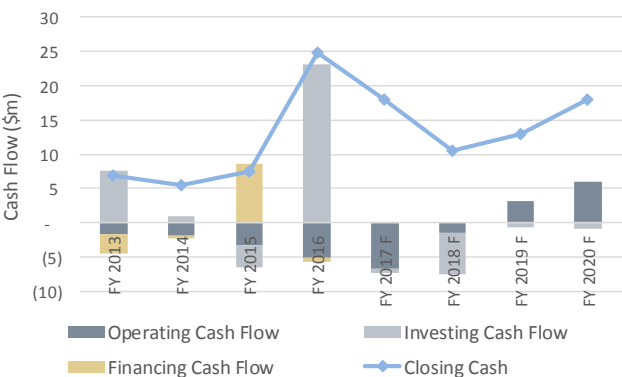
GP Margins



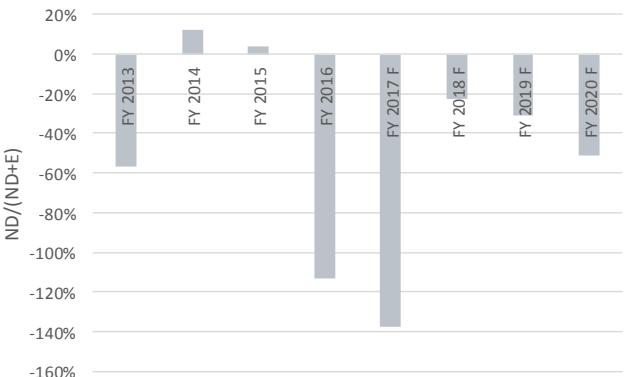
Balance Sheet



Cash Flow



Gearing (excludes Convertible Notes in historical periods)



Earnings forecasts

The presentation released on 25th July provided some detail on FY17 preliminary results. According to these unaudited numbers, operating revenue was \$14.3m, and reported EBITDA and NPAT were -\$6.5m and -\$12.4m respectively. A chart in the same release indicated a gross margin of ~41% in FY17, and expectations for revenue of \$22m and a GP margin close to 50% in FY18.

Figure 1: Preliminary results FY17

\$M	FY17	FY16	FY15
REVENUE	14.3	11.8	9.7
EBITDA*	(6.5)	4.7	1.3
NPAT	(12.4)	1.3	(0.7)
CASH	17.9	26.3	8.0
DEBT	8.1	8.3	17.2
NET ASSETS	19.2	31.2	21.9

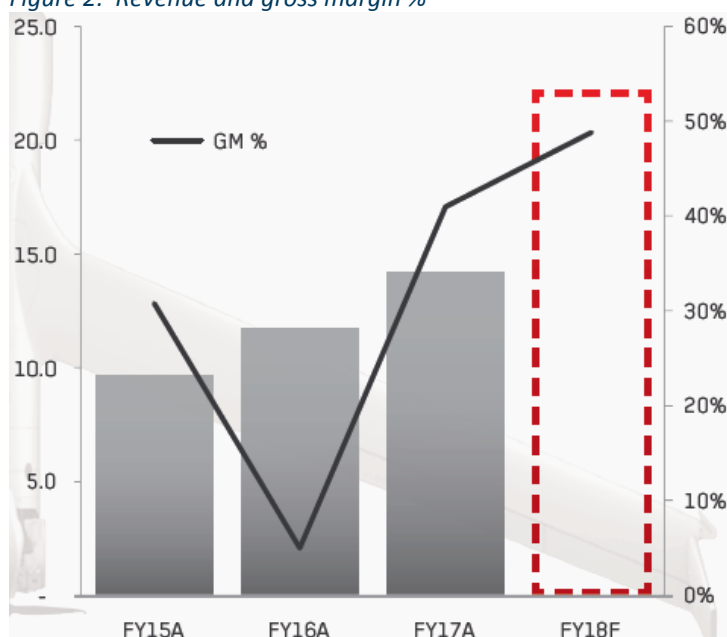
* FY17 EBITDA includes refundable R&D grant \$1.9M & loss on investment \$(0.6M)

- Cash & Trade Receivables \$22.1M
- REMSAFE Goodwill impairment \$5.2M non-cash
- REMSAFE annualised holding cost reduced from \$3.8M to \$2.4M
- Corporate annualised holding cost reduced from \$5.3M to \$4.5M
- DEBT represents WA Government Loan repayable through to 2025 with current liability \$0.9M & Long term liability \$7.2M

Significant losses expected in FY17, including a \$5.2m non-cash impairment of REMSAFE goodwill

Source: OEC presentation 25/07/17

Figure 2: Revenue and gross margin %



GP margins have improved, leading to expectations of a strongly improved performance in FY18 on higher revenue

Source: OEC presentation 25/07/17

Our FY17 estimates reflect preliminary numbers

Given OEC's revenue and GP margin guidance, together with our forecasts for fixed costs, we pencil in EBITDA of \$0.8m in FY18

Our forecasts make assumptions regarding reductions in fixed costs in FY18 (based on OEC comments and our assumptions on what were one-off costs in FY17)

FY17 estimates

We have adjusted our FY17 forecasts accordingly. Given GP of \$5.9m (\$14.3m at a 41% margin), other income of ~\$2.5m (our estimate, which includes \$1.9m in R&D rebates), and reported EBITDA of -\$6.5m, these numbers imply costs below the GP line of ~\$14.9m. This is higher than would be expected and suggests additional one-off costs associated with business restructuring and downsizing. While detail was not provided by OEC, we have estimated ~\$2.7m in one-off costs in FY17, meaning fixed costs were ~\$12.2m.

FY18 estimates

This provides the basis for the FY18 forecast. The chart in OEC's presentation implies GP of ~\$10.8m (\$22m revenue at a 49% GP margin). Corporate and REMSAFE costs are expected to be reduced by \$2.2m (see notes in Figure 1 above), which on our numbers suggests fixed costs of ~\$10.0m in FY18, and therefore EBITDA of ~\$0.8m. There is some uncertainty around the fixed costs assumption and we anticipate further clarification around FY17 one-off expenses when the audited results are released towards the end of the month.

Figure 3: Earnings calculations

Summary Financials	FY17E	FY18F	Change	Comments
Revenue	14.3	22.0	7.7	Revenue in both years based on OEC 25/07 presentation
Gross Profit	5.9	10.8	4.9	GP in both years as implied by OEC 25/07 presentation
GP Margin	41%	49%		GP Margin in both years based on OEC 25/07 presentation
Other Income	2.5	0.0	-2.5	Argonaut assumptions, including \$1.9m R&D rebate in FY17
Fixed Costs	-12.2	-10.0	2.2	FY17 based on Prelim. Results & Argonaut assumptions re One-offs (see below); FY18 based on OEC announced fixed cost savings
One off Costs	-2.7	0.0	2.7	FY17 is Argonaut assumption for restructuring & redundancy costs
Reported EBITDA (pre goodwill writedown)	-6.5	0.8	7.3	FY17 as per Prelim. Results; FY18 Argonaut forecast
Adjustments	1.3	0.0		FY17 includes adjustment for R&D rebate (-\$1.9m), loss on investment (+\$0.5m) and estimated other one-off costs (+\$2.7m)
Underlying EBITDA	-5.2	0.8	6.0	
Underlying EBITDA margin	-37%	4%		

Source: OEC, Argonaut

We expect a heavy skew to the 2H in FY18, with losses and cash outflows in the 1H

We have reduced REMSAFE contributions and increased UAVE contributions in forecast periods

Lower revenue forecasts in FY18+ have largely been offset by improved margins

Other items to note

- There will also be a \$5.2m non-cash impairment of REMSAFE goodwill in FY17. This is not included in the EBITDA calculations above, but is included in the reported EBITDA forecast shown on page 2.
- We expect FY18 earnings and cash flows to be strongly skewed towards the 2H. Our forecasts anticipate a 1H18 EBITDA loss of ~\$0.8m and a \$1.8m operating cash outflow.

Adjustments to forecasts

There have been significant changes made to our forecasts based on the above. Key to note:

- Significant downgrades to FY17 estimates at all lines
- Revenue forecasts for FY18 and FY19 are sharply lower, although improved GP margins have compensated to a large degree
- On a segment basis, we have sharply reduced our REMSAFE forecasts and now assume only marginal longer term profitability
- The bulk of earnings is driven by UAVE forecasts (refer to charts on page 3)

Figure 4: Changes to forecasts

Normalised	FY16	FY17F		FY18F		FY19F	
	Actual	Old	New	Old	New	Old	New
Revenue (\$m)	11.6	20.4	14.3	35.5	22.0	57.8	37.0
EBITDA (\$m)	-4.4	0.6	-5.2	1.9	0.8	7.7	8.2
EBITDA margin	-37.7%	2.9%	-36.6%	5.4%	3.7%	13.3%	22.1%
EBIT (\$m)	-4.9	0.2	-5.8	1.4	0.1	6.8	7.3
EBIT margin	-42.5%	0.9%	-40.7%	3.8%	0.5%	11.7%	19.7%
PBT (\$m)	-4.7	-0.4	-6.4	1.2	-0.5	6.5	6.7
PBT margin	-40.5%	-2.2%	-45.0%	3.5%	-2.2%	11.3%	18.1%
NPAT (\$m)	1.5	-0.4	-12.4	0.9	-0.5	4.6	4.7
EPS (cps)	-10.5	-0.5	-10.1	1.1	-0.6	5.6	5.9

Source: Argonaut

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