22 June 2023

Analyst
Daniel Laing 612 8224 2886

Authorisation
Chris Savage 612 8224 2835

Austal Limited (ASB)

A rising tide lifts all boats

Recommendation
Buy (Initiation)
Price
$2.45
Target (12 months)
$3.10 (Initiation)

GICS Sector

Capital Goods

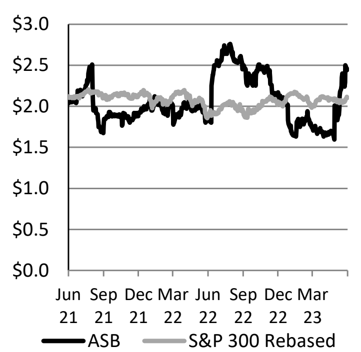
Expected Return	
Capital growth	27%
Dividend yield	3.3%
Total expected return	30%

Company Data & Ratios	
Enterprise value	$872.2m
Market cap	$880.0m
Issued capital	362.4m
Free float	~91%
Avg. daily val. (52wk)	$2.7m
12 month price range	$1.58-$2.82

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.60	1.78	1.85
Absolute (%)	53.61	38.03	32.43
Rel market (%)	52.55	33.03	21.79

Absolute Price



SOURCE: IRESS

Australia's largest defence exporter

Austal Ltd (ASB) is an Australian shipbuilder and defence contractor providing design, manufacturing and support capabilities for defence and commercial customers. The company is Australia's largest defence exporter and in the last 35 years it has contracted more than 350 vessels across 59 countries. The company is headquartered in Henderson, WA and operates 5 shipyards across 4 countries.

Record contract book

ASB is set to enter FY24 with a record contract book of ~$11b AUD, with recent contracts such as the OPC (~$4.3b), the T-AGOS (~$4.7b) and the likely award of the EMS (~$1.25b) contract, providing a deep pipeline of work for the next decade. These programs were vital to replace the two major programs, the LCS and EPF, which were historically the foundation of Austal's contract book, with both programs scheduled to deliver their final vessels in FY26.

Structural tailwinds driving growth

Austal's expansion into steel shipbuilding has reaffirmed its place as a key pillar in the US naval industrial base and positioned itself to be a prime beneficiary of structural growth in both the Australian and US markets. Naval shipbuilding is experiencing significant tailwinds including 1) record defence expenditure globally, 2) renewed emphasis on maritime capabilities due to potential conflict in the pacific and 3) increased work domestically in light of the AUKUS agreement and release of the DSR.

Investment view: Price target $3.10, Initiate with BUY

Despite the strong SP performance, we are comfortable ASB still has a level upside before reaching its fair valuation. ASB is currently trading on 7.8x EV/EBIT and 12.1x PE, based on our FY24 forecasts, and is evidently undervalued versus its peers. We believe a PT of $3.10 is a relatively undemanding valuation at this stage considering the record contract book, potential for new contracts and private equity interest.

Earnings Forecast

Year End 30 Jun	FY22	FY23e	FY24e	FY25e
Revenue ($m)	1,429.0	1,505.7	1,593.2	1,684.6
EBIT (Statutory) ($m)	120.7	56.2	108.8	107.3
NPAT (Statutory) ($m)	79.6	35.3	73.4	72.3
EBIT (Underlying) ($m)	120.7	98.2	108.8	107.3
EPS (cps)	21.9	9.7	20.2	19.9
EPS growth (%)	0.0	-56%	108%	-2%
PE (x)	7.4	25.2	12.1	12.3
EV/EBIT (x)	7.2	15.5	8.0	8.1
FCF Yield (%)	nm	nm	1%	7%
Dividend (¢ps)	8.0	8.0	8.0	8.0
Yield (%)	0.0	3.3%	3.3%	3.3%
Franking (%)	0.0	0.0	0.0	0.0
ROE(%)	8.6%	3.8%	7.5%	7.1%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Contents

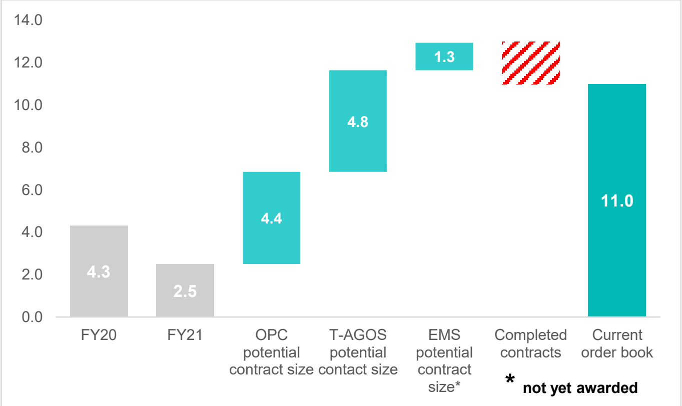
Investment Thesis

We initiate coverage on Austal Limited (ASB) with a BUY recommendation and a price target of $3.10 per share. Our investment thesis is driven by the following factors:

- **Record contract book:** Austal is set to enter FY24 with a record contract book of ~$11b AUD, with recent contracts such as the OPC (~$4.3b), the T-AGOS (~$4.7b) and the likely award of the EMS (~$1.25b) contract, providing a deep pipeline of work for the next decade. These contracts were vital to replace the two major programs, the LCS and EPF, which were historically the foundation of the company's contract book, with both programs scheduled to deliver their final vessels in FY26.
- **Diversified revenue streams:** In April 2022, AUSA opened their new steel shipbuilding facility in Mobile Alabama, funded by a joint $100m USD investment with the US Department of Defense. This major investment in the company's capabilities has broadened the scope for future work and allowed the company to diversify their contract book from 2 major aluminium programs to 6 major programs spread across both aluminium and steel shipbuilding, with the T-ATS, OPC and T-AGOS contracts the company's first in steel shipbuilding.
- **Forecast growth in support segment:** The company has detailed a goal of $500m in support revenue by FY27, compared to its pre-COVID high in FY20 (~$360m) and most recent FY22 result (~$270m). We believe this is a realistic target for the company considering the general growth in the US Navy sustainment budget presenting greater opportunities for work and also the significant investment the company has made in its support network to boost capacity.
- **Macro tailwinds driving structural growth:** Austal has solidified its position as a key contributor in both the Australian and US naval industrial bases. Thus, we have identified ASB as one of the major beneficiaries of the macro tailwinds driving structural growth in these markets, including 1) record defence expenditure globally, 2) renewed emphasis on maritime capabilities due to potential conflict in the Pacific and 3) increased work domestically in light of the AUKUS agreement and release of the DSR.
- **Catalysts:** Recent media reports have suggested up to three parties are considering takeover bids for ASB, including Arlington Capital Partners, Cerberus Capital Management and the 1941 Fund (Bondi Partners and Ellerston Capital). The potential for multiple bids will likely maintain the recent upward pressure on ASB's share price. Other catalysts include the upcoming FY23 results, release of separate reviews into both the US and AUS Naval force structures and any new contract awards, particularly the EMS, which we believe is imminent.
- **Healthy financials:** The company is in a strong financial position, with a robust balance sheet (FY23e cash ~$140m) and a forecast return to positive Free Cash Flow in FY24 ($6.9m), with the FCF yield increasing YoY in FY24 and FY25. This is primarily driven by moderate revenue growth and reduced levels of capital expenditure, as the company completes its recent investment in both its shipbuilding and support facilities globally.
- **Valuation:** Despite the recent strong share price performance, we are comfortable ASB still has a level of upside before reaching its fair valuation. The company is currently trading on 7.8x EV/EBIT and 12.1x PE, based on our FY24 estimates, which is below its long run historical median PE (15.0x, see **Figure 5**) and is evidently undervalued when compared to both its domestic and international peers. We believe a target price of $3.10 is a relatively undemanding valuation at this stage considering the current contract book, potential for new contracts and private equity interest.

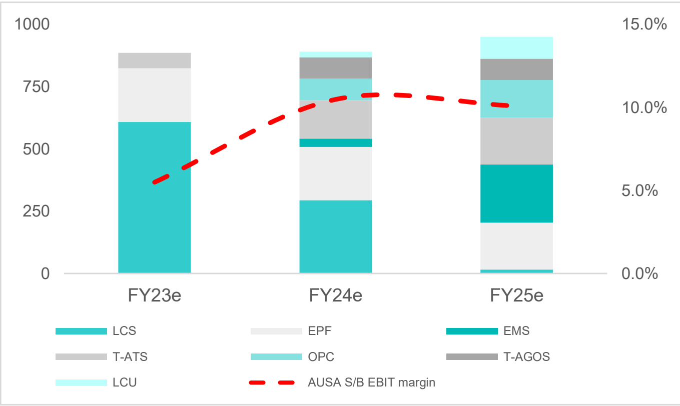
Key Charts

Figure 1 – ASB potential contract book ($Am)



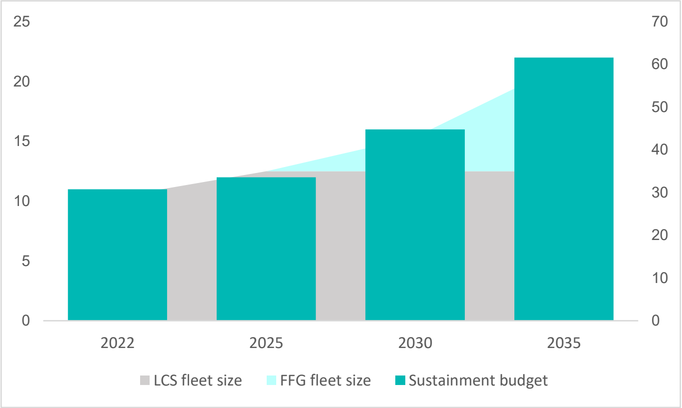
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 2 – AUSA shipbuilding revenue with segment EBIT margin



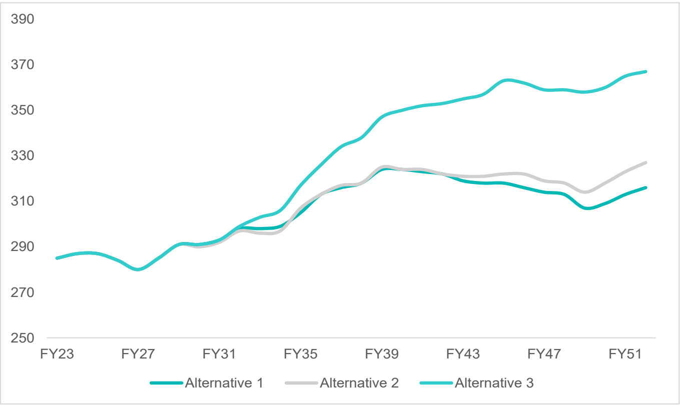
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 3 – Forecast growth in USN sustainment budget (US$b)



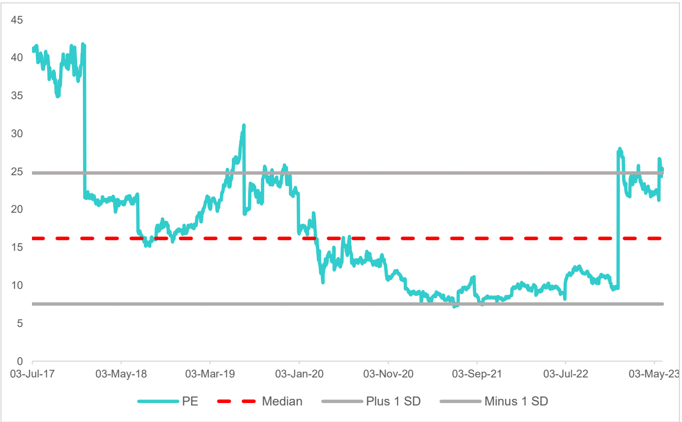
SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 4 – US Navy 30-year shipbuilding plan 2023



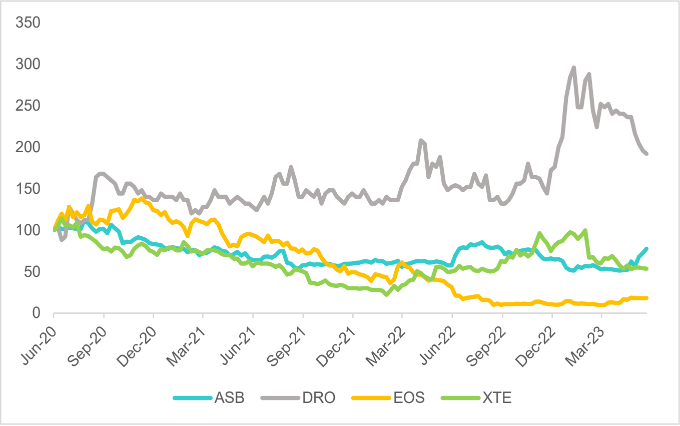
SOURCE: CONGRESSIONAL RESEARCH OFFICE

Figure 5 – Consensus PE FY23e (+/- 1 SD)



SOURCE: BLOOMBERG AND BELL POTTER SECURITIES ESTIMATES

Figure 6 – ASX-listed defence companies relative performance



SOURCE: IRESS AND BELL POTTER SECURITIES ESTIMATES

Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Regulatory risk:** Austal has been the subject of investigation by Australian and US authorities since 2019 relating to allegations former Austal USA employees made false and misleading statements about Austal USA's performance and financial condition between 2012 and 2016. The Australian investigation has been resolved (in the form of a monetary fine) and the US investigation is ongoing, with the three former employees involved recently charged by both the SEC and DOJ. Whilst we believe the US investigation is similarly likely to result in a monetary fine, if the resulting punishment were harsher than anticipated and restricted ASB's ability to tender for future US naval projects, then the operational performance of the company will be severely impacted.
- **Contract awards:** We have assumed a number of contracts will be awarded to Austal, that have not yet been announced, in our forecasts based on official US Department of Defense FY24 Budget estimates. If adverse events were to occur and the Department of Defense were not to award these contracts to Austal as intended, there would be significant down side risk to our forecasts.
- **Contract risk:** Contract risk refers to the potential for negative outcomes or uncertainties associated with the performance or execution of a contract. If Austal were to not fulfil the terms of their contract due to quality or timing concerns, the company will likely be exposed to unfavourable terms under the contract, which would affect the financial performance of the company.
- **Foreign currency risk:** Austal is exposed to currency risk on sales, purchases or components for construction that are denominated in a currency other than the respective functional currencies of the Group entities, primarily Australian Dollars (AUD) for the Australia operations and US Dollars (USD) for the USA, Philippines and Vietnam operations. The Group is also exposed to foreign exchange movements (primarily in USD) on the translation of the earnings, assets and liabilities of its foreign operations.
- **Government policy:** Changes in Government policy regarding support for the domestic shipbuilding industry or general reductions in defence spending could have a material adverse effect on ASB.
- **Competition Risk:** Austal operates in a competitive market of both public and private companies. The company is often bidding for contracts in opposition to multiple parties, which may result in loss of contracts or less favourable terms for contracts they are awarded.
- **Key personnel risk:** The loss of key management personnel, delays in their replacement, and/or failure to attract new talent, may adversely affect ASB's operations and future performance.

Company Overview

Introduction to Austal

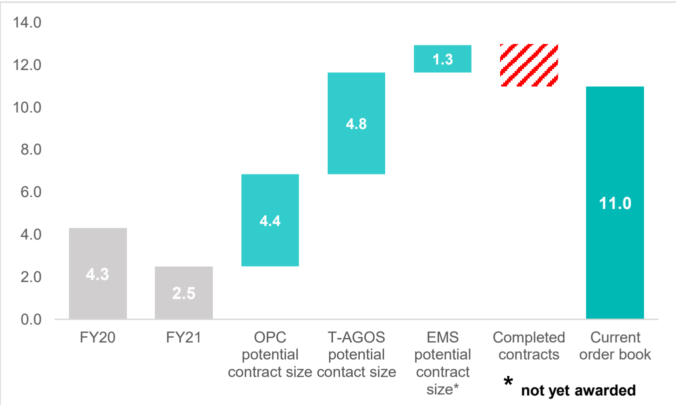
Austal Limited (ASB) is an Australian shipbuilder and defence contractor providing design, manufacturing and support capabilities for defence and commercial customers. The company is Australia's largest defence exporter, and in the last 35 years, it has contracted more than 350 vessels for over 120 customers across 59 countries. The company is headquartered in Henderson, Western Australia and operates 5 shipyards across 4 countries (Australia, USA, Philippines and Vietnam). ASB operates two major divisions, Austal Australasia and Austal USA (AUSA).

Shipbuilding segment

The shipbuilding segment is the primary business line of the company, designing and constructing both naval and commercial vessels. The shipbuilding segment contributed ~81% of total revenue in FY22 ($1.15b), which was down -11.9% YoY.

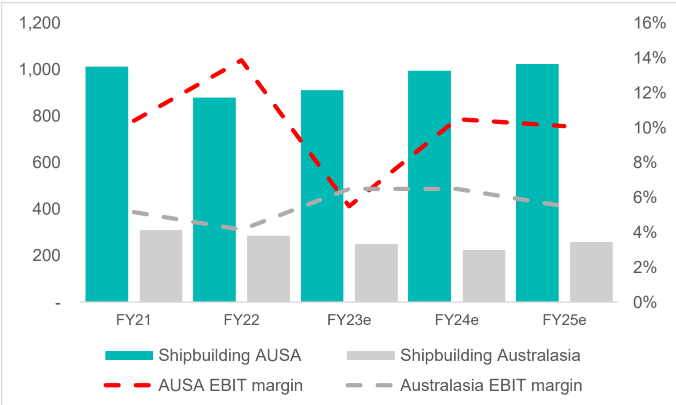
Austal Australasia operates as a provider of design, construction and support services for aluminium and steel ships, servicing both defence and commercial customers. Alternatively, Austal USA (AUSA) primarily pursues defence contracts in North America, particularly with the US Navy and US Coast Guard.

Figure 7 – ASB potential contract book ($Am)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 8 – ASB shipbuilding revenue with segment EBIT margin



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Margins

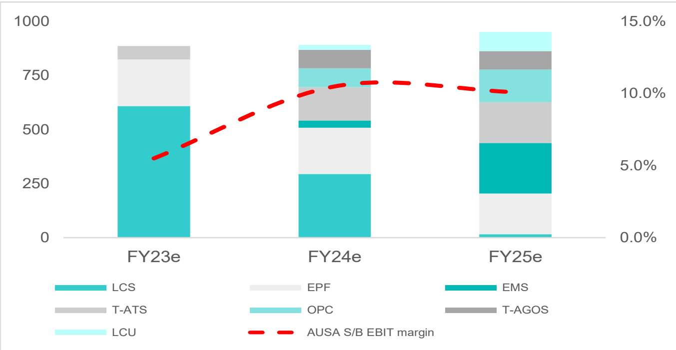
The shipbuilding segment historically produces EBIT margins between 7% and 12%. The company has stated the target range when tendering for any contract (both in AUSA and Australasia) is EBIT margins of 7%-10% however it does appear that Austal Australasia produces EBIT margins below the lower end of this range. Realised margins may differ from this range on an annual basis and may be influenced by a range of factors, including:

1) Competitive tender processes may result in margins at the lower end of the range
2) Vessels constructed earlier in a multi-ship program may return lower margins, with later ships experiencing significantly higher margins as efficiencies are realised, thus resulting in a total margin within the specified range.
3) Onerous contract provisions may place downward pressure on margins depending on the size of the relevant provision. This is the case in FY23 with the T-ATS provision resulting in a shipbuilding margin (5.7%) well below the target range and historical levels.

Austal USA (AUSA)

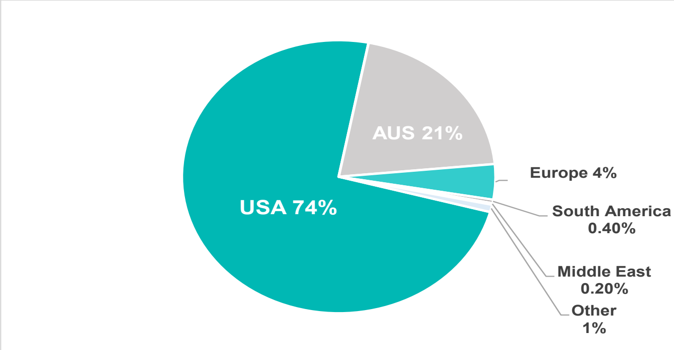
Austal USA is a key pillar in the US naval industrial base and has been since it was awarded the contract for the Littoral Combat Ship 2 (LCS 2) in October 2005. The shipbuilding segment of AUSA is the greatest revenue contributor for ASB, with $880m of revenue in FY22 (-13% YoY) and 75% of total shipbuilding revenue.

Figure 9 – AUSA shipbuilding revenue w/ segment EBIT margin



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 10 - Geographical location of customers FY22



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The company's principal shipyard in the US is located on the Mobile River in Mobile, Alabama and includes both its aluminium and steel shipbuilding facilities. Historically, AUSA strictly possessed aluminium shipbuilding capabilities, however after the company's unsuccessful tender for the USN Frigate design and construction contract, the company correctly identified a need to diversify its revenue streams. This was executed through a joint $100m USD ($50m USD each) investment with the US Department of Defense to establish a new 11,000 square metre steel shipbuilding facility, which opened in April 2022.

Over the last decade, AUSA's strong performance has largely been driven by design and construction contracts for the Littoral Combat Ships (LCS), 19 vessels contracted, and the Expeditionary Fast Transports (EPF), 8 vessels contracted. However, both of these programs are nearing conclusion with 17 LCS and 5 EPF vessels already delivered and the final vessel in each program scheduled for delivery in FY26.

Fortunately, the company has continued to grow its order book with the receipt of contracts for 5 Navajo Class Towing, Salvage and Rescue Ships (T-ATS) and one Offshore Patrol Cutter (OPC) for the US Coast Guard, with an option for an additional 10. The T-ATS, OPC and T-AGOS contracts are the company's first contracts for steel vessels and validate AUSA's significant investment in steel shipbuilding capabilities to diversify its revenue stream and broaden its base for potential tenders. Additionally, the company has recently started working as a sub-contractor for General Dynamics Electric Boat on the US Navy Virginia Class Submarine Program, manufacturing the Command Deck Module.

We also believe AUSA is likely to be awarded contracts for 3 Emergency Medical Ships (EMS) and at least 8 Landing Craft, Utility (LCU) vessels before the end of CY23 based on US Department of Defence FY24 Budget estimates. These programs have potential total contract values of ~$1.25b AUD and ~$350m AUD respectively.

Below is a summary of recent material contracts awarded to Austal USA.

Figure 11 - Material contract summary Austal USA

Vessel	Value per ship	Delivered	Total contracted	Estimated Final Delivery
Littoral Combat Ships (LCS)	>$600m AUD	17	19	Jul-24
Virgina Class Submarine Program, Command Deck Module	>$40m AUD	0	1	FY24
Landing Craft, Utility (LCU)	>$350m AUD	0	8**	Jan-26
Expeditionary Fast Transport (EPF)	>$300m AUD	13	16	Mar-26
Navajo Class Towing, Salvage and Rescue Ships (T-ATS)	>$90m AUD	0	5	Jan-27
Emergency Medical Ships (EMS)	>$400m AUD	0	3**	Apr-29
Auxiliary General Ocean Surveillance Ship (T-AGOS)	>$150m AUD	0	7*	Feb-32
Offshore Patrol Cutters (OPC)	>$350m AUD	0	11*	TBC

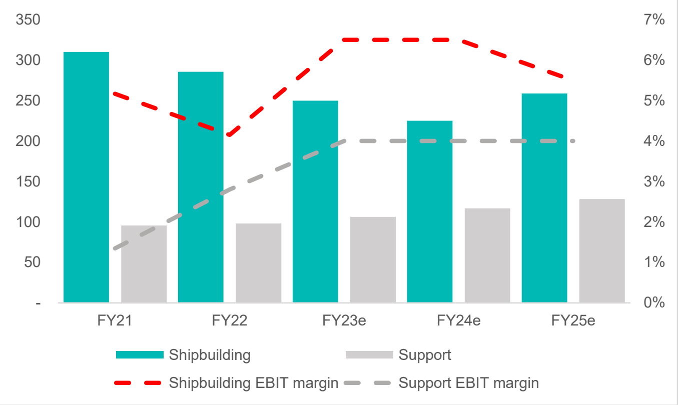
* Includes options not yet exercised
** Contracts not yet announced

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Austal Australasia

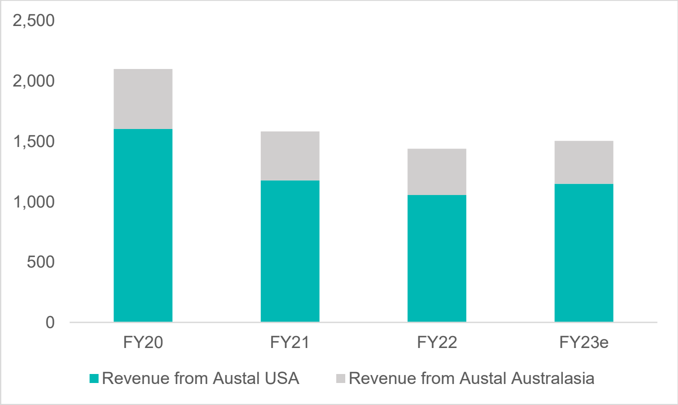
Austal Australasia is a more diverse, albeit smaller, segment of the business with contracted revenue consisting of a mix between naval and commercial vessels. The division's commercial operations were severely impacted by the COVID-19 pandemic, with shipbuilding revenue falling from $426m in FY20 to $285 million in FY22.

Figure 12 –Australasia segment revenue w/ EBIT margin (A$m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 13 – Revenue contribution AUSA v Australasia (A$m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The company is able to construct both naval and commercial vessels at its shipyard in Henderson Western Australia, whilst the shipyards in Vietnam and The Philippines largely focus on the production of commercial vessels such as passenger and vehicles ferries.

The major defence programs for Austal Australasia have provided consistent levels of revenue in recent years and have included the design and construction of the Guardian Class Patrol Boats (GCPB), 22 vessels contracted, and Evolved Cape Class Patrol Boats (eCCPB), 8 vessels contracted. Specifically, ASB has delivered 15 of 22 vessels of the GCPB contract, with 12 of those vessels delivered to Pacific Island nations and Timor-Leste under the Pacific Maritime Security Program.

Below is a summary of recent material contracts awarded to Austal Australasia.

Figure 14 - Material contract summary Austal Australasia

Vessel	Value per ship	Delivered	Total contracted	Estimated Final Delivery
Guardian Class Patrol Boats (GCPB)	> $15m AUD	15	22	1HFY25
Evolved Cape Class Patrol Boats (eCCPB)	> $50m AUD	4	8	1HFY25
High speed passenger catamaran ferry	> $30m AUD	1	1	May-23

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Looking forward, the most significant contract opportunity for Austal will be the Independent Littoral Manoeuvre Vessel (ILMV), part of *Land 8710 Phase 1A* for the Australian Army. ASB has partnered with BMT and Raytheon Australia to bid for the project, valued up at ~$800m. See **Page 13** for greater detail on additional defence opportunities for Austal Australasia provided by the AUKUS agreement and the DSR.

As stated above, the Covid-19 pandemic particularly cruelled ASB's commercial operations. Historically, the division has delivered a range of High Speed Passenger and Vehicle Ferries to customers throughout South East Asia, French Polynesia and Europe however the company has not received a new order since the contract from Groupe Degage in August 2021, which was delivered in May this year. It is the company's intention to maintain their shipyards in Vietnam and The Philippines despite their current underutilisation, see **Page 14** for greater detail on the outlook of the division's commercial operations.

Support segment

The support segment of the business is complementary to the main shipbuilding line, contributing ~19% of FY22 revenue (~$270m), which was a +5% increase YoY. Support operations in both USA and Australasia were strongly affected by the Covid-19 pandemic with revenue reaching a high of ~$360m in FY20 before retreating to ~$257m in FY21.

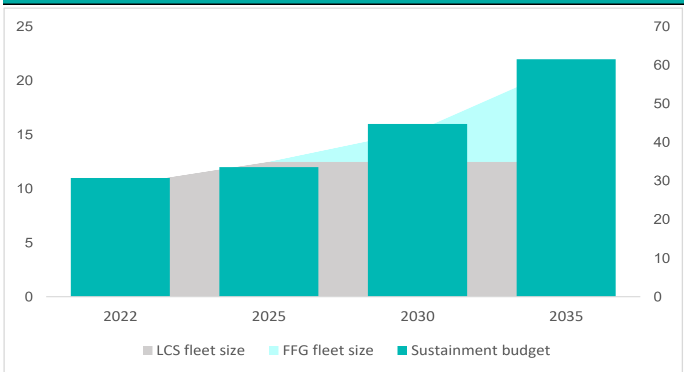
ASB has an extensive network of support bases globally. AUSA has bases located near major naval bases in San Diego California, Mayport Florida, Singapore and also on premises in Mobile, Alabama. Additionally, Austal Australasia has support bases located in Henderson, Brisbane, Cairns, Darwin, Vietnam and The Philippines.

The major contracts driving growth in ASB's support division are likely to be the Sustainment Execution Contracts (SEC) awarded to the company in August 2021. AUSA was awarded 3 SEC's, which enable the company to bid as the prime contractor for all support work on Littoral Combat Ships (LCS) at homeport on the West Coast and East Coast or deployed in the Western Pacific.

The company has outlined a target of $500m in support revenue by FY27, which we believe is a realistic goal due to the below factors:

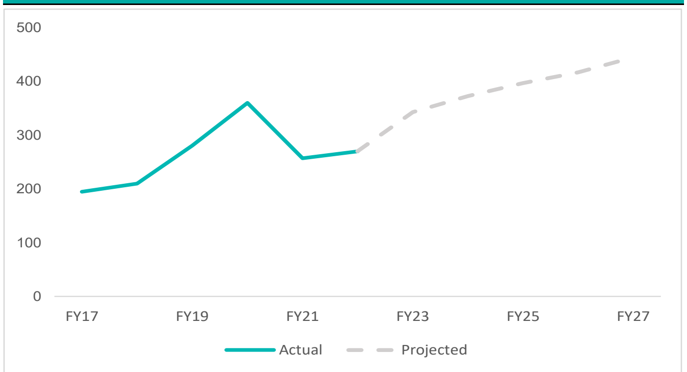
1) **Forecast growth in US sustainment budget:** US Navy budget estimates forecast a 6% compound annual growth rate in the sustainment budget to the year 2030 due to an increase in size of the fleet and the accelerating age of the existing fleet[1]. In FY22, Austal USA captured 1% of the total ~$11b per year support market, which demonstrates the opportunity presented to the company if it can increase its market share following its investment in greater capacity.
2) **Potential for greater opportunities in Australia:** Once ASB completes delivery of all remaining vessels in the GCPB and eCCPB programs, the company is likely to received increased support work as the fleet is deployed. Further, the AUKUS agreement and DSR has provided additional opportunities domestically, see **Page 14.**
3) **Increased investment in support facilities:** AUSA has invested over $100m USD to upgrade the support facility in San Diego, including the construction of a floating dry dock, which is scheduled to be completed in 2023. Further, Austal Australasia recently invested in a new support base in Cairns and a new slipway in Brisbane. This commitment to expand the capacity of its support network places ASB in a prime position to benefit from increasing support work globally.

Figure 15 - Forecast growth in USN sustainment budget (US$b)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 16 – ASB support revenue (A$m)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

[1] (Office of the Chief of Naval Operations, 2020)

Growth Strategy

The primary goal of Austal is to expand their shipbuilding operations for long term growth and the company has outlined multiple initiatives to implement this strategy, see below.

1. **Grow contract book:** The company has already made significant strides to replace the revenue contributions of the LCS and EPF programmes with material contracts wins in the last 12 months. Below is a breakdown of the company's current and targeted shipbuilding programs
   - **Current:** LCS, EPF, EMS, T-ATS, OPC, T-AGOS, AFDM, OUSV 3
   - **Targets:** LCU, LUSV, MUSV, NGLS, LAW, AS(X), S72, MAST 13
2. **Increase sub-contractor work:** Historically, ASB would tender exclusively for shipbuilding contracts as the prime contractor. However, the company has now identified the benefit of partnering with major shipbuilders as a sub-contractor to increase their order book, realise better utilisation of their facilities and improve margins by adding volume and lowering cost.
3. **Autonomous vessels:** Autonomous vessels provide an opportunity for the company to position itself as major player in a new area of the shipbuilding market. AUSA successfully delivered EPF 13 in February 2023, which is the US Navy's largest surface ship with autonomous capabilities.

   Other on-going/future opportunities include:
   - ASB and Saildrone Inc. have entered an exclusive Teaming Agreement to jointly identify opportunities to collaborate on the manufacture of the 20 metre Saildrone Surveyor, in Australia.
   - AUSA is partnered with L3Harris on the MCS upgrade of Overlord vessel, Mariner (OUSV 3), and construction of Vanguard (OUSV 4)LUSV
   - Patrol Boat Autonomy Trial (PBAT) for the Royal Australian Navy
4. **Support:** ASB has outlined their strategy to grow the support area of the business, see **page 9** for details.

Regulatory Issues

ASB has been the subject of investigation by Australian and US authorities since 2019 relating to allegations former AUSA employees made false and misleading statements about AUSA's performance and financial condition between 2012 and 2016. The ASIC investigation was settled in September last year with ASB paying a $650,000 penalty. The US investigation, conducted by the SEC and DOJ, is ongoing and the three former employees in question have been indicted by the DOJ and had civil charges filed against them by the SEC.

Whilst it has been reported in the media[2] that individuals in US congress are arguing for ASB to be cut off from future US naval contracts, we believe this is unlikely. We base this opinion on 1) the US DoD invested $50m USD in ASB's new steel shipbuilding facility in 2021 despite investigations beginning in 2019, 2) ASB has received multiple strategically significant contracts since the investigation began and 3) the US shipbuilding industry is already unable to meet required demand and is therefore unlikely to reduce industry capacity even further by blacklisting one of their prime contractors.

It appears the investigation is now primarily targeting the individuals involved and, whilst it is unlikely ASB will avoid penalty, we do not believe it will have a material impact on the company's future operations and will more likely result in a form of monetary fine.

[2] (Australian Financial Review, 2023)

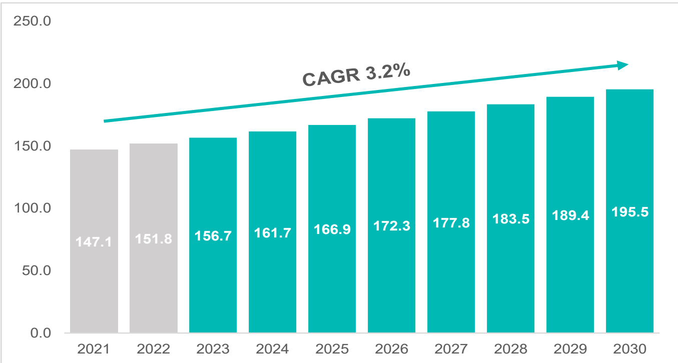
Industry Overview

Market definition and size

Austal is a participant of the global shipbuilding industry, which includes the design, construction and maintenance of all maritime vessels. South Korea, China and Japan are the world's largest shipbuilders, accounting for approximately 94% of new ships built in 2022. The overall market was valued at $153b USD in 2022 and is forecast to increase to approximately $195b USD by 2030[3].

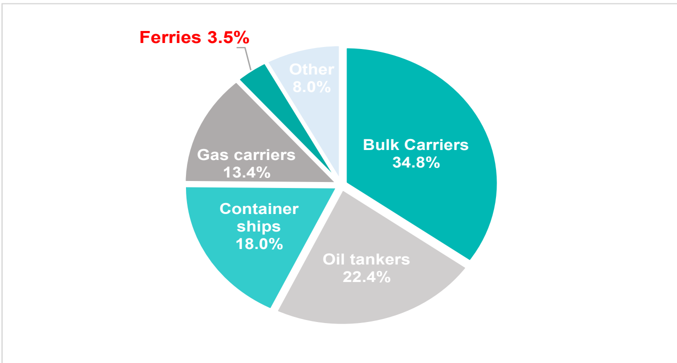
When analysing the industry by end user, the market can be categorised by commercial vessels and military vessels. Considering the importance of sea-based travel for international trade and transport, it is unsurprising that in recent years commercial vessels have accounted for the majority of new ship builds, approximately 70% in 2020 with military vessels accounting for the balance. Of new commercial vessels, passenger and vehicle ferries accounted for 3.5% of new builds in 2022[4].

Figure 17 – Global Shipbuilding market size 2020 - 2030



SOURCE: STATISTA, GLOBAL SHIPBUILDING MARKET

Figure 18 – New commercial vessel builds 2022



SOURCE: UNCTAD, REVIEW OF MARITIME TRANSPORT 2022

Competitive Landscape

Below is an overview of Austal's key competitors.

Figure 19 - Competitive landscape

	AUSTAL	BAE SYSTEMS	FINCANTIERI AUSTRALIA	GENERAL DYNAMICS Electric Boat	INGALLS SHIPBUILDING A Division of HII
Country of origin					
AUS operations	✓	✓	✓	✗	✗
US operations	✓	✓	✓	✓	✓
Shipbuilding	✓	✓	✓	✓	✓
Defence (naval)	✓	✓	✓	✓	✓
Large Surface vessels	✗	✗	✗	✗	✓
Small Surface vessels	✓	✓	✓	✗	✓
Submarines	✗	✓	✓	✓	✗
Submarine modules	✓	✓	✓	✓	✗
Support	✓	✓	✓	✓	✓
Commercial	✓	✓	✓	✗	✗
Comments	A smaller player in the US than many of its competitors however still a vital contributer. Strong presence throughout Australasia in both commercial and Defence operations.	Major player in the UK and Aus however does prime and sub-contracting work in the US on small surface vessels. Small commercial presence.	Small presence in the US. Major player in Europe and Australia. Large commercial operations.	Major nuclear-powered submarine builder in the US. No commerical operations. No presence in Australia.	Major shipbuilder for the US Navy, builds both small and large surface vessels. Another division of HII, Newport News Shipbuilding, constructs nuclear-powered submarines and aircraft carriers for the US Navy.

SOURCE: BELL POTTER SECURITIES

[3] (Statista, 2022)

[4] (United Nations Conference on Trade and Development, UNCTAD)

Market trends and drivers

The key trends and drivers in market are detailed below.

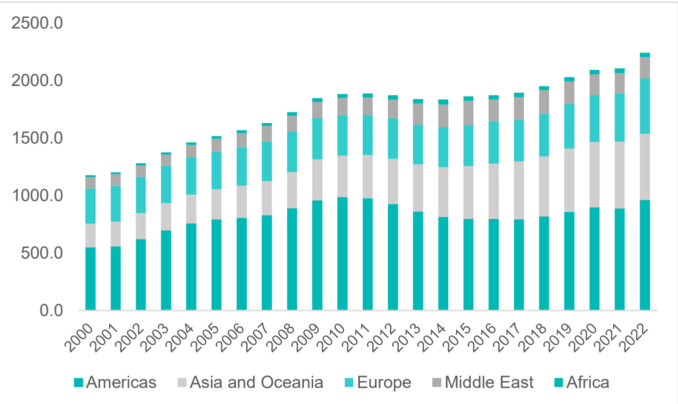
Geopolitical tensions fuelling increased military spending

The Russian invasion of Ukraine and geopolitical tensions in the Asia-Pacific (see below) is driving increased military expenditure globally, with total military expenditure increasing by 3.7% in 2022 to reach a new high of $2,240 billion USD[5].

The largest increases were experienced by Finland (+36%) Lithuania (+27%), Sweden (+12%) and Poland (+11%) as they prioritised their national defence in the response to the War in Ukraine. Japanese military expenditure (+5.9%, 1.1% of GDP) surged in a clear rebuke of China, a sign the post-war restraints Japan imposed on its military spending and capabilities seem to be loosening

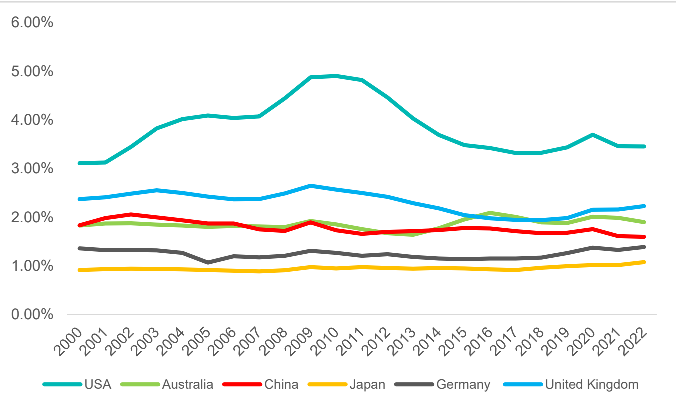
Further, the Australian Government recently completed its "*Defence Strategic Review*" amid fears current defence expenditure and structure are not adequate to combat the growing strategic threats in the region. In the 2023-2024 budget, defence spending over the forward estimates (through to 2026-27) remain broadly in line with its long-term goal 2.0% of GDP, whilst additional spending to implement the Defence Strategic Review will raise this to 2.3% by 2032-33.

Figure 20 - Global military expenditure ($b USD) 2000-2022



SOURCE: STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE

Figure 21 - Military expenditure as a % of GDP, 2000-2022



SOURCE: STOCKHOLM INTERNATIONAL PEACE RESEARCH INSTITUTE

Conflict in the Pacific requires changes to existing fleet sizes

China's ambition to assert its presence throughout the Asia-Pacific, territorial disputes over the South China Sea and a potential invasion of Taiwan have all contributed to rising tensions between China and the US, increasing the likelihood that the next major global conflict will occur in the Asia-Pacific region. It is clear any potential conflict in Asia-Pacific will place far greater emphasis on maritime capabilities than any other major conflict since the Cold War due to the vast expanse of maritime territory in the region and the increasing importance of sea lanes for global trade and commerce.

The US Navy, and many other global powers, are in an arms race to reverse the reduction in their fleet sizes to a level that can adequately cope with conflict in the Pacific after decades of war largely waged in land-forces-intensive theatre, such as the Middle East.

This thesis is supported by the US Navy's FY24 30-year shipbuilding plan, which details an immediate requirement to accelerate the construction and procurement of a variety of naval vessels to significantly increase the size of its fleet. The report presents three options to increase the size of the fleet to 319, 328 or 367 manned ships by 2053. Whilst a final decision is not expected before July 2023 at the earliest, alternative 3 is the singular option that will see the US fleet achieve the required 355 ship fleet as legislated by the 2016

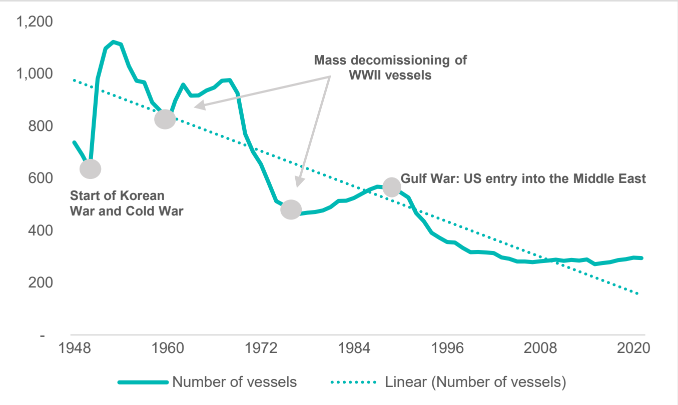
[5] (Stockholm International Peace Research Institute, 2023)

force-level goal. If the US Navy were to proceed with alternatives 1 or 2, they would be required to legislate a reduced force-level goal[6].

What this means for Austal?

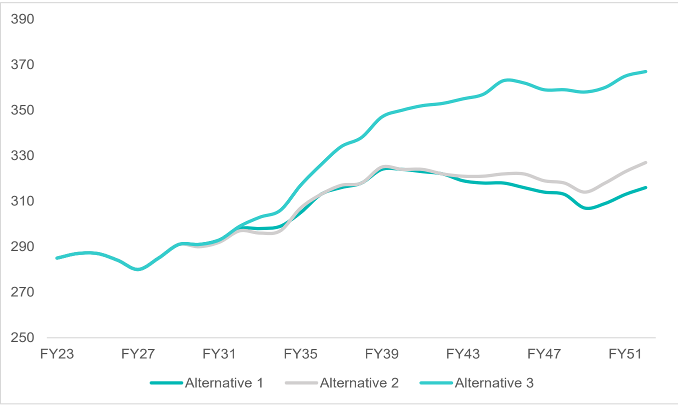
As a whole, the naval shipbuilding industry, particularly in the US, is about to enter a phase of increasing demand and investment. As a key pillar of the US naval industrial base, Austal is well positioned to benefit from the surge in new ship builds, with the increased capacity to tender for both aluminium and steel ships.

Figure 22 - Historical size of US naval force 1948 - 2021



SOURCE: CONGRESSIONAL RESEARCH OFFICE

Figure 23 - US Navy 30-year shipbuilding plan



SOURCE: CONGRESSIONAL RESEARCH OFFICE

AUKUS and the DSR: Long-term commitment to Australian shipbuilding

The recent Defence Strategic Review (DSR) reaffirmed the Australian government's commitment to the domestic shipbuilding industry, with the report detailing a sovereign shipbuilding capability as a "critical component" of Australia's national defence strategy.

The construction of the AUKUS nuclear-powered submarine fleet will be the major project for the next three decades and provides a range of opportunities for domestic businesses. Whilst the majority of the submarine construction will occur at Osborne Shipyard, South Australia, the submarine fleet will be based out of HMAS Stirling, Western Australia.

The government has committed $8b to upgrade HMAS Stirling and the surrounding infrastructure to the scale required to house nuclear-powered submarines and boost naval shipbuilding capacity, including a large vessel dry dock at Henderson shipyard. Further, the DSR recommended the government encourage industry consolidation for the Henderson Shipyard to make better use of the current workforce.

The one disappointing element from the DSR was the recommendation for a separate review to be conducted in the RAN's surface fleet. Whilst we do not expect any major deviations from the recommendations detailed above, it does add another layer of risk and delays the implementation of these measures for at least 6 months.

What this means for Austal?

1. As one of the major players at Henderson shipyard, any consolidation is likely to benefit ASB and increase its presence in the industry. Further, improved naval shipbuilding capacity at Henderson shipyard, including a large vessel dry dock, will expand the projects available to tender for ASB, which is currently restricted to small surface vessels.
2. AUSA has recently commenced work as a sub-contractor on the US Virginia-class submarine program, constructing the Command Deck Module on behalf of the prime contractor, General Dynamics. These expertise and its location at Henderson

[6] (Congressional Research Office, 2023)

shipyard, positions ASB as a leading candidate for any support contracts associated with the AUKUS nuclear-powered submarine fleet based at HMAS Stirling, WA.

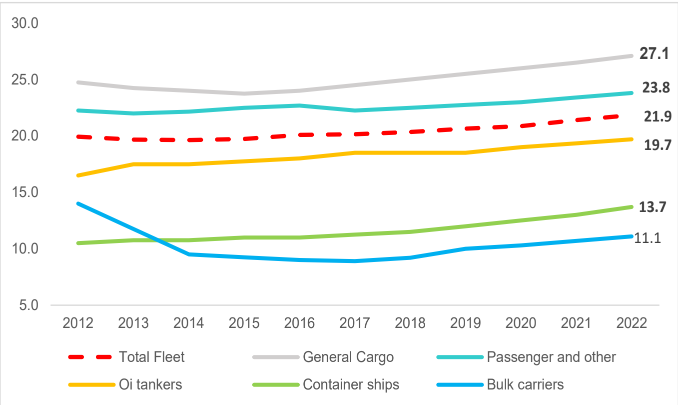
Aging commercial fleet amongst push for '*green*' vessels

Commercial shipping operators are facing two distinct issues; 1) the global commercial fleet is ageing and 2) increasing regulatory pressure to reduce carbon emissions. These two issues are inextricably linked as older ships produce greater emissions.

Greenhouse gas emissions from the world's maritime fleet are increasing and measures need to be taken to reverse this course. Between 2020 and 2021, emissions increased by 4.7% despite reduced traffic due to the COVID pandemic. The average age of the commercial fleet is 21.9 years, with the passenger ferries and other segment the second oldest at 23.8 years. Similarly, this segment of the fleet produces the third largest level of carbon dioxide emissions, emitting 12 million tons a month in 2021[7].

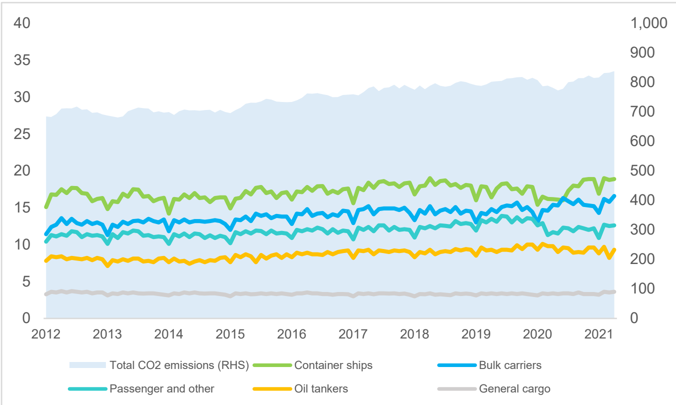
Consequently, there is a global push to replace ageing vessels with a new generation of 'green' ships built with the latest fuel efficiency technologies and alternative power sources. However, change has been slow with the commercial fleet growing by less than 3% in 2021, which was the second lowest rate since 2005. Whilst low shipbuilding volumes can largely be attributed to the impact of the COVID pandemic, the stall in new builds has exasperated these issues for fleet owners.

Figure 24 - Commercial fleet age 2012-2022



SOURCE: UNCTAD, REVIEW OF MARITIME TRANSPORT 2022

Figure 25 – Co2 emissions by vessel type 2011 -2021



SOURCE: UNCTAD, REVIEW OF MARITIME TRANSPORT 2022

What this means for Austal?

Austal Australasia had already released plans for a range of zero emission fast ferries back in 2021 however commercial orders were severely impacted by the COVID pandemic. Further, there does appear to be a lag in new commercial orders as fleet operators investigate the best technologies for their new fleet. However, we anticipate this segment of the business to perform strongly in the medium to long-term once operators commit to the optimal technology for future vessels and begin the process of replacing the ageing commercial fleet,

[7] (United Nations Conference on Trade and Development, UNCTAD)

Financials

Contract Book

Below is a breakdown of our forecast contract book FY23e- FY25e.

Figure 26 - Contract book FY23e - FY25e

Contract book (A$m) Year end 30 June	Jun-23 FY23e	Jun-24 FY24e	Jun-25 FY25e
AUSA Shipbuilding			
Littoral Combat Ships (LCS)	608.5	294.6	16.2
Expeditionary Fast Transport (EPF)	216.1	213.9	188.3
Emergency Medical Ships (EMS)	-	33.3	233.3
Towing, Salvage and Rescue Ships (T-ATS)	61.6	154.0	189.3
Offshore Patrol Cutters (OPC)	-	87.9	151.7
Auxiliary General Ocean Surveillance Ship (T-AGOS)	-	85.0	85.0
Landing Craft, Utility (LCU)	-	22.5	88.7
Virgina Class Submarine: Command Deck Module (CDM)	7.0	28.2	-
Auxiliary Floating Dry Dock (AFDM)	18.9	75.7	75.7
Revenue from AUSA Shipbuilding	**912.2**	**995.2**	**1,028.3**
Revenue from AUSA Support	**237.4**	**256.3**	**269.2**
Total revenue from AUSA operations	**1,149.6**	**1,251.5**	**1,297.5**
Revenue from Australasia Shipbuilding	**250.0**	**225.0**	**258.7**
Revenue from Australasia Support	**106.1**	**116.7**	**128.4**
Total revenue from Australasia operations	**356.1**	**341.7**	**387.1**

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Contract book assumptions:

- AUSA submits costs and recognises revenue based on the percentage of ship completed. Thus, we have booked revenue pro-rata over the duration of each individual ship build. The construction schedule is based on the dates provided by the *US Department of Defense Fiscal Year FY24 Budget Estimates*, released in March 2023.
- Shipbuilding contracts for Austal Australasia are commonly structured to include an upfront payment (15%), 3 equal payments throughout the duration of the contract (75%) and the final payment (10%) made on delivery. Our revenue recognition schedule is based on this assumption.
- We have assumed a number of contracts will be awarded to Austal, which have not yet been announced, in our forecasts based on the US *Department of Defense FY24 Budget Estimates*. These include additional contract options for the OPC and T-AGOS programs, and new programs including the EMS and LCU vessels.
- There is upside/downside risks to our forecasts on an annual basis depending on the time period the company recognises certain revenue, which may differ from our assumptions.

Forecast Profit & Loss

Our forecast Profit & Loss for the next 3 years (FY23-FY25) is shown below.

Figure 27 - Forecast Profit & Loss

Income Statement (A$m)	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
Year end 30 June	FY21	FY22	FY23e	FY24e	FY25e
Shipbuilding	1314.9	1158.9	1162.2	1220.1	1851.8
Support	257.3	270.2	343.5	373.1	445.4
Total Revenue	**1572.2**	**1429.0**	**1505.7**	**1593.2**	**1684.6**
growth %	*-25%*	*-9%*	*5.4%*	*5.8%*	*5.7%*
COGS	-1349.6	-1198.8	-1279.9	-1357.4	-1440.3
Gross Profit	**222.6**	**230.3**	**225.9**	**235.8**	**244.3**
Gross margin %	*14.2%*	*16.1%*	*15.0%*	*14.8%*	*14.5%*
Total expenses	-70.4	-72.5	-125.3	-80.3	-87.3
Other income/(loss)	8.1	7.6	0.0	0.0	0.0
Statutory EBITDA	**160.3**	**165.4**	**100.5**	**155.5**	**157.0**
Total D&A	-45.7	-44.7	-44.3	-46.7	-49.7
Statutory EBIT	**114.6**	**120.7**	**56.2**	**108.8**	**107.3**
EBIT Margin %	*7.3%*	*8.4%*	*3.7%*	*6.8%*	*6.4%*
Interest Expense	-7.4	-8.2	-7.6	-7.6	-7.6
Profit Before Tax	**107.2**	**112.4**	**48.6**	**101.2**	**99.7**
Income Tax Expense	-26.2	-32.9	-13.4	-27.8	-27.4
Statutory NPAT	**81.1**	**79.6**	**35.3**	**73.4**	**72.3**
abs. & extras (post-tax)	0.0	0.0	42.0	0.0	0.0
Underlying EBIT	**114.6**	**120.7**	**98.2**	**108.8**	**107.3**

SOURCE: BELL POTTER SECURITIES ESTIMATES

The key points are:

- **Moderate revenue growth:** We forecast moderate revenue growth of 5.4%, 5.8% and 5.7% in FY23, FY24 and FY25 respectively. This growth is primarily driven by the new EMS, T-AGOS and OPC contracts awarded to the company in the last 12 months.
- **Onerous contract provision T-ATS:** In Jan-23, ASB informed the market it would include the full extent of its forecast losses, arising from the T-ATS onerous contact provision, in its FY23 forecasts. Thus, we have included a -$42.0m impairment write-down in our FY23e forecasts. The company has submitted Requests for Equitable Adjustment (REAs) seeking recovery of these amounts however it is unknown whether these will be successful. This impairment has driven significant decrease in the FY23e EBIT margin (3.7%), with BPe EBIT forecast ($56.2m) slightly below ASB guidance of $58m.
- **EBIT margins:** As the LCS and EPF programs draw to a close and new multi-vessel programs contribute a greater proportion of total revenue, we forecast EBIT margins in FY24 and FY25 to fall below recent levels (exc. FY23). We anticipate EBIT margins to increase post FY25 as these new programs mature and stronger margins are realised.
- **NPAT:** We forecast statutory NPAT in FY23 of $35.3m (-55.7% YoY) largely due to the T-ATS impairment write-down. Excluding the impairment, we forecast underlying EBIT of $98.2m (-18.6% YoY). We anticipate a return to normal operations in FY24 with NPAT of $73.4m (-7.7% on FY22) where moderate revenue growth is offset by falling EBIT margins, resulting in NPAT of $72.3m (-1.8% YoY) in FY25.

Balance Sheet

The key figures from the Balance Sheet over the next 3 years are shown below.

Figure 28 - Key figures and ratios from forecast Balance Sheet

Balance Sheet (A$m)	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
Year end 30 June	FY21	FY22	FY23e	FY24e	FY25e
Cash	346.9	240.1	140.3	118.3	152.9
Total Debt	147.2	124.5	124.5	124.5	124.5
Net debt/(cash)	**-199.7**	**-115.6**	**-15.8**	**6.2**	**-28.4**
PPE	644.2	799.4	862.5	880.3	877.9
Intangibles	6.4	5.9	6.1	6.3	6.6
NTA per share	**2.0**	**2.5**	**2.5**	**2.6**	**2.7**
Net Assets	**774.0**	**924.3**	**930.5**	**974.9**	**1018.2**
Inventories	138.3	132.1	97.9	127.5	143.2

SOURCE: BELL POTTER SECURITIES ESTIMATES

The key points are:

- Despite the reduction from pre-COVID highs, ASB has a strong cash balance, which will benefit further from reduced capex in future periods. The company normally has a strong liquidity buffer between its cash on hand and debt obligations other than in FY24e, which will only improve with the forecast return to positive Free Cash Flow.
- The strong growth in PPE in recent periods was driven by company investment in its steelmaking facilities and support network. We anticipate this growth to normalise in future periods.

Cash flow

The key figures from the Cash Flow Statement over the next 3 years are shown below.

Figure 29 - Key figures and ratios from forecast Cash Flow statement

Cash Flow Statement (A$m)	Jun-21	Jun-22	Jun-23	Jun-24	Jun-25
Year end 30 June	FY21	FY22	FY23e	FY24e	FY25e
Gross Cash Flow	124.3	70.8	57.9	107.1	146.2
Operating Cash Flow	93.5	37.5	36.9	71.6	111.2
Capex	-76.3	-116.3	-105.2	-62.1	-44.8
Free Cash Flow	17.2	-78.8	-68.3	9.5	66.4
Dividends paid	-31.3	-28.9	-29.0	-29.0	-29.0
Net Change in Cash	**-31.5**	**-128.3**	**-99.8**	**-22.1**	**34.6**
FCF per share (cps)	*4.5*	*-22.1*	*-19.6*	*1.9*	*17.6*

SOURCE: BELL POTTER SECURITIES ESTIMATES

The key points are:

- **Capex:** We expect Capex to reduce in future years as the company completes its in large investment in its facilities, which included the new steelmaking facilities and increased capacity across its support bases.
- **Free Cash Flow:** Consequently, we forecast the company to return to positive Free Cash flow in FY24 once their capex levels normalise from recent highs.

Valuation

Our PT of $3.10 is calculated using a blend of three valuation methodologies; PE ratio, EV/EBIT and DCF. The 12 month PT is 27% premium to the current share price so we initiate with a BUY recommendation.

Peer Analysis

Constructing a peer group of like-for-like peers for ASB is quite difficult considering its unique position in the market. We believe the groups that share key characteristics with the company include, 1) domestic aerospace & defence, 2) domestic manufacturing & construction companies and 3) international aerospace & defence companies. See below for a breakdown of the peer group and the key figures associated with each company.

Figure 30 - ASB Peer Analysis

						Revenue		EBIT		EV/EBIT	P/E
Company name	**Code**	**Currency**	**Last**	**Market Cap ($m)**	**EV ($m)**	**FY23e**	**FY24e**	**FY23e**	**FY24e**	**FY24e**	**FY24e**
Domestic Peers- Aerospace & Defence											
DroneShield Ltd	DRO	AUD	$ 0.24	141.1	131.5	30.5	44.6	1.2	2.3	80.2	30.0
XTEK Ltd	XTE	AUD	$ 0.39	43.8	37.1	83.9	89.6	12.5	17.8	1.7	2.8
Domestic Peers- Capital Goods											
GenusPlus Group Ltd	GNP	AUD	$ 1.06	181.3	166.6	452.5	494.5	17.8	30.1	5.9	8.9
Lycopodium Ltd	LYL	AUD	$ 10.37	407.3	328.5	320.5	323.0	61.7	60.6	7.9	9.7
Monadelphous Group Ltd	MND	AUD	$ 12.20	1193.7	1116.4	1803.8	1994.3	67.3	89.5	10.8	18.7
Domestic Median				***181.3***	***166.6***	***320.5***	***323.0***	***17.8***	***30.1***	***7.9***	***9.7***
International Peers- Aerospace & Defence											
Raytheon Technologies Corp	RTX US Equity	USD	$ 97.70	142812.0	174619.0	72778.5	78467.5	8609.0	9583.5	18.0	17.1
Boeing Co/The	BA US Equity	USD	$ 212.37	132344.6	172992.6	77614.3	90871.0	2112.2	6684.8	24.2	37.9
Lockheed Martin Corp	LMT US Equity	USD	$ 458.38	116286.0	129446.0	65827.9	67921.2	8477.5	8632.4	15.1	16.5
Northrop Grumman Corp	NOC US Equity	USD	$ 454.34	69604.8	82668.8	38372.2	40465.5	4046.1	4426.2	18.2	18.6
General Dynamics Corp	GD US Equity	USD	$ 215.49	59624.1	69684.1	41475.0	44295.9	4480.8	5112.7	13.0	14.7
BAE Systems PLC	BA/ LN Equity	GBP	£ 9.57	29543.7	33456.7	23975.4	25064.7	2570.6	2743.4	11.9	15.2
Rolls-Royce Holdings PLC	RR/ LN Equity	GBP	£ 1.57	12651.8	16022.8	13788.8	14869.6	913.0	1149.5	11.8	19.6
Huntington Ingalls Industries Inc	HII US Equity	USD	$ 218.47	8823.0	11627.0	10924.4	11287.2	667.8	753.6	14.1	13.8
International Median				***64614.4***	***76176.4***	***39923.6***	***42380.7***	***3308.3***	***4769.4***	***14.6***	***16.8***
All Peers Median				***12651.8***	***16022.8***	***13788.8***	***14869.6***	***913.0***	***1149.5***	***13.0***	***16.5***
Austal Ltd	***ASB***	***AUD***	***$ 2.45***	***878.9***	***930.9***	***1505.7***	***1593.2***	***97.1***	***102.0***	***7.8***	***12.1***

SOURCE: BLOOMBERG AND BELL POTTER SECURITIES ESTIMATES

The key points are:

- **Domestic defence comps limited:** The listed defence industry in Australia is fairly immature when compared to foreign markets, with a small group of diverse companies. ASB is clearly the major player in this market and it is therefore difficult to value the company without expanding the comps group to include other domestic industries with similar operations. Thus we chose to include domestic manufacturers and construction companies operating in capital intensive industries, which operate under similar operational requirements to Austal.
- **International peer group trading on higher multiples:** The international peer group primarily consists of large multinational defence companies, which operate in a range of different business segments within the larger defence industry. These companies clearly trade on higher multiples, which we believe is justified when compared to the size and relatively limited offering of Austal.

Conclusion:

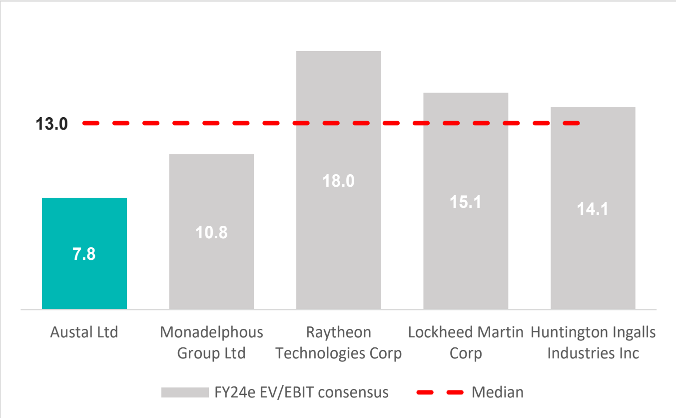
- Austal is currently trading on 7.8x EV/EBIT and 12.1x PE, based on FY24e, and is clearly undervalued when compared to both its domestic and international peers.
- However, we believe it is appropriate to apply a 20% discount to the median EV/EBIT and PE ratio (13.0x and 16.5x) of its peers to more closely align ASB with domestic valuations. Therefore, we will utilise a 10.5x EV/EBIT multiple and 13.3x PE ratio in the determination of our price target.

Relative Valuation- PE ratio and EV/EBIT

The PE ratio and EV/EBIT valuation for Austal is shown below.

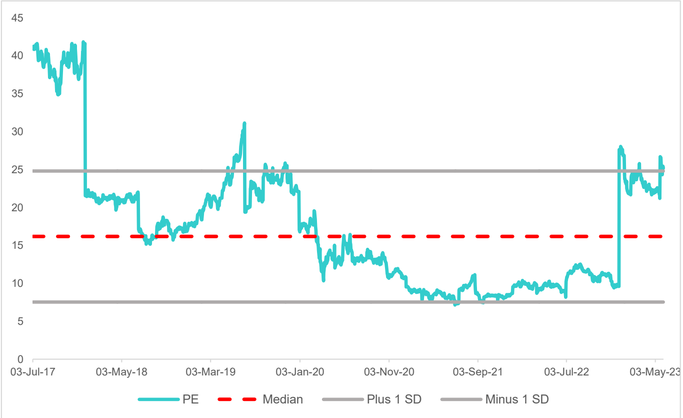
Note we use our FY24e forecasts as the basis for these valuations to be generally consistent with a one year price target and given proximity to the end of FY23.

Figure 31 - FY24e EV/EBIT versus peers consensus



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 32 - Consensus PE FY23e (+/- 1 SD)



SOURCE: BLOOMBERG AND BELL POTTER SECURITIES ESTIMATES

Austal is currently trading on 12.1x PE based on our FY24 estimates, which is below its long run historical median (15.0x) as shown above in **Figure 32.** The significant increase in the PE in 2H23 is a combination of the strong share price performance and poor FY23 consensus earnings (T-ATS impairment), which should normalise in FY24.

See **Figure 33** for the breakdown of the PE ratio valuation.

Figure 33 - PE ratio

PE ratio		
EPS cps (FY24e)		20.2
Median PE ratio		16.5x
Discount		*20%*
P/E Target Multiple		13.3x
12-month forward Valuation	**$**	**2.68**

SOURCE: BELL POTTER SECURITIES ESTIMATES

We have opted to utilise an EV/EBIT multiple, as opposed to EV/EBITDA, in our valuation considering the capital-intensive nature of the shipbuilding industry and Austal's current high levels of capital expenditure.

See Figure **34** for the breakdown of the EV/EBIT valuation.

Figure 34 - EV/EBIT

EV/ EBIT		
FY24e EBIT		108.8
Median EV/ EBIT		13.0x
Discount		*20%*
EV/ EBITDA Target Multiple		10.5x
Implied Enterprise Value		**1,139.0**
Net Debt /(cash) FY24e		-15.2
Implied Equity Value		**1,154.2**
Diluted shares on issue		361.9
Valuation per Share	**$**	**3.19**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Discounted Cash Flow (DCF)

Our DCF valuation is shown below along with the calculation of the WACC we have used. This valuation is a year from now to be consistent with a 12 month price target.

Figure 35 - DCF Valuation

DCF methodology		FY24e	FY25e	FY26e	FY27e	FY28e	FY29e
Operating Cash Flow (A$m)		71.6	111.2	109.1	134.6	184.3	
Capex		- 64.7	- 47.6	- 55.1	- 62.7	- 64.0	
Free Cash Flow		**6.9**	**63.6**	**54.0**	**71.8**	**120.3**	**1,665.1**
Discount Rate		*0.0*	*1.0*	*2.0*	*3.0*	*4.0*	*5.0*
PV of cash flows		6.9	57.2	43.7	52.4	79.1	986.1
Sum of present values	**239.3**						
Market value of investments	0.0						
Net debt/(cash)	-15.2						
Equity value	**1240.6**						
Equity Value per share ($)	**$ 3.43**						

Key DCF Inputs	
Cost of debt	3.5%
Market risk premium	6.0%
Beta	1.30
Cost of equity	12.3%
WACC	**11.0%**
Terminal growth Rate	3.5%

Sensitivity Analysis for DCF		Terminal Growth Rate				
		2.5%	**3.0%**	**3.5%**	**4.5%**	**5.0%**
	10.0%	$3.53	$3.75	$4.00	$4.63	$5.04
	10.5%	$3.29	$3.48	$3.69	$4.22	$4.55
WACC	**11.0%**	$3.08	$3.25	**$3.43**	$3.88	$4.16
	11.5%	$2.89	$3.03	$3.18	$3.57	$3.80
	12.0%	$2.72	$2.84	$2.98	$3.31	$3.51

SOURCE: BELL POTTER SECURITIES ESTIMATES

The sensitivity analysis in **Figure 35** outlines the effect of changes in the WACC and/or terminal growth rate on the DCF valuation.

Key assumptions used in our DCF Valuation:

- **5 year forecast period:** We have chosen to only use 5 forecast period given the visibility over the contract book and required investment during this period.
- **Post-tax WACC of 11.0%:** Our WACC is derived from a risk free rate of 4.5%, market risk premium of 6% and unlevered asset beta of 1.30.
- **Terminal growth rate of 3.5%:** We have elected to use a terminal growth rate of 3.5% as this is largely in-line (a small premium to) the forecast growth in the global shipbuilding industry over the next decade.

Price Target

We use a blend of three valuation methodologies; PE ratio, EV/EBITDA and DCF to determine a 12 month price target of $3.10.

We acknowledge the market tends to focus more on short term earnings multiples however we applied an equal weighting to each valuation method as we believe the DCF valuation provides a fairly accurate representation of the forecast earnings considering the strong visibility over the company's contract book.

Figure 36 - Price target calculation

Methodology	Weighting	Value
DCF Valuation	33%	$ 3.43
EV/ EBIT	33%	$ 3.19
PE ratio	33%	$ 2.68
Blended Valuation		**$ 3.10**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Board of Directors & Key Management

Board of Directors

The Austal Board of Directors are detailed below

Figure 37 - Board of Directors

Mr John Rothwell AO – *Non-Executive Chairman*	**Mr Paddy Gregg –** *Executive Director and Chief Executive Officer*
Mr Lee Goddard – *Independent Non-Executive Director*	**Mrs Sarah Adam-Gedge –** *Independent Non-Executive Director*
Mr Chris Indermaur- *Independent Non-Executive Director*	**Mr Michael McCormack –** *Independent Non-Executive Director*

SOURCE: COMPANY DATA

Mr John Rothwell AO – *Non-Executive Chairman*

John has played a major role in the development of the Australian aluminium shipbuilding industry approaching 50 years of experience in boat and shipbuilding. He is the architect responsible for the establishment of Austal and was the founding Managing Director of Austal. John was appointed as an Officer of the Order of Australia (AO) in January 2004 for services to the Australian shipbuilding industry, and for significant contributions to vocational education and training.

Mr Paddy Gregg – *Executive Director and Chief Executive Officer*

Paddy Gregg was promoted to the position of CEO on 1-Jan-21, following 4 years as COO. Immediately prior to joining Austal, Paddy was working for Network Rail in the UK. Paddy has extensive experience in the naval sector having worked for BAE Systems Submarines, where he was the Head of Project for the second Astute Class hunter killer nuclear submarine build. Paddy is a Chartered Engineer and fellow of the Institution of Mechanical Engineers, with a Masters Degree in Mechanical Engineering and a Masters in Business Administration.

Key Management

The key Management of Austal are detailed below

Figure 38 - Key management

Mr Paddy Gregg – *Chief Executive Officer*	**Mr Ian McMillan –** *Chief Operating Officer*
Mr Rusty Murdaugh – *President Austal USA*	**Mr Christian Johnstone –** *Chief Financial Officer*

SOURCE: COMPANY DATA

Christian Johnstone – *Chief Financial Officer*

Mr Johnstone commenced his role as CFO on 03-Apr-23. Christian was previously CFO of AusGroup Limited (SGX:5GJ) and has also held CFO, Company Secretary and Executive M&A roles with Iron Ore Holdings (ASX:IOH) and Wesfarmers (ASX:WES). A qualified Chartered Accountant, Christian has a Bachelor of Accountancy (Hons) from the University of Dundee, Scotland and is a Graduate of the Australian Institute of Company Directors (since 2013). He has a Master of Business Administration and a Graduate Diploma in Applied Finance and Investment.

Rusty Murdaugh – *President Austal USA*

Mr Murdaugh commenced his role as President of Austal USA on 09-Sep-21, having joined Austal USA in 2017 as CFO, and serving as interim President of the Company since February 2021. As interim president, Rusty led the addition of steel shipbuilding to the Austal USA manufacturing operations, including the facility expansion in Mobile Alabama. A veteran of the defence industry in the US, Rusty previously held leadership positions with Esterline Corporation, Avnet, United Technologies (formerly Goodrich), and Honeywell.

Shareholder Register

The Austal top shareholders are detailed below.

Figure 39 - Top shareholders ASB

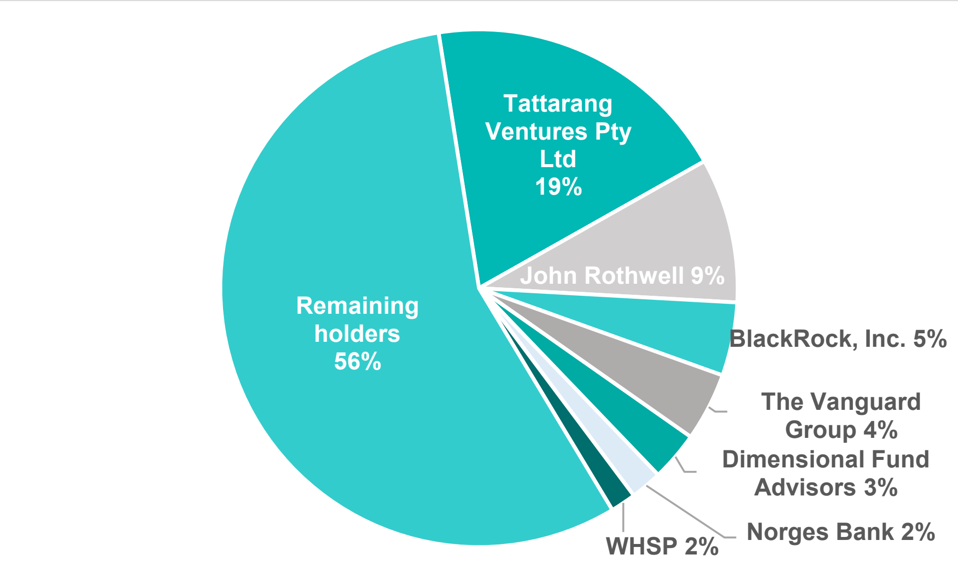
Name	No. of Shares held	% of total shares on issue
Tattarang Ventures Pty Ltd	70,089,988	19.3%
John Rothwell	32,761,692	9.0%
BlackRock, Inc.	16,637,402	4.6%
The Vanguard Group, Inc.	15,476,146	4.3%
Dimensional Fund Advisors LP	11,178,249	3.1%
Norges Bank Investment Management	7,116,652	2.0%
Washington H. Soul Pattinson and Company Limited	5,770,000	1.6%
Onyx (WA) Pty Ltd.	5,600,000	1.5%
Wellington Management Group LLP	4,047,622	1.1%
Top 9 Total	168,677,751	46.5%
Remaining holders	193,764,124	53.5%

SOURCE: IRESS, BLOOMBERG AND COMPANY DATA

Key points:

- Tattarang Ventures Pty Ltd is the largest shareholder of ASB with almost ~20% of the total shares on issue. Tattarang is the private investment group of Andrew and Nicola Forrest.
- The second largest shareholder is Mr John Rothwell, Non-Executive Chairman and founding Managing Director of Austal.
- The company is well held across a range of institutions, particularly amongst mutual funds, including BlackRock, Vanguard, Dimensional Fund Advisers, Norges Bank and WHSP.
- Any potential takeover bid from one or more of the interested parties (Arlington Capital Partners, Cerberus Capital Management and the 1941 Fund/Bondi Partners/Ellerston Capital) will require shareholder support, particularly Tattarang due to the size of the holding.

Figure 40 - ASB register composition



SOURCE: IRESS

Austal Limited
as at 22 June 2023

Recommendation	Buy
Price	$2.45
Target (12 months)	$3.10

Table 1 - Financial summary

Profit & Loss (A$m)	FY21	FY22	FY23e	FY24e	FY25e
Year Ending 30 June					
Revenue	**1,572.2**	**1,429.0**	**1,505.7**	**1,593.2**	**1,684.6**
Change	*-24.6%*	*-9.1%*	*5.4%*	*5.8%*	*5.7%*
Cost of sales	(1,349.6)	(1,198.8)	(1,279.9)	(1,357.4)	(1,440.3)
Gross profit	**222.6**	**230.3**	**225.9**	**235.8**	**244.3**
Gross margin	*14%*	*16%*	*15%*	*15%*	*15%*
Other income/(expense)	8.1	7.6	-	-	-
Expenses (excl. D&A, int.)	**(70.4)**	**(72.5)**	**(125.3)**	**(80.3)**	**(87.3)**
Statutory EBITDA	**160.3**	**165.4**	**100.5**	**155.5**	**157.0**
Depreciation and amortisation	(45.7)	(44.7)	(44.3)	(46.7)	(49.7)
Statutory EBIT	**114.6**	**120.7**	**56.2**	**108.8**	**107.3**
Net interest (expense)/revenue	(7.4)	(8.2)	(7.6)	(7.6)	(7.6)
Pre-tax profit	**107.2**	**112.4**	**48.6**	**101.2**	**99.7**
Income tax benefit /(expense)	(26.2)	(32.9)	(13.4)	(27.8)	(27.4)
Stautory NPAT	**81.1**	**79.6**	**35.3**	**73.4**	**72.3**
Abs & extras.	-	-	42.0	-	-
Underlying EBIT	**114.6**	**120.7**	**98.2**	**108.8**	**107.3**

Cashflow (A$m)	FY21	FY22	FY23e	FY24e	FY25e
EBITDA	160.3	165.4	100.5	155.5	157.0
Change in working capital	36.1	94.6	42.7	48.5	10.8
Gross cash flow	**124.3**	**70.8**	**57.9**	**107.1**	**146.2**
Income tax refunded/(paid)	(26.7)	(28.3)	(13.4)	(27.8)	(27.4)
Operating cash flow	**93.5**	**37.5**	**36.9**	**71.6**	**111.2**
Payments for PPE	(76.3)	(116.3)	(105.2)	(62.1)	(44.8)
Payments for Intangibles	(0.9)	(0.8)	(2.4)	(2.6)	(2.7)
Investing cash flow	**(78.7)**	**(127.5)**	**(107.7)**	**(64.7)**	**(47.6)**
Net Proceeds from issue of shares	-	-	-	-	-
Net proceeds of borrowings	0.0	0.0	0.0	0.0	0.0
Repayment of borrowings	(7.5)	(0.8)	0.0	0.0	0.0
Payment of lease liabilities	(7.6)	(8.6)	0.0	0.0	0.0
Dividends	(31.3)	(28.9)	(29.0)	(29.0)	(29.0)
Other	0.0	0.0	0.0	0.0	0.0
Financing cash flow	**(46.3)**	**(38.3)**	**(29.0)**	**(29.0)**	**(29.0)**
Net change in cash	**(31.5)**	**(128.3)**	**(99.8)**	**(22.1)**	**34.6**
Cash at start of period	396.7	346.9	240.1	140.3	118.3
Exchange rate impact	(18.3)	21.6	0.0	0.0	0.0
Cash at end of period	**346.9**	**240.1**	**140.3**	**118.3**	**152.9**

Balance Sheet (A$m)	FY21	FY22	FY23e	FY24e	FY25e
Cash and cash equivalents	346.9	240.1	140.3	118.3	152.9
Trade and other receivables	138.3	132.1	97.9	127.5	143.2
Inventories	178.3	263.1	293.6	318.6	320.1
PPE	644.2	799.4	862.5	880.3	877.9
Goodwill and intangibles	37.6	37.5	37.7	38.0	38.2
Right-of-use assets	56.0	152.5	152.5	152.5	152.5
Other	48.2	64.8	64.8	64.8	64.8
Total assets	**1,449.5**	**1,689.4**	**1,649.4**	**1,699.9**	**1,749.6**
Trade and other payables	133.4	151.7	105.4	111.5	117.9
Provisions	101.2	100.5	100.5	100.5	100.5
Lease liabilities	57.4	109.6	109.6	109.6	109.6
Borrowings	147.2	124.5	124.5	124.5	124.5
Other liabilities	236.3	278.8	278.8	278.8	278.8
Total liabilities	**675.5**	**765.2**	**718.8**	**725.0**	**731.4**
Net Assets	**774.0**	**924.3**	**930.5**	**974.9**	**1,018.2**
Share capital	141.7	143.9	143.9	143.9	143.9
Other reserves	205.3	302.5	302.5	302.5	302.5
Accumulated losses	427.1	477.9	484.2	528.6	571.8
Total shareholders' equity	**774.0**	**924.3**	**930.5**	**974.9**	**1,018.2**

Austal Limited			Year End 30 Jun
Share Price:	**$2.45**	**Target Price:**	**$3.10**
No. of issued shares (m):	**362.4**	**Market cap:**	**$888.0m**

Valuation Ratios	FY21	FY22	FY23e	FY24e	FY25e
Basic EPS (cps)	31.7	33.2	9.7	20.2	19.9
Diluted EPS (cps)	31.7	33.2	9.7	20.2	19.9
EPS growth (%)	*-9%*	*-2%*	*-56%*	*108%*	*-2%*
PE(x)	7.7	7.4	25.2	12.1	12.3
EV/Sales (x)	0.6	0.6	0.6	0.5	0.5
EV/EBITDA (x)	5.4	5.3	8.7	5.6	5.6
EV/EBIT (x)	7.6	7.2	15.5	8.0	8.1
FCF per share	4.5	-22.1	-19.6	1.9	17.6
FCF yield %	1.8%	nm	nm	0.8%	7.2%
NTA per share ($ps)	2.05	2.45	2.47	2.59	2.71
P/NTA (x)	1.2	1.0	1.0	0.9	0.9
Book value ($ps)	2.15	2.55	2.57	2.69	2.81
Price/Book (x)	1.1	1.0	1.0	0.9	0.9
DPS (cps)	8.7	8.0	8.0	8.0	8.0
Payout ratio % of NPAT	27.3%	36.3%	82.3%	39.5%	40.1%
Dividend Yield %	3.5%	3.3%	3.3%	3.3%	3.3%

Performance Ratios	FY21	FY22	FY23e	FY24e	FY25e
EBITDA Margin (%)	10.2%	11.6%	6.7%	9.8%	9.3%
EBIT Margin (%)	7.3%	8.4%	3.7%	6.8%	6.4%
NPAT Margin (%)	5.2%	5.6%	2.3%	4.6%	4.3%
Net debt/(cash)	(199.7)	(115.6)	(15.8)	6.2	(28.4)
ROE (%)	10.5%	8.6%	3.8%	7.5%	7.1%

Segmentals (A$m)	FY21	FY22	FY23e	FY24e	FY25e
Revenue					
Shipbuilding	1,314.9	1,158.9	1,162.2	1,220.1	1,287.0
Support	257.3	270.2	343.5	373.1	397.6
Total Revenue	**1,572.2**	**1,429.0**	**1,505.7**	**1,593.2**	**1,684.6**
Revenue Breakdown					
Shipbuilding	*na*	*81.1%*	*77.2%*	*76.6%*	*76.4%*
Support	*na*	*18.9%*	*22.8%*	*23.4%*	*23.6%*
Shipbuilding- USA	*na*	*75.9%*	*78.5%*	*81.6%*	*79.9%*
Shipbuilding- Australasia	*na*	*24.7%*	*21.5%*	*18.4%*	*20.1%*
Support- USA	*na*	*65.1%*	*69.1%*	*68.7%*	*67.7%*
Support- Australasia	*na*	*36.4%*	*30.9%*	*31.3%*	*32.3%*

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
Chris Savage	Head of Research/Industrials	612 8224 2835	csavage
Analysts			
John Hester	Healthcare	612 8224 2871	jhester
Anubhav Saxena	Healthcare	612 8224 2846	asaxena
Tara Speranza	Healthcare	612 8224 2815	tsperanza
Michael Ardrey	Industrials	613 9256 8782	mardrey
Marcus Barnard	Industrials	618 9326 7673	mbarnard
Sam Brandwood	Industrials	612 8224 2850	sbrandwood
Olivia Hagglund	Industrials	612 8224 2813	ohagglund
Daniel Laing	Industrials	613 8224 2886	dlaing
Chami Ratnapala	Industrials	612 8224 2845	cratnapala
Jonathan Snape	Industrials	613 9235 1601	jsnape
Thomas Sima	Industrials	612 8224 2843	tsima
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9235 1856	showe
Brad Watson	Resources	618 9326 7672	bwatson
Regan Burrows	Resources	618 9326 7677	rburrows
Joseph House	Resources	613 9235 1624	jhouse
Associates			
James Williamson	Associate Analyst	613 9235 1692	jwilliamson
Connor Eldridge	Associate Analyst	612 8224 2893	celdridge
Baxter Kirk	Associate Analyst	613 9235 1625	bkirk

Research Coverage & Policies

For Bell Potter Securities' Research Coverage Decision Making Process and Research Independence Policy please refer to our company website: https://bellpotter.com.au/research-independence-policy/.

Authoring Research Analyst's Certification

The Authoring Research Analyst is responsible for the content of this Research Report, and, certifies that with respect to each security that the Analyst covered in this Report (1) all the views expressed accurately reflect the Analyst's personal views about those securities and were prepared in an independent manner and (2) no part of the Analyst's compensation was, is or will be, directly or indirectly, related to specific recommendations or views expressed by that Research Analyst in the Research Report.

Research Analyst's Compensation

Research Analyst's compensation is determined by Bell Potter Securities Research Management and Bell Potter Securities' Senior Management and is based upon activities and services intended to benefit the investor clients of Bell Potter Securities Ltd. Compensation is not linked to specific transactions or recommendations. Like all Company employees Research Analysts receive compensation that is impacted by overall Company profitability.

Prices

The Price appearing in the Recommendation panel on page 1 of the Research Report is the Closing Price on the Date of the Research Report (appearing in the top right hand corner of page 1 of the Research Report), unless a before midday (am) time appears below the Date of the Research Report in which case the Price appearing in the Recommendation panel will be the Closing Price on the business day prior to the Date of the Research Report.

Availability

The completion and first dissemination of a Recommendation made within a Research Report are shortly after the close of the Market on the Date of the Research Report, unless a before midday (am) time appears below the Date of the Research Report in which case the Research Report will be completed and first disseminated shortly after that am time

Dissemination

Bell Potter generally disseminates its Research to the Company's Institutional and Private Clients via both proprietary and non-proprietary electronic distribution platforms. Certain Research may be disseminated only via the Company's proprietary distribution platforms; however such Research will not contain changes to earnings forecasts, target price, investment or risk rating or investment thesis or be otherwise inconsistent with the Author's previously published Research. Certain Research is made available only to institutional investors to satisfy regulatory requirements. Individual Bell Potter Research Analysts may also opt to circulate published Research to one or more Clients by email; such email distribution is discretionary and is done only after the Research has been disseminated. The level and types of service provided by Bell Potter Research Analysts to Clients may vary depending on various factors such as the Client's individual preferences as to frequency and manner of receiving communications from Analysts, the Client's risk profile and investment focus and perspective (e.g. market-wide, sector specific long term and short term etc.) the size and scope of the overall Client relationship with the Company and legal and regulatory constraints.

Disclaimers

This Research Report is a private communication to Clients and is not intended for public circulation or for the use of any third party, without the prior written approval of Bell Potter Securities Limited.

The Research Report is for informational purposes only and is not intended as an offer or solicitation for the purpose of sale of a security. Any decision to purchase securities mentioned in the Report must take into account existing public information on such security or any registered prospectus.

This is general investment advice only and does not constitute personal advice to any person. Because this Research Report has been prepared without consideration of any specific client's financial situation, particular needs and investment objectives ('relevant personal circumstances'), a Bell Potter Securities Limited Broker (or the financial services licensee, or the representative of such licensee, who has provided you with this report by arrangement with Bell Potter Securities Limited) should be made aware of your relevant personal circumstances and consulted before any investment decision is made on the basis of this Research Report.

While this Research Report is based on information from sources which are considered reliable, Bell Potter Securities Limited has not verified independently the information contained in this document and Bell Potter Securities Limited and its directors, employees and consultants do not represent, warrant or guarantee expressly or impliedly, that the information contained in this Research Report is complete or accurate.

Nor does Bell Potter Securities Limited accept any responsibility for updating any advice, views, opinions or recommendations contained in this Research Report or for correcting any error or omission which may have become apparent after the Research Report has been issued.

Bell Potter Securities Research Department has received assistance from the Company referred to in this Research Report including but not limited to discussions with management of the Company. Bell Potter Securities Policy prohibits Research Analysts sending draft Recommendations, Valuations and Price Targets to subject companies. However, it should be presumed that the Author of the Research Report has had discussions with the subject Company to ensure factual accuracy prior to publication.

All opinions, projections and estimates constitute the judgement of the Author as of the Date of the Research Report and these, plus any other information contained in the Research Report, are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice.

Notwithstanding other departments within Bell Potter Securities Limited advising the subject Company, information obtained in such role is not used in the preparation of the Research Report.

Although Bell Potter Research does not set a predetermined frequency for publication, if the Research Report is a fundamental equity research report it is the intention of Bell Potter Research to provide research coverage of the covered issuers, including in response to news affecting the issuer. For non-fundamental Research Reports, Bell Potter Research may not provide regular updates to the views, recommendations and facts included in the reports.

Notwithstanding that Bell Potter maintains coverage on, makes recommendations concerning or discusses issuers, Bell Potter Research may be periodically restricted from referencing certain Issuers due to legal or policy reasons. Where the component of a published trade idea is subject to a restriction, the trade idea will be removed from any list of open trade ideas included in the Research Report. Upon lifting of the restriction, the trade idea will either be re-instated in the open trade ideas list if the Analyst continues to support it or it will be officially closed.

Bell Potter Research may provide different research products and services to different classes of clients (for example based upon long-term or short term investment horizons) that may lead to differing conclusions or recommendations that could impact the price of a security contrary to the recommendations in the alternative Research Report, provided each is consistent with the rating system for each respective Research Report.

Except in so far as liability under any statute cannot be excluded, Bell Potter Securities Limited and its directors, employees and consultants do not accept any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in the document or for any resulting loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of the document or any other person.

In the USA and the UK this Research Report is only for institutional investors. It is not for release, publication or distribution in whole or in part in the two specified countries. In Hong Kong this Research Report is being distributed by Bell Potter Securities (HK) Limited which is licensed and regulated by the Securities and Futures Commission, Hong Kong. In the United States this Research Report is being distributed by Bell Potter Securities (US) LLC which is a registered broker-dealer and member of FINRA. Any person receiving this Research Report from Bell Potter Securities (US) LLC and wishing to transact in any security described herein should do so with Bell Potter Securities (US) LLC.

Bell Potter Securities Limited
ABN 25 006 390 772
Level 29, 101 Collins Street
Melbourne, Victoria, 3000
Telephone +61 3 9256 8700
www.bellpotter.com.au

Bell Potter Securities (HK) Limited
Room 1701, 16/F
Prosperity Tower, 39 Queens Road Central, Hong Kong, 0000
Telephone +852 3750 8400

Bell Potter Securities (US) LLC
Floor 39
444 Madison Avenue, New York NY 10022, U.S.A
Telephone +1 917 819 1410

Bell Potter Securities (UK) Limited
16 Berkeley Street London, England
W1J 8DZ, United Kingdom
Telephone +44 7734 2929