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Electro Optic Systems (EOS)

Early runs on the board

Recommendation
Buy (unchanged)
Price
\$1.72
Target (12 months)
\$2.20 (previously \$2.10)

Sector
Capital Goods

Expected Return

Capital growth	27.9%
Dividend yield	0.0%
Total expected return	27.9%

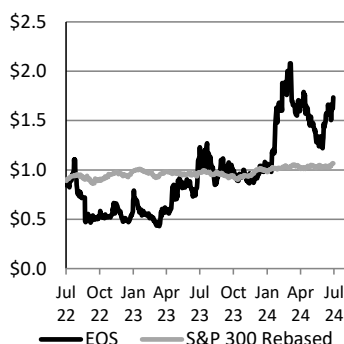
Company Data & Ratios

Enterprise value	\$308.6m
Market cap	\$331.9m
Issued capital	193.0m
Free float	~95%
Avg. daily val. (52wk)	\$0.8m
12 month price range	\$0.82 - \$2.09

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	1.34	1.67	0.99
Absolute (%)	29.48	4.20	76.14
Rel market (%)	25.83	2.46	64.26

Absolute Price



SOURCE: IRESS

First half ahead of BPe

EOS released unaudited results for 1H24, detailing a better-than-expected start to the year. EOS recorded 1H revenue of \$142.6m, which was +92% on 1H23 and represented 59% of BPe CY24 revenue (\$241.1m). We believe the strong 1H result was likely the due to the acceleration of revenues from the 2H into the 1H, rather than any additional contract awards. The cash flow result was slightly weaker than anticipated, with the gross contract asset increasing to \$89.7m and the \$20.5m debt repayment contributing to a reduced cash balance of \$52.2m.

Minor changes to forecasts

We have made no changes to our CY24 revenue forecast (\$241.1m) and expect a softer 2H due to certain revenues being recognised earlier in the year. We are comfortable our full-year forecast is covered by the current orderbook, so any risk to our estimates is likely to the upside based on the potential for new contracts awarded in the 2H. We have updated our working capital forecasts and corresponding cash flows in-line with the announcement, and we expect improved cash flow results in 2H24 and 1H25. Our CY24e EBITDA forecast remains unchanged (\$12.1m) and we continue to forecast a return to profitability in CY25.

Investment view: PT up 5% to \$2.20, retain BUY

Over the past 2 years EOS has consistently performed ahead of expectations and this 1H result again provides a strong foundation for the remainder of CY24 and de-risks our full-year forecasts. The focus for the remainder of the year will turn to growing the order book, with particular focus on the conversion of the Ukraine contracts to unconditional purchase agreements and further RWS sales into Europe. We await further information on the 1H result from the Appendix 4c to be released later this month and the audited 1H24 results to be released in late August.

We increase our price target by 5% to \$2.20, which a >15% premium to the current share price so we maintain our BUY recommendation.

Earnings Forecast

Year End 31 Dec	CY23	CY24e	CY25e	CY26e
Revenue (\$m)	219.3	241.1	286.3	311.6
EBITDA (\$m)	6.8	12.1	30.1	37.4
NPAT (underlying) (\$m)	-34.1	-21.0	3.5	18.5
NPAT (reported) (\$m)	-35.0	-21.0	3.5	18.5
EPS (cps)	-22.0	-11.5	1.8	9.6
EPS growth (%)	NM	NM	NM	NM
PE (x)	NM	NM	94.9	18.0
FCF Yield (%)	NM	-9%	11%	10%
EV/EBITDA (x)	45.4	25.6	10.3	8.3
Dividend (cps)	0.0	0.0	0.0	0.0
Yield (%)	NM	NM	NM	NM
Franking (%)	NM	NM	NM	NM
ROE(%)	NM	NM	NM	NM

SOURCE: BELL POTTER SECURITIES ESTIMATES

Forecast and Valuation Changes

Minor changes in forecasts

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Figure 1 - Change in key forecasts

Year end 31 Dec	CY24e	Change	CY25e	Change	CY26e	Change
Total revenue (A\$m)	241.1	<i>no change</i>	286.3	<i>no change</i>	311.6	<i>no change</i>
EBITDA	12.1	<i>no change</i>	30.1	<i>no change</i>	37.4	<i>no change</i>
NPAT	-21.0	<i>no change</i>	3.5	<i>no change</i>	18.5	<i>no change</i>
Diluted EPS	-11.5c	<i>no change</i>	1.8c	<i>no change</i>	9.6c	<i>no change</i>
DPS	0.0	<i>no change</i>	0.0c	<i>no change</i>	0.0c	<i>no change</i>

SOURCE: BELL POTTER SECURITIES ESTIMATES

PT up 5% to \$2.20

We have updated each valuation used in the determination of our price target for the earnings changes as well as market movements and time creep.

We have increased the multiple we apply in our EV/EBITDA valuation to 13.0x (prev. 12.5x) and there are no changes to our DCF assumptions.

The change in each valuation and the impact on our PT calculation is shown below.

Figure 2 - Change in valuations and impact on PT

	Old (as at 11-Jun-24)			New (as at 16-Jul-24)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
Methodology						
DCF	\$2.13	50%	\$1.06	\$2.22	50%	\$1.11
EV/ EBITDA	\$2.07	50%	\$1.04	\$2.18	50%	\$1.09
Total			\$2.10			\$2.20

SOURCE: BELL POTTER SECURITIES ESTIMATES

Electro Optic Systems

Company Description

Electro Optic Systems (EOS) is an Australian defence manufacturer specialising in advanced weapon systems and satellite tracking technology. The company operates two distinct divisions: EOS Defence Systems and EOS Space Systems, which service a range of military customers around the globe. EOS has offices on four continents and employs a global workforce of around 400 including engineers, technicians and management.

Investment Thesis

We currently have a BUY recommendation on EOS. Our investment thesis is based on:

- **Valuation:** Our investment thesis is based on the current market valuation of EOS undervaluing the EM Solutions business and essentially providing a free call option on the Defence and Space (exc. EMS) divisions, which we believe are well positioned to produce substantial earnings growth in future periods. We believe a valuation of \$2.20 per share is relatively undemanding considering this translates to a ~10x EV/EBITDA multiple based on BPe CY25 estimates.
- **Contracted revenue provides strong visibility:** Recent material contract wins in both EOS Defence Systems and EOS Space Systems provides significant revenue visibility throughout CY24 and CY25. This largely consists of contracts to Ukraine (total \$181m), a Western European customer (\$52m), Royal Australian Navy (BPe \$44.9m CY23/24, up to \$202m over 7-year period) and other material contracts announced in the last 12 months.
- **Macro tailwinds driving structural growth:** We have identified EOS as a major beneficiary of the macro tailwinds driving structural growth in the defence market, as well as the emerging growth market of Space. These tailwinds include 1) geopolitical tensions driving global rearmament, 2) record defence expenditure globally, 3) increasing investment in the Space economy, and 4) the emerging need to protect critical infrastructure in Space.

Key Risks

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

- **Liquidity and Funding Risks:** The company has a significant level of debt, which was necessary to recapitalise the balance sheet following the issues experienced during CY22. If adequate cash is not received, and the company is unable to make scheduled repayments, the group may breach borrowing covenants and/or may not have sufficient liquidity and funds to continue operations.
- **Sales Revenue Risk:** The nature of the industry in which EOS operates suggests a significant proportion of future sales revenue will likely materialise in the form of one-off contracts, often with no recurring revenue. This indicates any failure to continue winning new contracts will impact revenue growth and financial performance.
- **Supply Chain Risks:** In recent years, the company's operations were severely impacted by the COVID-19 pandemic. In future, the group's continuing operations may be affected by a range of factors, including the interruption of availability of materials and components caused by supply chain issues, access to operational premises and access to high-level engineering skills and personnel and to customer and supplier facilities and equipment.

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.

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Disclosure: Bell Potter Securities acted as Manager and Underwriter of EO's \$35m capital raising in March 2024 and received fees for that service.

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