

Analyst

Daniel Laing 612 8224 2886

Authorisation

Sam Brandwood 612 8224 2850

Electro Optic Systems (EOS)

Catalysts on the horizon

Recommendation

Buy (unchanged)

Price

\$1.605

Target (12 months)

\$2.20 (unchanged)

Sector

Capital Goods

Expected Return

Capital growth	37.1%
Dividend yield	0.0%
Total expected return	37.1%

Company Data & Ratios

Enterprise value	\$306.0m
Market cap	\$309.7m
Issued capital	193.0m
Free float	~95%
Avg. daily val. (52wk)	\$0.9m
12 month price range	\$0.82 - \$2.09

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	1.85	1.48	1.00
Absolute (%)	-13.24	8.81	61.31
Rel market (%)	-14.56	6.16	48.68

Absolute Price



SOURCE: IRESS

Revenue pre-released, strong beat at bottom-line

EOS had pre-released 1H24 revenues of \$142.6m (+92% on pcp). The company recorded 1H24 underlying EBITDA of \$11.5m, ahead of BPe (\$7.1m) based on a slightly stronger gross margin (44%) and lower operating expenses than forecast. The NPAT result (-\$3.5m) was a strong improvement on 1H23 (-\$32.5m) and well ahead of BPe (-\$11.6m) based on lower-than-expected finance costs (\$12.5m vs BPe \$15m) and a foreign exchange gain of \$5.1m. The company had \$52.2m in cash (in-line with BPe) as at 30-Jun-24 and is on track to make its final debt repayment in Oct-25.

Market development update

For the first time, EOS provided a detailed breakdown of near-term sales opportunities with varying levels of maturity (Advanced, Evaluation, Preliminary). Projects at the advanced stage which, if successful, may be announced during the 2H include 1) a >\$100m opportunity with Hanwha in Australia, 2) the \$181m in conditional contracts with Ukraine and 3) High Energy Laser Weapon sales opportunities in Europe and the middle East with a total value of \$50m - \$100m. Additionally, EOS detailed a >\$500m opportunity in the Middle East, which would be the largest ever contract received by the company. This project is still at the preliminary stage, however the company is confident in its bid and expects a decision in CY25.

Investment View: \$2.20 PT unchanged, retain BUY

We have made no changes to our revenue forecasts and only minor changes to cashflows and working capital in-line with today's result. We continue to forecast a softer 2H due to the acceleration of revenues into 1H24, with full year revenue of \$241.1m and continued positive EBITDA of \$12.1m. We believe EOS is at an inflection point, with significant near-term sales opportunities, a forecast return to profitability in CY25 and the final debt repayment due in Oct-2025, there is numerous catalysts to place upward pressure on the share price over the next 18-months. Our \$2.20 price target remains unchanged, which is a 37% premium to the current share price, so we retain 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	-20.0	3.5	18.5
NPAT (reported) (\$m)	-35.0	-20.0	3.5	18.5
EPS (cps)	-22.0	-11.0	1.8	9.6
EPS growth (%)	NM	NM	NM	NM
PE (x)	NM	NM	88.3	16.7
FCF Yield (%)	NM	-13%	17%	12%
EV/EBITDA (x)	45.0	25.4	10.2	8.2
Dividend (eps)	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

1H24 Result

1H24 Result summary

A summary of the 1H24 result is show below.

Figure 1 - 1H24 result summary

Year end 31 Dec	Result vs PCP			Result vs Forecast		Comment
	1H23	1H24	Change	1H24e	Variance	
Revenue (A\$m)	74.3	142.6	92%	142.6	0%	Figure pre-released
Cost of Goods Sold	-48.3	-80.5		-80.6		
Gross profit	26.0	62.2	139%	62.0	0%	GM in-line with Bpe
Total expenses	-41.2	-51.9	-26%	-54.9	6%	Lower opex than forecast
EBITDA	-15.1	10.7	170%	7.1	50%	EBITDA ahead of Bpe
Depreciation and amortisation	-7.0	-7.6	-9%	-6.4		Higher D&A than forecast
EBIT	-22.1	3.0	114%	0.7	345%	
Net interest (expense)/revenue	-15.7	-11.7	26%	-14.4		Lower finance expense than forecast
Pre-tax profit	-37.8	-8.6	77%	-13.7	37%	
Income tax benefit /(expense)	3.0	0.0	-99%	2.1		
Underlying NPAT	-34.8	-8.6	75%	-11.6	26%	Strong beat at bottom-line
Abs & extras.	2.4	5.1	nm	0.0	nm	Foreign exchange gain
Reported NPAT	-32.4	-3.5	nm	-11.6	nm	
Gross margin	35.0%	43.6%	862bps	43.5%	8bps	
EBITDA margin	-20.4%	7.5%	2,784bps	5.0%	247bps	
NPAT margin	-46.8%	-6.0%	4,081bps	-8.1%	211bps	
Diluted EPS	-20.4c	-2.1c	89%	-7.3c	71%	EPS well ahead of Bpe

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The key take-outs are:

- **Revenue pre-released:** EOS had pre-released 1H24 revenues of \$142.6m (+92% on pc). We continue to forecast a softer 2H due to the acceleration of revenues into 1H24, with full year revenue of \$241.1m.
- **Gross margin:** The gross margin (44%) was in-line with BP estimates and management expects it to remain steady at this level in future periods.
- **Beat at EBITDA:** The company recorded 1H24 underlying EBITDA of \$11.5m, ahead of BPe (\$7.1m) based on a slightly stronger gross margin (44%) and lower operating expenses than forecast.
- **Beat at NPAT:** The NPAT result (-\$3.5m) was a strong improvement on 1H23 (-\$32.5m) and well ahead of BPe (-\$11.6m) based on lower-than-expected finance costs (\$12.5m vs BPe \$15m) and a foreign exchange gain of \$5.1m.
- **Cash:** The company had \$52.2m in cash (in-line with BPe) as at 30-Jun-24 and is on track to make its final debt repayment in Oct-25.

Forecast and Valuation Changes

Changes to forecasts

We have made no changes to our revenue forecasts and only minor changes to cashflows and working capital in-line with today's result.

We continue to forecast a softer 2H, with full year revenue of \$241.1m and continued positive EBITDA of \$12.1m. We anticipate a return to profitability for the company in CY25.

A summary of the changes in our key forecasts is how below.

Figure 2 - Change in key forecasts						
Year end 31 Dec	CY24e	Change	CY25e	Change	CY26e	Change
Total revenue (A\$m)	241.1	no change	286.3	no change	311.6	no change
EBITDA	12.1	no change	30.1	no change	37.4	no change
NPAT	-20.0	4%	3.5	no change	18.5	no change
Diluted EPS	-11.0c	4%	1.8c	no change	9.6c	no change
DPS	0.0	no change	0.0c	no change	0.0c	no change

SOURCE: BELL POTTER SECURITIES ESTIMATES

No change in \$2.20 PT

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.

There are no changes to our DCF assumptions, which include a WACC of 10.7% and terminal growth rate of 4.5%.

We have increased the multiple we apply in our EV/EBITDA valuation to 14.0x (prev. 13.0) based on the strong beat to bottom line earnings, forecast return to profitability in CY25 and potential upside to consensus forecasts based on the detailed sales pipeline.

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

Methodology	Old (as at 26-Jul-24)			New (as at 27-Aug-24)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
DCF	\$2.22	50%	\$1.11	\$2.21	50%	\$1.10
EV/ EBITDA	\$2.18	50%	\$1.09	\$2.20	50%	\$1.10
Total			\$2.20			\$2.20

SOURCE: BELL POTTER SECURITIES ESTIMATES

Electro Optic Systems (EOS)

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 ~13x 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.

Electro Optic Systems

as at 27 August 2024

Recommendation

Buy

Price

\$1.605

Target (12 months)

\$2.20

Table 1 - Financial summary

Profit & Loss (A\$m)	CY22	CY23	CY24e	CY25e	CY26e	Electro Optic Systems					
Year Ending 30 June						Year End 31 Dec					
Revenue	137.9	219.3	241.1	286.3	311.6	Share Price:	\$1.605	Price Target:	\$2.20		
<i>Growth</i>	-35.0%	59.0%	10.0%	18.7%	8.9%	No. of issued shares (m):	193.0	Market cap:	\$309.7m		
Cost of sales	(91.4)	(123.7)	(136.2)	(158.9)	(171.4)	Valuation Ratios					
Gross profit	46.5	95.6	104.9	127.4	140.2	CY22	CY23	CY24e	CY25e	CY26e	
<i>Gross margin</i>	34%	44%	44%	45%	45%	Basic EPS (cps)	(36.5)	(22.0)	(11.0)	1.8	9.6
Other income/(expense)	(1.5)	0.2	-	-	-	Diluted EPS (cps)	(36.5)	(22.0)	(11.0)	1.8	9.6
Expenses (excl. D&A, int.)	(89.7)	(89.0)	(92.8)	(97.3)	(102.8)	<i>EPS growth (%)</i>	NM	NM	NM	NM	NM
EBITDA	(43.2)	6.8	12.1	30.1	37.4	PE(x)	NM	NM	NM	88.3	16.7
Depreciation and amortisation	(11.1)	(12.4)	(12.9)	(13.4)	(13.6)	EV/Sales (x)	2.2	1.4	1.3	1.1	1.0
EBIT	(54.2)	(5.6)	(0.8)	16.7	23.8	EV/EBITDA (x)	NM	45.0	25.4	10.2	8.2
Net interest (expense)/revenue	(14.0)	(34.6)	(22.8)	(12.7)	(0.7)	EV/EBIT (x)	NM	NM	NM	18.4	12.8
Pre-tax profit	(68.2)	(40.2)	(23.7)	3.9	23.1	FCF per share	NM	45.8	(20.7)	26.9	19.9
Income tax benefit/(expense)	9.3	6.1	3.7	(0.4)	(4.6)	FCF yield %	NM	NM	-12.9%	16.7%	12.4%
Underlying NPAT	(59.0)	(34.1)	(20.0)	3.5	18.5	NTA per share (\$ps)	1.22	0.98	0.96	0.99	1.09
Abs & extras.	5.4	(0.9)	-	-	-	P/NTA (x)	1.3	1.6	1.7	1.6	1.5
Reported NPAT	(53.6)	(35.0)	(20.0)	3.5	18.5	Book value (\$ps)	1.36	1.16	1.11	1.13	1.23
Cashflow (A\$m)						Price/Book (x)	1.2	1.4	1.4	1.4	1.3
EBITDA	(43.2)	6.8	12.1	30.1	37.4	DPS (cps)	0.0	0.0	0.0	0.0	0.0
(-) Change in working capital	(0.4)	(102.8)	35.6	(37.3)	(15.4)	Payout ratio %	NM	NM	NM	NM	NM
Gross cash flow	(42.7)	109.6	(23.5)	67.4	52.8	Dividend Yield %	NM	NM	NM	NM	NM
Income tax refunded/(paid)	(1.0)	16.7	3.7	(0.4)	(4.6)	Performance Ratios					
Operating cash flow	(51.6)	113.1	(36.7)	57.7	48.0	CY22	CY23	CY24e	CY25e	CY26e	
Payments for PPE	(19.3)	(2.9)	(3.3)	(5.9)	(9.7)	EBITDA Margin (%)	-31.3%	3.1%	5.0%	10.5%	12.0%
Payments for Intangibles	-	-	-	-	-	EBIT Margin (%)	-39.3%	-2.5%	-0.3%	5.8%	7.7%
Investing cash flow	(28.3)	(34.7)	(1.2)	(5.9)	(9.7)	NPAT Margin (%)	-42.8%	-15.5%	-8.3%	1.2%	5.9%
Net Proceeds from issue of shares	14.6	-	35.4	-	-	Net debt/(cash)	51.1	(6.2)	(3.7)	(55.5)	(93.8)
Repayment of borrowings	(39.9)	(24.4)	(20.5)	(44.3)	-	ROE (%)	-25.3%	-17.1%	-9.3%	1.6%	7.8%
Dividends	-	-	-	-	-	Segments (A\$m)					
Other	(5.0)	(4.6)	-	-	-	CY22	CY23	CY24e	CY25e	CY26e	
Financing cash flow	45.4	(29.1)	14.9	(44.3)	-	Revenue					
Net change in cash	(34.5)	49.3	(23.0)	7.5	38.3	EOS Defence Systems	106.0	155.4	163.0	185.8	191.0
Cash at start of period	59.3	21.7	71.0	48.0	55.5	EOS Space Systems	32.0	63.9	78.1	100.5	120.6
Exchange rate impact	(3.0)	(0.0)	-	-	-	Total Revenue	137.9	219.3	241.1	286.3	311.6
Cash at end of period	21.7	71.0	48.0	55.5	93.8	<i>Revenue Breakdown</i>					
Balance Sheet (A\$m)						EOS Defence Systems	77%	71%	68%	65%	61%
Cash and cash equivalents	21.7	71.0	48.0	55.5	93.8	EOS Space Systems	23%	29%	32%	35%	39%
Inventories	74.8	73.4	90.4	104.5	115.3						
Trade and other receivables	7.4	8.5	24.1	20.0	21.8						
Contract asset	164.4	68.0	68.7	25.8	17.1						
PPE	37.2	29.5	21.8	15.9	13.5						
Goodwill and intangibles	24.8	30.7	28.8	27.2	25.7						
Right-of-use assets	18.3	19.8	19.8	19.8	19.8						
Other	68.8	92.4	90.3	90.3	90.3						
Total assets	417.4	393.2	391.9	358.9	397.3						
Trade and other payables	43.2	40.8	38.6	42.9	62.3						
Provisions	21.8	40.4	40.4	40.4	40.4						
Lease liabilities	24.4	23.9	23.9	23.9	23.9						
Borrowings	72.7	64.8	44.3	-	-						
Other	22.2	24.2	30.2	33.7	34.2						
Total liabilities	184.3	194.2	177.4	141.0	160.9						
Net Assets	233.1	199.1	214.4	217.9	236.4						
Share capital	429.0	428.2	463.6	463.6	463.6						
Other reserves	12.5	12.6	12.6	12.6	12.6						
Accumulated losses	(208.5)	(241.8)	(261.8)	(258.3)	(239.8)						
Total shareholders' equity	233.1	199.1	214.4	217.9	236.4						

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

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Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
Chris Savage	Head of Research/Industrials	612 8224 2835	csavage
Rob Crookston	Strategy	612 8224 2813	rcrookston
Analysts			
John Hester	Healthcare	612 8224 2871	jhester
Martyn Jacobs	Healthcare	613 9235 1683	mjacobs
Thomas Wakim	Healthcare	612 8224 2815	twakim
Michael Ardrey	Industrials	613 9256 8782	mardrey
Marcus Barnard	Industrials	618 9326 7673	mbarnard
Sam Brandwood	Industrials	612 8224 2850	sbrandwood
Joseph House	Industrials	613 9325 1624	jhouse
Baxter Kirk	Industrials	613 9235 1625	bkirk
Daniel Laing	Industrials	612 8224 2886	dlaing
Hayden Nicholson	Industrials	613 9235 1757	hnicholson
Chami Ratnapala	Industrials	612 8224 2845	cratnapala
Jonathan Snape	Industrials	613 9235 1601	jsnape
Connor Eldridge	Real Estate	612 8224 2893	celdridge
Andy MacFarlane	Real Estate	612 8224 2843	amacfarlane
Regan Burrows	Resources	618 9236 7677	rburrows
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9325 1856	showe
Brad Watson	Resources	618 9326 7672	bwatson
James Williamson	Resources	613 9235 1692	jwilliamson
Associates			
Leo Armati	Associate Analyst	612 8224 2846	larmati
Kion Sapountzis	Associate Analyst	613 9235 1824	ksapountzis
Ritesh Varma	Associate Analyst	613 9235 1658	rvarma

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

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 1601, 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