27th April 2021

Small Cap

Austal Limited – Stronger Shipbuilding Margins Continues to Drive Austal Earnings

Reading Time: 5 Mins
By Team Ace Investors

Stock Code	ASX: ASB
Shares O/S	359.56 million
Closing Price	AUD 2.49
Market Cap	891.70 million
52 High/Low	3.86/1.98
One Year Stock Performance	-18.36%
Avg volume (TTM)	1.49 million
EPS (TTM)	0.278
P/E	8.9
Annual Dividend Yield	3.61%
Franking	0%
Last Dividend Ex-Date	17 March 2021
Last Dividend Pay Date	22 April 2021
DPS (AUD)	0.04
ROE %	6.60%

COMPANY OVERVIEW

Austal Limited **("Austal" or the "Company)** is Australia's global shipbuilder and defence prime contractor designing, constructing and sustaining some of the world's most advanced commercial and defence vessels. For more than 30 years Austal has contracted more than 300 vessels for over 100 commercial and defence operators in 54 countries, worldwide.

Austal is Australia's largest defence exporter and first ASX-listed shipbuilder. Austal has industry leading shipyards in Australia, the United States of America, Philippines and Vietnam with service centres worldwide, including the Middle East.

During FY 2020, the Company exceeded $2 billion of revenue for the first time and delivered record earnings. The Company posted revenue of $2.086 billion (FY2019: $1.851 billion), up 13%, EBIT of $130.4 million (FY2019: $92.8 million), up 41% and NPAT of $89.0 million (FY2019: $61.4 million), up 45%.

On 26th February 2021, the Company achieved another strong half of earnings. The strong interim financial results were driven by excellent shipbuilding operating margins in both of its USA and Australasia operations. Austal reported a 17.6% increase in EBIT to $70.5 million (FY 2020 H1: $59.9 million). The EBIT improvement was driven by improved shipbuilding margins in both the USA and Australasia. This was also reflected in the NPAT result of $52.4 million (FY2020 H1: $40.8 million), an increase of 28.7%.

Austal USA accounted for 76% of total revenue, with Australasia at 25% (FY2020 H1: USA 77%, Australasia 23%). Shipbuilding accounted for ~ 84% of total revenue and support ~17% (FY2020 H1: shipbuilding ~ 85%, support ~15%).

Source – Company's Presentation

INVESTMENT RATIONALE:

- **Focus on Growing Defense Business** – Over the years, the Company has increased its focus on growing defense business. Currently, it contributes 88% to the Company's revenue across construction and support. The Company has witnessed strong defence opportunities in its Australasia segment. The Commonwealth of Australia has demonstrated a commitment to defence with the $324 million contract for six Cape Class Patrol Boats awarded to Austal this year, adding to the 21-vessel Guardian Class Patrol Boat program. The recent Defence White Paper and Force Structure Plan identified more heavy steel ships to be built in Australia.
- **Strong Growth in Australasia Segment** – After 3 years of implementation activity, the Company has now successfully completed the repositioning of its Australasia business to increase its competitiveness, reduce its cost base and set the business up for sustained profitability. Australasia growth and profitability was driven by the successful expansion of its Philippines and Vietnam shipyards, which launched their first large ferries in FY2020. This represented a significant milestone for each of those shipyards and allows the Henderson shipyard in Western Australia to focus on Defence projects. The Henderson shipyard continued to deliver the Guardian Class Patrol Boat program and was bolstered by the award of a $324 million contract during FY2020 to design and construct six Cape Class Patrol Boats (CCPB) for the Royal Australian Navy.

FY2020

$ m	Concept	Ships	Support	Other	Total
USA	Revenue	$ 1,310.7	$ 293.0	$ -	$ 1,603.8
	EBIT	106.8	16.9	(0.7)	123.0
	EBIT Margin %	8.1%	5.8%	-	7.7%
Australasia	Revenue	$ 426.0	$ 70.8	$ -	$ 496.8
	EBIT	17.8	13.0	-	30.9
	EBIT Margin %	4.2%	18.4%	-	6.2%

Source – Company's Presentation

- **Strong Cash Position** – Austal's cash at bank declined to $371.9 million (30 June 2020: $396.7 million), largely due to foreign exchange translation, with operating cash flow funding sustaining and enhancing capital expenditure and 5cps of dividends paid within the half. This decrease in cash at bank was offset by a decrease in gross debt to $111.7 million (30 June 2020: $124.3 million, resulting in Austal maintaining a strong net cash position of $260.2 million (30 June 2020: $272.4 million). This continued strong cash position and prudent capital management has enabled the ongoing payment of dividends, whilst ensuring Austal retains capacity to invest in the business for its next phase of growth.

- **Acquisition of BSE Maritime Solutions Group** – Austal's strategic expansion of its support business has continued, achieving year over year revenue growth of 28% and almost quadrupling over the last 6 years. To further grow its support busines, the Company has entered into an agreement to acquire Australian-based BSE Maritime Solutions Group. The acquisition aligns with Austal's stated strategy of continuing to build the Company's key support business. Austal expects that the new business will generate an EBITDA of A$5 million in FY2021 rising to A$11 million by FY2025 as more Austal ships covered by current sustainment contracts are delivered to the Commonwealth of Australia.
- Austal has declared a final unfranked dividend of 4 cents per share, which is a 33% increase over the FY2020 interim dividend. The franking position continues to reflect the predominance of Austal's earnings being generated in the USA.

ACE's RECOMMENDATION

Austal has maintained its October 2020 guidance for FY2021 EBIT of $125 million. Austal entered the 2021 financial year with a $4.2 billion dollar order book, including contracted orders for the US Navy that extend through to 2024. The Company's order book is largely comprised of defence vessel programs for the US Navy and Commonwealth of Australia, which helps shield the business from the emerging broader global economic challenges.

The Company has deployed capital in FY2021 H1 to make strategic investments in capability that will enhance Austal's ability to add to its healthy $2.9 billion order book in the short to medium-term. The Company has a strong balance sheet supporting investment in both organic and inorganic growth opportunities, the capability to build in both steel and aluminium, and it can deliver both shipbuilding and sustainment contracts. The Company is investing in R&D and are shaping the future of vessel manufacturing with concept vessels such as the Volta electric ship and exciting developments opportunities in advanced digital systems. We recommend the stock as **BUY** at closing price of $2.49.