

18 June 2018

## Electro Optic Systems (EOS)

**BUY**

**Share Price: \$2.99**

### Positive Defence update

**Target Price: A\$4.05**

**EOS issued a strong update last week, highlighted the successful transition from an R&D focused business to a large scale manufacturer. In addition, management expect to meet or exceed previous FY18 guidance. We reiterate our Buy recommendation and A\$4.05 target price.**

#### Hume production facility tracking to expectations

- EOS is on schedule to achieve its output of 240 RWS units in its Hume plant during FY18, having shipped 80 units YTD (end of May).
- Product yield and quality both meet or exceed management's expectations and input costs are in-line.
- EOS expect to double production to 40 units per month from 1Q19, implying the facility will be operating at full capacity.

#### Customer momentum increasing

- During June 2018, there was a working capital release to EOS of ~US\$25m as Efic funded the majority of the performance bonds (~US\$31.6m). This leaves EOS well placed to pursue additional customer contracts.
- Last week EOS attended EUROSATORY (the largest military trade show globally in 2018) to initiate expansion of its supply chain with new relationships.
- Both existing and potential customers as well as the Minister for Defence visited the EOS stand, providing promising leads.
- Furthermore, EOS officially opened its new facility in the US in early June, which is already functional for RWS testing, training and integration with US Army vehicles.
- EOS expects that this facility will have production capacity of 50 units per month in 2019, leaving the company well placed to win potential contracts for the US military (which is not reflected in our forecasts).

#### Outlook – on track to meet or exceed guidance

- In terms of outlook, EOS expects to meet or exceed its guidance for profit exceeding A\$5.0m in FY18, in-line with our forecasts.
- We have taken a conservative valuation approach and have only included announced contracts for existing products in our forecasts and valuation methodology.
- This implies strong potential for significant upward revisions from an RWS replacement cycle and new product verticals, particularly in relation to space surveillance data and remote turrets systems.
- We reiterate our Buy recommendation and a A\$4.05 target price.

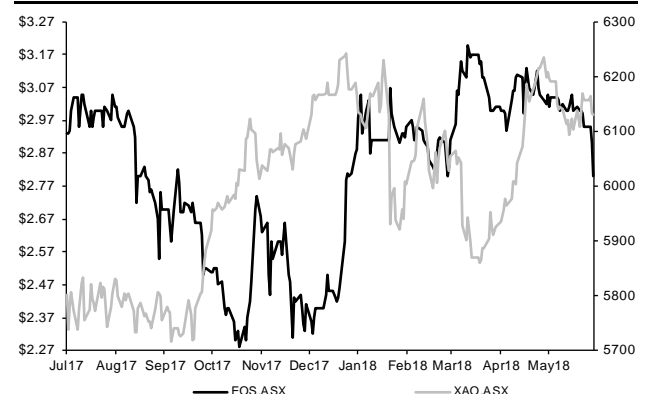
#### Company Data

|                                |                     |
|--------------------------------|---------------------|
| Shares – ordinary (M)          | 90.9                |
| Dilution (M)                   | 0.0                 |
| Total (fully diluted) (M)      | 90.9                |
| Market capitalisation (\$M)    | 271.8               |
| 12 month low/high (\$)         | 2.28/ 3.25          |
| Average monthly turnover (\$M) | 5.2                 |
| GICS Industry                  | Aerospace & Defense |

#### Financial Summary (fully diluted/normalised)

| Year end Dec           | 2016A | 2017A | 2018F | 2019F  | 2020F  |
|------------------------|-------|-------|-------|--------|--------|
| Revenue (\$M)          | 25.8  | 23.3  | 96.0  | 208.0  | 218.8  |
| Costs (\$M)            | -28.0 | -35.2 | -89.8 | -189.6 | -198.9 |
| EBITDA (\$M)           | -2.2  | -11.9 | 6.2   | 18.4   | 19.9   |
| NPAT (\$M)             | -0.9  | -9.4  | 5.3   | 17.5   | 13.3   |
| EPS (¢ps)              | -1.6  | -15.1 | 6.6   | 19.0   | 14.4   |
| EPS Growth (%)         | n/m   | n/m   | n/m   | 188%   | -24%   |
| PER (x)                | n/m   | n/m   | 45.3  | 15.7   | 20.7   |
| Free Cashflow (\$M)    | -3.1  | -27.1 | 1.1   | 5.4    | 17.1   |
| FCFPS (¢ps)            | -3.4  | -29.8 | 1.2   | 5.9    | 18.8   |
| PFCFPS (x)             | n/m   | n/m   | 251.2 | 50.5   | 15.9   |
| Enterprise Value (\$M) | 262.9 | 261.8 | 199.0 | 193.6  | 176.5  |
| EV / EBITDA (x)        | n/m   | n/m   | n/m   | 10.5   | 8.9    |
| Payout ratio (%)       | n/m   | n/m   | n/m   | n/m    | n/m    |
| Dividends (¢ps)        | n/m   | n/m   | n/m   | n/m    | n/m    |
| Yield (%)              | n/m   | n/m   | n/m   | n/m    | n/m    |
| Franking (%)           | n/a   | n/a   | n/a   | n/a    | n/a    |

#### EOS – performance over one year



#### Disclosure and Disclaimer

This report must be read with the disclosure and disclaimer on the final page of this document. Petra Capital was Sole Lead Manager for EOS's Placement to raise \$20.9M at \$2.30/sh on 19 September 2017 and \$65.0M at \$2.91/sh on 5 February 2018, for which a fee was received.

Killian Murphy  
+61 2 9239 9607

## Analysis

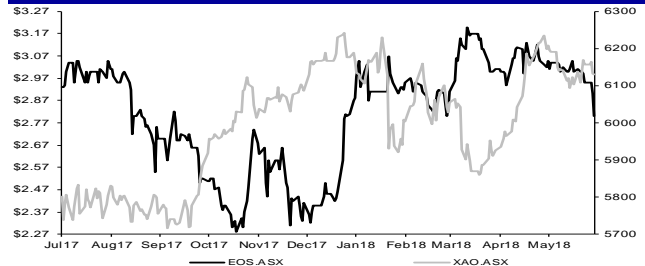
### Electro Optic Systems Holdings Limited

Year end 31 December

#### MARKET DATA

|                           |     |           |
|---------------------------|-----|-----------|
| Recommendation            |     | Buy       |
| Price                     | \$  | 2.99      |
| Target price (12-month)   | \$  | 4.05      |
| 52 week low / high        | \$  | 2.28/3.25 |
| Market capitalisation     | \$m | 271.8     |
| Shares on issue (basic)   | no. | 90.9      |
| Options / rights          | no. | 0.0       |
| Other equity              | no. | 0.0       |
| Shares on issue (diluted) | no. | 90.9      |

#### 12-MONTH SHARE PRICE PERFORMANCE



#### INVESTMENT FUNDAMENTALS

|                                   | FY16A     | FY17A  | FY18F | FY19F | FY20F |
|-----------------------------------|-----------|--------|-------|-------|-------|
| Reported NPAT                     | \$m (0.9) | (9.4)  | 5.3   | 17.5  | 13.3  |
| NPAT normalised                   | \$m (0.9) | (9.4)  | 5.3   | 17.5  | 13.3  |
| Reported EPS (undiluted)          | ¢ (1.6)   | (15.1) | 5.9   | 19.0  | 14.4  |
| EPS normalised (undiluted)        | ¢ (1.6)   | (15.1) | 6.6   | 19.0  | 14.4  |
| ....Growth                        | % n/m     | n/m    | n/m   | 188%  | -24%  |
| PER normalised                    | x n/m     | n/m    | 45.3  | 15.7  | 20.7  |
| Operating cash flow per share     | ¢ (2.9)   | (28.5) | 2.3   | 7.0   | 19.9  |
| Free cash flow per share          | ¢ (3.4)   | (29.8) | 1.2   | 5.9   | 18.8  |
| Price to free cash flow per share | x n/m     | n/m    | 251.2 | 50.5  | 15.9  |
| FCF yield                         | % (1.1)   | (10.0) | 0.4   | 2.0   | 6.3   |
| Dividend                          | ¢ 0.0     | 0.0    | 0.0   | 0.0   | 0.0   |
| Payout                            | % 0.0     | 0.0    | 0.0   | 0.0   | 0.0   |
| Yield                             | % 0.0     | 0.0    | 0.0   | 0.0   | 0.0   |
| Franking                          | % n/a     | n/a    | n/a   | n/a   | n/a   |
| Enterprise value                  | \$m 262.9 | 261.8  | 199.0 | 193.6 | 176.5 |
| EV/EBITDA                         | x n/m     | n/m    | n/m   | 10.5  | 8.9   |
| EV/EBIT                           | x n/m     | n/m    | n/m   | n/m   | 8.9   |
| Price to book (NAV)               | x 67.2    | 11.5   | 3.1   | 2.6   | 2.2   |
| Price to NTA                      | x 15.9    | 5.7    | 1.7   | 1.0   | 0.9   |

#### KEY RATIOS

|                                      | FY16A     | FY17A  | FY18F  | FY19F  | FY20F  |
|--------------------------------------|-----------|--------|--------|--------|--------|
| EBITDA margin                        | % (8.7)   | (51.3) | 6.5    | 8.8    | 9.1    |
| EBIT margin                          | % (9.1)   | (52.2) | 6.4    | 8.8    | 9.1    |
| NPAT margin                          | % (3.4)   | (40.4) | 5.5    | 8.4    | 6.1    |
| ROE                                  | % (21.9)  | (39.9) | 6.0    | 16.6   | 10.7   |
| ROA                                  | % (5.2)   | (19.7) | 3.3    | 6.5    | 4.5    |
| Net debt / (cash)                    | \$m (8.9) | (10.0) | (72.8) | (78.2) | (95.3) |
| Interest cover (EBIT / net interest) | x 4.0     | (4.4)  | 7.6    | 22.9   | 24.8   |
| Gearing (net debt / EBITDA)          | x 4.0     | 0.8    | (11.7) | (4.3)  | (4.8)  |
| Leverage (ND / (ND+E))               | % 184%    | n/m    | n/m    | n/m    | n/m    |

#### DUPONT ANALYSIS

|                    | FY16A    | FY17A  | FY18F | FY19F | FY20F |
|--------------------|----------|--------|-------|-------|-------|
| Net Profit Margin  | % (3.4)  | (40.4) | 5.5   | 8.4   | 6.1   |
| Asset Turnover     | x 1.5    | 0.5    | 0.6   | 0.8   | 0.7   |
| Return on Assets   | % (5.2)  | (19.7) | 3.3   | 6.5   | 4.5   |
| Financial Leverage | x 4.2    | 2.0    | 1.8   | 2.5   | 2.4   |
| Return on Equity   | % (21.9) | (39.9) | 6.0   | 16.6  | 10.7  |

#### PROFIT AND LOSS (PRO FORMA)

|                             | FY16A     | FY17A  | FY18F | FY19F | FY20F |
|-----------------------------|-----------|--------|-------|-------|-------|
| Total revenue               | \$m 25.8  | 23.3   | 96.0  | 208.0 | 218.8 |
| EBITDA                      | \$m (2.2) | (11.9) | 6.2   | 18.4  | 19.9  |
| Depreciation & amortisation | \$m 0.1   | 0.2    | 0.1   | 0.1   | 0.1   |
| EBIT                        | \$m (2.3) | (12.1) | 6.1   | 18.3  | 19.8  |
| Net interest                | \$m 0.6   | (2.7)  | (0.8) | (0.8) | (0.8) |
| Non-operating income        | \$m 0.0   | 0.0    | 0.0   | 0.0   | 1.0   |
| Pretax Profit               | \$m (2.9) | (9.4)  | 5.3   | 17.5  | 19.0  |
| Tax expense                 | \$m 2.0   | 0.0    | 0.0   | 0.0   | (5.7) |
| Minorities                  | \$m 0.0   | 0.0    | 0.0   | 0.0   | 1.0   |
| Operating NPAT              | \$m (0.9) | (9.4)  | 5.3   | 17.5  | 13.3  |
| Significant items           | \$m 0.0   | 0.0    | 0.0   | 0.0   | 0.0   |
| Reported NPAT               | \$m (0.9) | (9.4)  | 5.3   | 17.5  | 13.3  |

#### BALANCE SHEET

|                      | FY16A    | FY17A | FY18F | FY19F | FY20F |
|----------------------|----------|-------|-------|-------|-------|
| Cash                 | \$m 8.9  | 10.0  | 72.8  | 78.2  | 95.3  |
| Receivables          | \$m 3.8  | 11.7  | 50.6  | 109.7 | 115.4 |
| Inventory            | \$m 3.5  | 13.8  | 35.2  | 74.3  | 77.9  |
| Other                | \$m 0.5  | 2.4   | 2.5   | 2.6   | 2.8   |
| Current              | \$m 16.6 | 37.8  | 161.2 | 264.9 | 291.4 |
| Prop. plant & equip  | \$m 0.5  | 1.4   | 1.6   | 2.5   | 3.5   |
| Intangibles          | \$m 0.0  | 0.0   | 0.0   | 0.0   | 0.0   |
| Other                | \$m 0.0  | 8.4   | 0.0   | 0.0   | 0.0   |
| Non current          | \$m 0.5  | 9.8   | 1.6   | 2.5   | 3.5   |
| Total assets         | \$m 17.1 | 47.6  | 162.8 | 267.4 | 294.9 |
| Accounts Payable     | \$m 7.2  | 18.1  | 74.6  | 161.7 | 170.1 |
| Borrowings           | \$m 0.0  | 0.0   | 0.0   | 0.0   | 0.0   |
| Other                | \$m 5.9  | 6.0   | 0.0   | 0.0   | 0.0   |
| Total liabilities    | \$m 13.0 | 24.0  | 74.6  | 161.7 | 170.1 |
| Shareholder's equity | \$m 4.0  | 23.6  | 88.1  | 105.7 | 124.8 |

#### CASH FLOW

|                                     | FY16A     | FY17A  | FY18F | FY19F  | FY20F |
|-------------------------------------|-----------|--------|-------|--------|-------|
| EBITDA                              | \$m (2.2) | (11.9) | 6.2   | 18.4   | 19.9  |
| D&A                                 | \$m (0.1) | (0.2)  | (0.1) | (0.1)  | (0.1) |
| Interest                            | \$m 0.6   | (2.7)  | (0.8) | (0.8)  | (0.8) |
| Other                               | \$m (0.9) | (11.1) | (3.2) | (11.1) | (0.9) |
| Operating cash flow                 | \$m (2.7) | (25.9) | 2.1   | 6.4    | 18.1  |
| Capex                               | \$m (0.4) | (1.1)  | (1.0) | (1.0)  | (1.0) |
| Acquisitions                        | \$m 0.0   | 0.0    | 0.0   | 0.0    | 0.0   |
| Disposals                           | \$m 0.0   | 0.0    | 0.0   | 0.0    | 0.0   |
| Investing cash flow                 | \$m (0.4) | (1.1)  | (1.0) | (1.0)  | (1.0) |
| Equity                              | \$m 0.0   | 28.0   | 61.8  | 0.0    | 0.0   |
| Increase / (decrease) in borrowings | \$m 0.0   | 0.0    | 0.0   | 0.0    | 0.0   |
| Dividend/other                      | \$m 0.0   | 0.0    | 0.0   | 0.0    | 0.0   |
| Financing cash flow                 | \$m 0.0   | 28.0   | 61.8  | 0.0    | 0.0   |
| Free cash flow                      | \$m (3.1) | (27.1) | 1.1   | 5.4    | 17.1  |

Source: Petra Capital

Petra Capital  
Level 17, 14 Martin Place, Sydney NSW 2000

ABN 95 110 952 782  
ACN 110 952 782  
AFSL 317 944

|                         |                      |                    |                                  |
|-------------------------|----------------------|--------------------|----------------------------------|
| Director:               | George Marias        | +61 (0)2 9239 9601 | gmarias@petracapital.com.au      |
| Research (Resources):   | Brett McKay          | +61 (0)2 9239 9605 | brmckay@petracapital.com.au      |
| Research (Resources):   | Matthew Schembri     | +61 (0)2 9239 9630 | mschembri@petracapital.com.au    |
| Research (Resources):   | Craig Brown          | +61 (0)2 9239 9629 | cbrown@petracapital.com.au       |
| Research (Resources):   | Peter Chilton        | +61 (0)2 9239 9634 | pchilton@petracapital.com.au     |
| Research (Industrials): | Killian Murphy       | +61 (0)2 9239 9607 | kmurphy@petracapital.com.au      |
| Research (Industrials): | James Lennon         | +61 (0)2 9239 9618 | jlennon@petracapital.com.au      |
| Research (Industrials): | David Fraser         | +61 (0)2 9239 9633 | dfraser@petracapital.com.au      |
| Sales:                  | Frank Barila         | +61 (0)2 9239 9603 | fbarila@petracapital.com.au      |
| Sales:                  | Neil Watson          | +61 (0)2 9239 9602 | nwatson@petracapital.com.au      |
| Sales:                  | Vincent Pisani       | +61 (0)2 9239 9617 | vpisani@petracapital.com.au      |
| Sales:                  | Jamie Campbell       | +61 (0)2 9239 9620 | jcampbell@petracapital.com.au    |
| Sales:                  | Peter Veldhuizen     | +61 (0)2 9239 9609 | pveldhuizen@petracapital.com.au  |
| Sales:                  | Colin Redmond        | +61 (0)2 9239 9613 | credmond@petracapital.com.au     |
| Sales:                  | Vince Barila         | +61 (0)2 9239 9627 | vbarila@petracapital.com.au      |
| Sales:                  | Michael Casey        | +61 (0)2 9239 9608 | mcasey@petracapital.com.au       |
| Sales:                  | Richard Macphillamy  | +61 (0)2 9239 9604 | rmacphillamy@petracapital.com.au |
| Corporate (ECM):        | Conrad Anderson      | +61 (0)2 9239 9610 | canderson@petracapital.com.au    |
| Corporate (ECM):        | Verity Barritt       | +61 (0)2 9239 9622 | vbarritt@petracapital.com.au     |
| Administration:         | Krystle Garven       | +61 (0)2 9239 9635 | kgarven@petracapital.com.au      |
| Administration:         | Samantha Tingley     | +61 (0)2 9239 9636 | stingley@petracapital.com.au     |
| Administration:         | Silvia Fratta Pasini | +61 (0)2 9239 9621 | spasini@petracapital.com.au      |
| Administration:         | Larissa Falvo        | +61 (0)2 9239 9611 | lfalvo@petracapital.com.au       |
| Legal & Compliance:     | Stephen Newton       | +61 (0)2 9239 9612 | snewton@petracapital.com.au      |
| Financials:             | Tony Christelis      | +61 (0)2 9239 9615 | tchristelis@petracapital.com.au  |

#### Disclosure

This document has been prepared in Australia by Petra Capital Pty Ltd which holds an Australian Financial Services License AFSL 317 944. Petra Capital Pty Ltd is an ASX Market Participant. Petra Capital Pty Ltd and its associates, officers, directors, employees and agents, from time to time, may receive brokerage, commissions, fees or other benefits or advantages, hold securities in companies researched by Petra Capital Pty Ltd and may trade in these securities either as principal or agent. Petra Capital was Sole Lead Manager for EOS's Placement to raise \$20.9M at \$2.30/sh on 19 September 2017 and \$65.0M at \$2.91/sh on 5 February 2018, for which a fee was received.

#### Disclaimer

The information or advice contained in this report has been obtained from sources that were accurate at the time of issue, however the information has not been independently verified and as such, Petra Capital Pty Ltd cannot warrant its accuracy or reliability. Persons relying on this information do so at their own risk. To the extent permitted by law, Petra Capital Pty Ltd disclaims all liability or responsibility for any direct or indirect loss or damage (including consequential loss or damage) caused by any error or omission within this report, or by persons relying on the contents of this report.

This report is published by Petra Capital Pty Ltd by way of general information or advice only. This report does not take into account specific investment needs or other considerations that may be pertinent to individual investors. Before making any investment decisions based on this report, parties should consider, with or without an investor adviser, whether any relevant part of this report is appropriate to their financial circumstances and investment objectives. Petra Capital Pty Ltd is a licensed institutional/wholesale stockbroking firm. The report is only intended for institutional and sophisticated clients to whom Petra Capital Pty Ltd has issued the report. Petra Capital Pty Ltd is not licensed to advise retail investors – retail investors should contact their own stockbroker or financial adviser/planner for advice.

#### Ratings

Information regarding the scope and expertise of our research services, processes for selection for coverage, and the management of conflicts of interest can be found on Petra Capital's website at <http://www.petracapital.com.au/research-disclosures>.

Petra Capital uses the following ratings system and definitions: Buy - Forecast to outperform the Market by more than 5%; Hold - Forecast to perform up to 5% above or below the Market; Sell - Forecast to underperform the Market by more than 5%; Speculative Buy - Speculative Investment; Take Profits - Recommend taking short term profits in a stock we remain fundamentally positive on a medium term view; Accept Offer - For a company under takeover where we see the offer as a fair price with low risk of a competing offer; No Rating - No rating at this time. Market performance is relative to the S&P/ASX Small Ordinaries Index which we assume generates a neutral return on a 12 month basis.

#### US Investors

This material is intended for use in the US only by major US Institutional Investors, as that term is defined by the SEC Rule 15a-6. Transactions with US Institutional Investors and major US Institutional Investors, as those terms are defined by SEC Rule 15a-6, are chaperoned by Global Alliance Securities, LLC, ("Global Alliance"), a SEC-registered broker-dealer and FINRA member (web: [www.globalalliancesecurities.com](http://www.globalalliancesecurities.com)) in accordance with the agreement between Global Alliance and Petra Capital Pty Ltd. The information upon which this material is based was obtained from sources believed to be reliable, but has not been independently verified. Therefore, its accuracy is not guaranteed. Additional and supporting information is available upon request. This is not an offer or solicitation of an offer to buy or sell any security or to make any investment. Any opinion or estimate constitutes the preparer's best judgement as of the date of preparation and is subject to change without notice. Petra Capital Pty Ltd or Global Alliance and their associates or affiliates, and their respective officers, directors and employees may buy or sell securities mentioned herein as agent or principal for their own account.

#### Other International

International investors are encouraged to contact their local regulatory authorities to determine whether restrictions apply in buying/selling this investment.