



Adacel Ltd (ADA.ASX)

David snaring Goliath

Event:

- We initiate research coverage on Adacel Ltd (ADA).

Investment Highlights:

- ADA is major global provider of air traffic management (ATM) and air traffic control (ATC) training simulation systems, as well as speech recognition products.** The company employs real-time software, simulation, and voice activated control technologies in its core products.
- Aurora is ADA's ATM system to automatically monitor and manage aircraft in various airspace environments.** Key benefits to customers are enhanced airline safety; efficiency gains by automation of air traffic control; improved communications and decision-making; and reduction of flight times and delays. ADA claims that Aurora systems account for managing 75% of oceanic airspace.
- MaxSim ATC simulators – MaxSim - allow efficiencies in training of air traffic controllers by minimising the need for instructors, reducing training time, and simulating various conditions that may be encountered.** There are over 341 MaxSim installations in over 30 countries. Major customers include the Federal Aviation Authority (FAA, 50 installations) and the United States Air Force (92).
- The outlook for both ATM and simulation is positive. ATM is forecast to grow at 11.7% CAGR to US\$87b in 2022e (source: MarketsandMarkets) while International Civil Aviation Organisation forecasts \$12b p.a. of spend.** Drivers include increasing passenger travel; increase in drones; increasing congestion; greater focus on safety; modernisation of airports and aircraft; and technology changes. The FAA has stated it wants increased training air traffic controllers, stating it is hiring 6,300 new controllers over 2015-2020e.
- While provision of ATM and simulators is competitive, ADA has established a significant presence with some of the world's leading military and civil aviation bodies including the FAA, USAF, and US Army.** The company protects its product mostly via trade secrets. Giants Leidos and Lockheed Martin have relied on ADA to supply systems that they cannot provide themselves to the FAA.
- Most customers opt for support services.** Systems comprises one-off and lumpy type hardware and software sales, while Services includes more reliable and predictable sales generated from product maintenance; field services, and support. Most customers opt for multi-year support contracts.
- Successful retention.** The average age of ADA's customers' contracts is over 8 years, while that of the twelve oldest clients is 15. This reflects the clients' satisfaction with ADA's systems and the ongoing support provided.

Earnings and Valuation:

- We forecast ADA to report NPAT of \$8.2M in FY17e and \$8.9M in FY18e, driven by sales growth. We expect 1HFY17e NPAT of \$4.1M. We model ADA by DCF, and determine an NPV₁₀ per share of \$2.60 now and \$2.79 in one years' time.

Recommendation:

- We initiate with a Buy recommendation on ADA and 12-month price target of \$2.79/share based on our valuation. Catalysts for the shareprice include: 1) Increasing sales and earnings; 2) New customers; 3) Retention and enhancement of existing contracts; and 4) New products.

Recommendation		Buy
Previous		n/a
Price Target		\$2.79
Previous		n/a
Risk		Medium

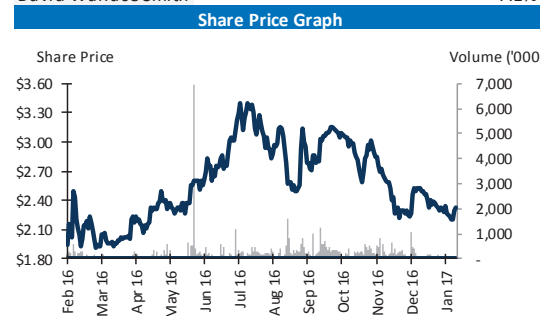
Share price		\$2.38
ASX code		ADA
52 Week Low-High		\$1.815-\$3.55
Valuation		\$2.60 now; \$2.79 in 12 mths
Methodology		DCF

Capital Structure	
Shares on Issue (M)	79
Market Cap (A\$M)	189
Net Cash/(Debt) (A\$M)	15.8
EV (A\$M)	173
Diluted mkt cap (A\$M)	189
12mth Av Daily Volume ('000)	324

Y/e Jun	FY16a	FY17e	FY18e	FY19e
Sales \$M	47.9	52.4	58.5	65.3
EBITDA \$M	11.9	12.9	14.1	15.7
NPAT Adj. \$M	7.6	8.2	8.9	10.0
EPS adj c	9.6	10.3	11.3	12.6
DPS c	3.0	4.1	4.5	5.1
PER x	24.9	23.0	21.1	18.8
EV/EBITDA x	14.6	13.4	12.3	11.0
Yield	1.3%	1.7%	1.9%	2.1%

Board of Directors	
Peter Landos	Non-Executive Chairman
Julian Beale	Non-Executive Director
David Smith	Non-Executive Director
Silvio Salom	Non-Executive Director
Natalya Jurchensin	Non-Executive Director

Substantial Shareholders	
Thorney Holdings	32.4%
Silvio Salom	9.9%
David Wallace Smith	7.1%



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 The analyst owns 21,000 ADA shares.

This report was prepared by Foster Stockbroking.