



Adacel Technologies Ltd (ADA.ASX)

Some turbulence but attractively priced

Event:

- FY18 result review; Earnings changes; Price target change.

Investment Highlights:

- ADA reported an underlying PBT of \$10.3M, up 30% YoY, below our forecast of \$10.8M and company guidance of 35% growth (\$10.6M).** Key difference vs our forecast was a lower Systems gross margin.
- Systems – sales momentum maintained but margin compresses.** Systems sales in 2HFY18 rose 15% to \$11.7M vs \$10.2M in interim, but the gross profit fell to \$2.7M from \$3.4M. ADA cited competitive bidding for contracts that were not sole sourced, and those requiring a high degree of software customisation. Given its low cost position, ADA is purposely submitting low priced bids which can maximise its chance of success while still providing adequate return. Product mix such as software vs hardware was another factor.
- Systems outlook – Contracts from FY18 to contribute further in FY19e.** Given many systems contracts typically run 12-18 months, we expect further strong sales in FY19e on the back of the FY18 performance. These include Guadeloupe, NavPortugal, Sri Lanka, Morocco, and Air Services Australia. Additionally ADA envisages four new ATM opportunities in FY19e.
- Services – return to growth in 2HFY18 while margin increases.** Services returned to HoH sales growth in the 2H after the surprising drop in the interim. 2H sales were up 3% HoH but still -5% YoY. The key negative was loss of a component of the previously flagged FAA support contract, and the halt of a software component of the contract while ADA lodged a formal protest.
- Services outlook - we expect modest growth in Services in FY19e, which accounts for the full year impact of the loss of the FAA support contract and halt in software support.** Outside of these we expects Services revenue to grow 10% YoY based on existing contracts and new customers, including FAA ATOP, FAA sims training; USAF sims; and NavPortugal.
- Capital management – special dividend and value accretive share buyback.** A special dividend of 5.0cps was declared bringing total to the year to 9.5cps. Since the result ADA has commenced a share buyback which we estimate is value accretive at current share prices.

Earnings and Valuation:

- We have upgraded our FY19e NPAT by 5% to \$9.1M (prior \$8.7M), and downgraded FY20e and FY21e both by 13% to \$9.9M (prior \$11.4M) and \$10.9M (prior \$12.6M). FY19e has been upgraded on higher Services sales while downgrades in FY20e and beyond are from a lower Systems gross margin.
- We reduce our NPV₁₀ valuation of ADA to \$2.26/share from \$2.38/share, based on lower earnings, partially offset by rolling forward our DCF by six months.

Recommendation:

- We maintain ADA as a Buy, and reduce our 12-month price target to \$2.26/share from \$2.38/share, based on our valuation. While the FAA and gross margin shrinkage tarnished the result, we believe ADA is well positioned to grow earnings (10% eps growth in FY19e) and attractively priced at 14x PE FY19e vs 29x for tech peers and 19x for Industrials ex-Financials.

Recommendation	Buy
Previous	Buy
Price Target	\$2.26
Previous	\$2.38
Risk	Medium
Share price	\$1.67
ASX code	ADA
52 Week Low-High	\$1.50-\$3.18
Valuation	\$2.26
Methodology	DCF
Capital Structure	
Shares on Issue (M)	78
Market Cap (A\$M)	131
Net Cash/(Debt) (A\$M)	13
EV (A\$M)	118
Diluted mkt cap (A\$M)	131
12mth Av Daily Volume ('000)	177

Y/e Jun	2018a	2019e	2020e	2021e
Sales \$M	53.1	54.9	61.0	67.1
EBITDA adj. \$M	11.0	11.1	12.0	13.2
NPAT adj. \$M	8.5	9.1	9.9	10.9
EPS adj c	10.6	11.7	12.6	14.0
DPS c	9.5	4.1	4.4	4.9
PER x	15.7	14.3	13.2	11.9
EV/EBITDA x	10.8	10.6	9.8	8.9
Yield	5.7%	2.4%	2.6%	2.9%

Board of Directors	
Peter Landos	Non-Executive Chairman
David Smith	Non-Executive Director
Silvio Salom	Non-Executive Director
Michael McConnell	Non-Executive Director

Substantial Shareholders	
Thorney Holdings	32.4%
Silvio Salom	7.4%

Share Price Graph



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The analyst owns 21,000 ADA shares. Foster Stockbroking and associates (excluding Cranport Pty Ltd) own 21,000 ADA shares. Cranport Pty Ltd does not own ADA securities. Refer details at end of report.