



Adacel Technologies Ltd (ADA.ASX)

Flight reaction

Event:

- FY19e guidance; Earnings changes; Price target change.

Investment Highlights:

- Adacel Technologies' (ADA) recent interim and full year guidance for FY19e was significantly below our and the market's expectations.** The company guided 1HFY19e PBT to be down 65%-70% on pcp, implying range of \$1.4M-\$1.7M vs our forecast of \$5.0M. Full year FY19e NPAT guidance was 25%-35% below pcp implying range of \$6.6M-\$7.7M vs our estimate of \$10.7M.
- Two major reasons for the downgrade were 1) Increase in R&D and marketing costs; and 2) Removal of all FAA TSS Services work from forecasts.**
- ADA invests for future.** ADA has consciously increased R&D and marketing costs, which includes spend on the recent product portfolio acquired earlier this year, as well on increasing staff in both Australia and North America, including hiring of Business Development and Marketing Product Managers.
- Currency move worsens impact.** While cost increases over FY18e are 15% to 18% in US\$ terms, the fall in A\$ vs US\$ over the pcp translated into increases of 26%-27% in A\$ terms. While most of ADA's sales are US\$ denominated, the higher incremental gain in costs vs revenue has counter-intuitively meant the weaker currency has been negative for earnings.
- FAA contracts removed from forecasts.** While the loss of the FAA field support and halt to software contract had been previously flagged, ADA was unsuccessful in protesting the contract and has commenced legal action against a competitor over a different, but FAA related past contract. Under this uncertainty the company decided to remove all FAA TSS work from its forecasts. ADA's ATOP contract with the FAA which it subcontracts to Leidos remains unaffected.

Earnings and Valuation:

- We have downgraded our forecast NPAT for ADA by -34%, 30%, and 29% in FY19e, FY20e, and FY21e to \$6.0M, \$7.0M, and \$7.7M, mostly due to increase in our R&D and marketing and sales costs, as well as removal of all FAA TSS work.** We retain the ATOP contract in our forecasts.
- Our NPV₁₀ valuation of ADA falls by 28% to \$1.63/share from \$2.26/share as a result of our earnings downgrade.**

Recommendation:

- We maintain ADA as a Buy, and reduce our 12-month price target to \$1.63/share from \$2.26/share, based on our valuation.** While the quantum impact of the costs increase is surprising, we are at least comforted to a degree that the increase is being channelled into potential future benefits that can be realised. We also think that expectations of any lost FAA revenue is now very low.
- We expect share price catalysts include:** New Services and Systems contract wins; New product sales; Recovery of any lost FAA revenue; and resolution of litigation.

Disclosures

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.

Recommendation	Buy			
Previous	Buy			
Price Target	\$1.63			
Previous	\$2.26			
Risk	Medium			
Share price	\$0.80			
ASX code	ADA			
52 Week Low-High	\$0.77-\$3.18			
Valuation	\$1.63			
Methodology	DCF			
Capital Structure				
Shares on Issue (M)	78			
Market Cap (A\$M)	62			
Net Cash/(Debt) (A\$M)	6			
EV (A\$M)	57			
Diluted mkt cap (A\$M)	62			
12mth Av Daily Volume ('000)	149			
Y/e Jun	2018a	2019e	2020e	2021e
Sales \$M	53.1	52.1	57.9	63.7
EBITDA adj. \$M	11.0	7.5	8.7	9.6
NPAT adj. \$M	8.5	6.0	7.0	7.7
EPS adj c	10.8	7.7	8.9	9.9
DPS c	9.5	2.7	3.1	3.4
PER x	7.4	10.5	9.0	8.1
EV/EBITDA x	4.5	6.7	5.7	5.2
Yield	11.9%	3.3%	3.9%	4.3%

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



Analyst: Mark Fichera
mark.fichera@fostock.com.au

+61 2 9993 8162