

Quickstep (QHL)

Production on Target...

27 February 2018

Alex Smith

asmith@pacpartners.com.au

+613 8633 9865

KEY POINTS

- **QHL:** Is a key manufacturer of carbon fibre components for the F-35 Joint Strike Fighter program. They are on the verge of becoming profitable due to the approximate doubling of JSF related output over the next two years. We expect contracted revenue to increase from \$59m FY'18 to \$87m FY'20 up 40%.
- **Scale:** QHL is approaching the scale required to increase operating margins and generate long term profitability at its Bankstown facility, due to cost reduction actions from the OneQuickstep program.
- **Recommendation:** Maintain Buy, and price target of \$0.13 /share (previously \$0.16/share). Valuation has decreased due to greater risk around financial leverage.
- **Revenue:** First half revenue of \$28m was in line with expectation, however our full year is impacted by slightly lower volumes and we have decreased our estimate from \$62 to 59m. Total JSF components expected for the year remains at 1,495 and 24 C-130J wing sets. Throughout the half QHL announced two commercial contracts with Boeing for the F-15 and F-18, which add incremental revenue, but with the main opportunity to become an accredited supplier for further opportunities down track.
- **Gross Profit, EBITDA and EBIT Margins:** First half gross profit was \$3.4m or 12%, which was lower than our full year forecast of 17%, which we lowered to 15%. Impact on the margin was lower mainly due to commissioning of the C-130J drilling equipment and discontinuation of the Thales Hawkei Project. As production of the F-35 components continues to increase with ~30% growth over the next year, we expect positive EBIT margins in 2H FY'18, and FY'19 moving towards 8-10% at full capacity.
- **Debt:** Total debt increased from our full year forecast of \$13.6m to \$15.6m at half year, due to a six-month working capital agreement of \$2m. We expect this to be rolled over and have increased our full year estimate of total debt. Cash balance is currently \$2.3m, we anticipate positive cash flow during 2H FY'18, but achieving this will require a continued focus on reduction in costs, efficiencies in JSF program and controlling R&D spend.
- **Capital:** The contracted increase in JSF components and WC is covered by QHL's existing debt facilities. However, a contract win such as in commercial aerospace or automotive, may require an external funding requirement.
- **Strategic Direction:** QHL has narrowed its focus, specifically targeting composites which their technology can be applied to. We expect QHL to shift more into commercial automotive and aerospace markets, which utilise Qure and QPS, and utilise capacity at the Bankstown facility. OneQuickstep's focus is improving profitability, margins, and reducing R&D spend.

RECOMMENDATION

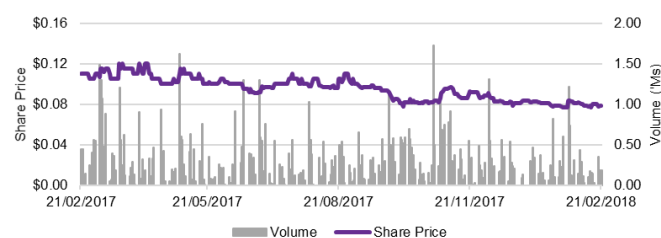
Buy

Previous Recommendation	Buy
Risk Rating	High
Current Share Price	\$0.08
12 Month Price Target	\$0.13
Price Target Methodology	DCF
Total Return (Capital + Yield)	60%
DCF Valuation	\$0.13
Market capitalisation	\$44m
Liquidity – Monthly Volume	0.8m

Financial Forecasts & Valuation Metrics

Y/e (\$m)	FY'17A	FY'18F	FY'19F	FY'20F
Revenue	51.9	58.7	76.5	87.7
Gross Profit	7.7	9.1	14.1	18.8
GP Margin	15%	15%	18%	21%
EBITDA	-5.7	0.4	5.2	10.3
EBITDA margin	-11%	1%	7%	12%
Interest Expense	-1.0	-1.0	-1.3	-1.1
NPAT	-6.7	-2.5	2.1	7.2
Debt	12.0	15.7	14.2	11.6
Net Debt/EV	13%	20%	14%	10%
Interest Coverage	NMF	NMF	2.6	7.4
EV/EBITDA	-5	89	7	3

QHL Share price performance



Source: Capital IQ

The information contained in this report is provided by PAC Partners to Wholesale Investors Only.

The information contained in this report is to be read in conjunction with other important disclosures at the end of this document.

3 Statement Operating Model

Income Statement (\$m)	FY15A	FY16A	FY17AF	FY18F	FY19F	FY20F
Revenue	39.5	50.1	51.9	58.7	76.5	87.7
COGs	-32.6	-39.7	-44.2	-49.7	-62.4	-69.0
Gross Profit	7.0	10.4	7.7	9.1	14.1	18.8
Cash OpEx.	-7.6	-10.3	-13.0	-8.7	-8.8	-8.5
EBITDA	-0.6	-1.5	-5.7	0.4	5.2	10.3
Depreciation	0.0	0.0	0.0	0.0	-2.0	-1.9
EBIT	-0.6	-1.5	-5.7	-1.6	3.3	8.4
Interest Expense	-1.8	-3.1	-1.0	-1.0	-1.3	-1.1
Tax Expense	0.0	0.0	0.0	0.0	0.0	0.0
NPAT underlying	-2.4	-4.6	-6.7	-2.5	2.1	7.2
Abnormal items	-1.5	-1.2	0.0	0.0	0.0	0.0
NPAT Reported.	-3.9	-5.8	-6.7	-2.5	2.1	7.2
Balance Sheet (\$m)	FY15A	FY16A	FY17A	FY18F	FY19F	FY20F
Cash	1.9	8.6	4.4	3.6	5.5	5.6
Inventory	6.0	11.9	10.6	12.0	15.0	16.6
Receivables	5.1	5.3	6.3	7.1	8.8	10.5
Prepaid Expenses	0.5	0.4	0.6	0.4	0.4	0.4
PP&E	12.0	13.1	14.8	13.8	13.4	13.3
Total Assets	25.6	39.3	36.8	37.0	43.3	46.5
Accounts Payable	5.3	8.1	11.7	10.8	15.2	12.9
Deferred Revenue	5.6	4.7	4.9	4.9	6.2	7.0
Other	0.1	0.2	0.2	0.2	0.2	0.2
Debt	15.7	11.9	12.0	15.7	14.2	11.6
Total Liabilities	26.8	25.0	28.8	31.6	35.8	31.7
Equity	-1.2	14.2	8.0	5.4	7.5	14.7
Cash Flow Statement (\$m)				FY18F	FY19F	FY20F
EBITDA				0.4	5.2	10.3
Interest & Tax				(1.0)	(1.3)	(1.1)
Change Working Capital				(2.9)	0.9	(4.6)
Other				0.0	0.0	0.0
Cash from Operating				(3.5)	4.9	4.5
Maintenance Capital - Aerospace				(1.0)	(1.5)	(1.8)
Expansion Capital - New Technology				0.0	0.0	0.0
Cash from Investing				(1.0)	(1.5)	(1.8)
Net Borrowings / Repayments				3.6	(1.5)	(2.6)
Share Issue / Repurchase				0.0	0.0	0.0
Cash from Financing				3.6	(1.5)	(2.6)
Net Cashflow				(0.8)	1.8	0.1

Valuation

VALUATION			
PV of Cashflows FY18 to FY33	43	15 Year Australian Govt. Bond	3.2%
PV of TV	31	Australian Equity Risk Premium	6.1%
PV of Equity	74	Small Cap Equity Risk Premium	2.4%
Shares on Issue	562	Levered Beta	0.8
PV of Equity per share	0.13	CAPM Cost of Equity	10.1%

VALUATION PARAMETERS	FY17A	FY18F	FY19F	FY20F
PE underlying (x)	-7.6	-15.0	54.0	5.3
Enterprise Value (\$m)	58.2	58.0	55.3	44.4
EV / EBITDA (x)	-10.2	-1987.2	14.0	3.9
EV / EBIT (x)	-6.5	-1257.9	9.3	3.2
Price / TA	-10.2	-28.9	26.6	4.6
DPS (¢ps)	0.0	0.0	0.0	0.0
D/E	35%	34%	28%	21%
Dividend Yield (%)	0%	0%	0%	0%

CONTACT INFORMATION

CORPORATE FINANCE	RESEARCH	DEALING
CRAIG STRANGER Managing Director <i>cstranger@pacpartners.com.au</i> 03 8633 9832	PAUL JENSZ Executive Director, Senior Analyst <i>pjensz@pacpartners.com.au</i> 03 8633 9864	JAMES WILSON Executive Director, Institutional Sales – Sydney <i>jwilson@pacpartners.com.au</i> 02 9994 5557
SEAN KENNEDY Corporate Finance <i>skennedy@pacpartners.com.au</i> 03 8633 9836	ANDREW SHEARER Senior Analyst <i>ashearer@pacpartners.com.au</i> 03 8633 9862	PHIL CAWOOD Institutional Sales – Sydney <i>pcawood@pacpartners.com.au</i> 02 9994 5552
ANTHONY STANI Corporate Finance <i>astani@pacpartners.com.au</i> 03 9618 8251	ERWIN TAN Analyst <i>etan@pacpartners.com.au</i> 02 9994 5559	MARK PASHLEY Head of Sale Trading – Sydney <i>mpashley@pacpartners.com.au</i> 02 9994 5558
BROOKE PICKEN COO <i>bpicken@pacpartners.com.au</i> 03 8633 9831	ALEX SMITH Analyst <i>asmith@pacpartners.com.au</i> 03 8633 9865	SEBASTIAN JURD Senior advisor – Sydney <i>sjurd@pacpartners.com.au</i> 02 9994 5553
ROGER CHEN Analyst <i>rchen@pacpartners.com.au</i> +852 2543 8600	LAWRENCE GRECH Analyst <i>lgrech@pacpartners.com.au</i> 0404 052 913	RYAN GALE Advisor – Melbourne <i>rgale@pacpartners.com.au</i> 03 8633 9833
		TOM FAIRCHILD Corporate Sales – Melbourne <i>tfairchild@pacpartners.com.au</i> 03 8633 9867
SYDNEY Kyle House, 27 – 31 Macquarie Place, Sydney +61 2 9233 9600		IAN LEETE Corporate Sales – Sydney <i>ileete@pacpartners.com.au</i> 02 9994 5551
MELBOURNE (Head Office) Level 10, 330 Collins Street, Melbourne +61 3 8633 9831		DANIEL GADALLA Desk Assistance – Melbourne <i>dgadalla@pacpartners.com.au</i> 03 8633 9834
Hong Kong Upper Ground Floor, 148 Queens Road Central +0011 852 041169 7866		SOL JONES Operator – Sydney <i>sjones@pacpartners.com.au</i> 02 9994 5554

RECOMMENDATION CRITERIA

Investment View

PAC Partners Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

Risk Rating

PAC Partners has a four tier Risk Rating System consisting of: Very High, High, Medium and Low. The Risk Rating is a subjective rating based on: Management Track Record, Forecasting Risk, Industry Risk and Financial Risk including cash flow analysis.

Disclosure of Economic Interests

The views expressed in this research report accurately reflect the personal views of Alex Smith about the subject issuer and its securities. No part of the analyst's compensation was, is or will be directly or indirectly related to any recommendation or view expressed in this report.

The following person(s) do not hold an economic interest in the securities covered in this report or other securities issued by the subject issuer which may influence this report:

- the author of this report
- a member of the immediate family of the author of this report

Disclaimer

PAC Partners Pty Ltd. ("PAC Partners" or "PAC") is a Corporate Authorised Representative of PAC Asset Management Pty Ltd holder of an Australian Financial Services Licence (AFSL No. 335 374).

The information contained in this report is provided by PAC Partners to Wholesale Investors only. Retail investor and third party recipients should not rely, directly or indirectly, on this report. Users of this research report should not act on any content or recommendation without first seeking professional advice. Whilst the report has been prepared with all reasonable care from sources which we believe are reliable, no responsibility or liability is accepted by PAC Partners, for any errors or omissions or misstatements however caused. Any opinions, forecasts or recommendations reflect our judgement and assumptions at the date of publication or broadcast and may change without notice. This report is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. This publication contains general securities advice. In preparing our Content it is not possible to take into consideration the investment objectives, financial situation or particular needs of any individual user. Access of this report does not create a client relationship between PAC Partners and the user. Before making an investment decision on the basis of this advice, you need to consider, with or without the assistance of a securities adviser, whether the advice in this publication is appropriate in light of your particular investment needs, objectives and financial situation. PAC and its associates within the meaning of the Corporations Act may hold securities in the companies referred to in this publication. PAC believes that the advice and information herein is accurate and reliable, but no warranties of accuracy, reliability or completeness are given (except insofar as liability under any statute cannot be excluded). No responsibility for any errors or omissions or any negligence is accepted by PAC or any of its directors, employees or agents. Any content is not for public circulation or reproduction, whether in whole or in part and is not to be disclosed to any person other than the intended user, without the prior written consent of PAC Partners.

Disclosure of Corporate Involvement

PAC Partners has not in the previous 12 months carried out work on behalf of the Company described in this report and has not received fees on commercial terms for its services. PAC Partners and/or their associates may own securities of the Company described in this report. PAC Partners does and seeks to do business with companies covered in the research. PAC may receive commissions from dealing in securities. As a result, investors should be aware that PAC Partners may have a conflict of interest that could affect the objectivity of this report.

For more information about PAC Partners please visit www.pacpartners.com.au

Buy	Hold	Sell
>20%	20% – 5%	<5%