



Quickstep Holdings Limited

New CEO sets a new direction

In an announcement and presentation released on 1 August, recently appointed CEO and MD Mark Burgess spelt out QHL's new strategic and operational direction - "The OneQuickstep Program". Key elements of this program, which has the objective of accelerating profitability and growth, include:

- Capping R&D spend at A\$2.8m in FY18E (vs ~A\$5m in FY17 and A\$3.5m in FY16), including reducing the R&D headcount by 12 full-time employees,
- Ceasing non-core/low-margin programs including the Thales Hawkei project,
- Implementing cost cutting and margin improvement programs at the Bankstown and Geelong operating sites,
- Simplifying the senior leadership structure, removing business segments and establishing a functional matrix organisation,
- Implementing an executive pay freeze and continuing with a freeze on directors fees,
- Focusing on quickly commercialising core process technologies (Qure, Quickstep Production System) and strengthening new sales and marketing resources (systems, people),
- Identifying technology and manufacturing partnerships.

State One commentary

Management's focus on cost cutting initiatives, including capping R&D and capex expenditure, should assist near-term profit margins and cash flow. We also see the strategic tilt away from the automotive sector and back to QHL's core strength - the aerospace sector - as a positive development. The ramp-up in sales from existing aerospace contracts is forecast to increase capacity utilisation at Bankstown to (only) 70% by FY20-21E. Filling up this spare capacity will require little additional capex and, more importantly, will build on existing production skill sets. In our revised forecast revenue profile, we assume that in FY20E, revenue of A\$25m from new (i.e., still to be won) aerospace business will augment A\$92m in forecast revenue from existing aerospace contracts. Prior to the strategic review, we forecast that the Geelong manufacturing site - via new process production of medium-to-high volumes of automotive panels - would be a significant driver (A\$29m in FY20E) of group revenue. Our revised forecast now assumes a far smaller contribution from non-aerospace business over the next 4 years.

We think it important to note the statement that "over the medium term (QHL) will be increasing our focus on market-specific technology and manufacturing partnerships". We believe that any developments here will only be seen after FY20-21E, and at this early stage, there is no visibility on what sector is targeted (aerospace, automotive, other) of if this would entail QHL building additional capacity in Australia or overseas. However, we see it as a positive that the group is targeting longer-dated "blue sky" growth opportunities.

Valuation: (A\$0.18ps)

Our base-case NPV/PER-derived target value for QHL is A\$0.16ps. Adding in 10% for "blue sky" opportunities, we derive a target price of A\$0.18ps (rounded). Note: predicated on our EPS forecast of A\$1c and A\$2c (rounded) in FY19E and FY20E respectively, our target price implies a one-year and two-year out PER of 18x and 9x. Risks to our forecast earnings profile and target price include, but are not limited to: unit US\$ prices, the AUD/USD exchange rate, near-term cash flow, operational performance (volume, quality, costs), successfully securing new business at Bankstown and increasing capacity utilisation to 100%.

14 August 2017

Share price: A\$0.10

Target price: A\$0.18

Recommendation
Buy

Risk Assessment
Higher

Industrial

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Senior Investment Analyst

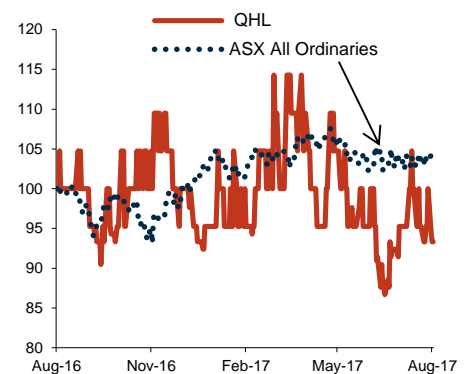
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Quickstep Holdings Limited

ASX Code	QHL
52 week range	A\$0.09-A\$0.12
Market Cap (ASm)	55
Shares Outstanding (m)	563
Av Daily Turnover (shares)	434k
ASX All Ordinaries	5,755
FY17E BV per share (A\$c)	1.7
EPS FY17E (A\$c)	-0.7
Net Cash/(Debt) FY17E (A\$m)	-8

Relative price performance



Source: IRESS

Financial Statements

Quickstep Holdings Limited

Year ending June

Profit & Loss Statement (A\$m)	FY16A	FY17E	FY18E	FY19E	FY20E
Sales	50.1	51.9	63.2	101.2	127.3
COGS	(37.3)	(41.0)	(49.9)	(79.0)	(98.0)
Operational/Marketing/Corporate	(7.6)	(8.0)	(8.2)	(11.0)	(11.0)
R&D	(3.5)	(4.9)	(2.8)	(3.0)	(3.0)
Total cash costs	(48.3)	(53.9)	(60.9)	(93.0)	(112.0)
EBITDA	1.8	(2.0)	2.3	8.3	15.3
Depreciation & Amortisation	(2.4)	(3.0)	(3.0)	(3.0)	(3.0)
Operating profit	(0.6)	(5.0)	(0.7)	5.3	12.3
NOI (Grants/Other)	(5.0)	1.4	1.5	0.75	0.0
EBIT	(5.6)	(3.6)	0.8	6.0	12.3
Interest income	1.0	0.2	0.1	0.1	0.1
Interest expense	(1.2)	(0.5)	(0.5)	(0.4)	(0.3)
Tax expense	0.0	0.0	0.0	0.0	0.0
Reported NPAT	(5.8)	(4.0)	0.4	5.7	12.1
Exceptional items	0.0	0.0	0.0	0.0	0.0
Underlying NPAT	(5.8)	(4.0)	0.4	5.7	12.1
EPS Reported (A\$)	(1.1)	(0.7)	0.1	1.0	2.1
EPS Normalised (A\$)	(1.1)	(0.7)	0.1	1.0	2.1
Dividend payout (%)	na	na	0%	0%	0%
DPS (A\$)	0.0	0.0	0.0	0.0	0.0
Dil Av no. of shares (m)	521	587	587	587	587
Dil YE no. of shares (m)	587	587	587	587	587

Cash Flow Statement (A\$m)	FY16A	FY17E	FY18E	FY19E	FY20E
EBITDA	1.8	(2.0)	2.3	8.3	15.3
Investment in working capital	(3.4)	1.7	1.0	(3.6)	(2.9)
Tax expense	0.0	0.0	0.0	0.0	0.0
Operating Cash Flow	(1.6)	(0.3)	3.3	4.7	12.4
Capex	(4.5)	(3.0)	(2.25)	(2.5)	(3.0)
Other investments	0.0	0.0	0.0	0.0	0.0
Investing Cash Flow	(4.5)	(3.0)	(2.25)	(2.5)	(3.0)
Net interest received / (paid)	(0.2)	(0.4)	(0.4)	(0.3)	(0.2)
Debt increase / (repayment)	(3.8)	0.0	(2.0)	(2.0)	(2.0)
Dividends declared	0.0	0.0	0.0	0.0	0.0
Equity raised / (repaid)	21.3	0.0	0.0	0.0	0.0
Financing Cash Flow	17.2	(0.4)	(2.4)	(2.3)	(2.2)
Non-operating & Other	(4.7)	(0.2)	1.5	0.8	0.0
Inc/(Dec) in Cash	6.4	(3.9)	0.1	0.6	7.2

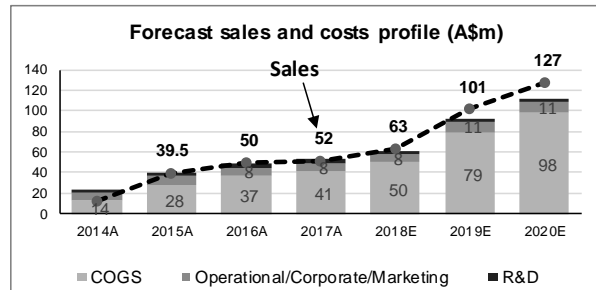
Balance Sheet (A\$m)	FY16A	FY17E	FY18E	FY19E	FY20E
Cash & Deposits	7.6	3.7	3.8	4.5	11.7
Receivables	5.3	6.2	7.0	11.1	14.0
Inventories	11.9	8.6	8.2	12.1	15.3
Other Current Assets	1.4	1.0	1.0	1.0	1.0
PPE and Exploration & Development	13.1	13.1	12.3	11.8	11.8
Deferred tax asset	0.0	0.0	0.0	0.0	0.0
Other Non Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	39.2	32.6	32.3	40.6	53.8
Payables and other current Liabilities	11.3	10.2	11.6	16.1	19.3
Short Term Debt	2.2	2.2	2.2	2.2	2.2
Long Term Debt	9.8	9.8	7.8	5.8	3.8
Other Non Current Liabilities	1.8	0.2	0.2	0.2	0.2
Total Liabilities	25.0	22.3	21.7	24.3	25.4
Total Equity	14.2	10.2	10.6	16.3	28.4
Net Debt (Cash)	4.3	8.2	6.1	3.4	(5.8)

Major Shareholders	%	Date
Washington H Soul Pattinson	15.9	
Deakin University	5.9	Aug-16
Farjoy PL	2.1	

Source: Company, IRESS, State One Stockbroking forecasts

Performance drivers	FY16A	FY17E	FY18E	FY19E	FY20E
Parts sold / delivered					
C-130J/LM-100J shipsets	35	26.5	26	28	28
F-35 JSF parts	578	1,230	1,520	2,345	2,650
.... JSF fuselage	558	716	1,060	1,385	1,580
.... JSF VTF	20	514	460	960	1,070
Revenue composition (A\$m)					
Aerospace - existing contracts	49.7	49.5	58.8	81.2	91.6
C-130J/LM-100J	30.1	19.3	20.6	22.6	22.6
F-35 JSF	19.7	30.2	38.2	58.5	69.0
.... JSF fuselage	19.3	20.7	29.7	40.6	49.0
.... JSF VTF	0.4	9.5	8.5	17.9	20.0
Aerospace - new business	0.0	0.0	0.0	12.5	25.0
Total Aerospace (Bankstown)	49.7	49.5	58.8	93.7	116.6
Automotive	0.4	0.7	0.7	1.5	2.9
X-Ray	0.0	0.2	1.7	4.1	5.8
Engineering/Other	0.0	1.5	2.0	2.0	2.0
Non-Aerospace (Geelong)	0.4	2.4	4.4	7.5	10.7
Group revenue	50.1	51.9	63.2	101.2	127.3
YoY revenue growth	nm	4%	22%	60%	26%
COGS as % revenue	74%	79%	79.0%	78%	77%
Operations/Other costs as % revenue	15%	15%	13%	11%	9%
R&D as % revenue	7%	9%	4%	3%	2%
Total cash costs as % revenue	96%	104%	96%	92%	88%

EBITDA margin (%)	4%	-ve	4%	8%	12%
Operating profit margin (%)	-ve	-ve	-ve	5%	10%



Leverage	FY16A	FY17E	FY18E	FY19E	FY20E
Net Debt/Equity	31%	80%	57%	21%	cash
Net Debt/Total Assets	11%	25%	19%	8%	cash
Net interest Cover (x)	na	na	2	19	55

Valuation Ratios (x)	FY16A	FY17E	FY18E	FY19E	FY20E
Normalised PER	-ve	-ve	144.5	10.0	4.7
Price/OP Cash Flow	-34.9	-183.1	17.3	12.1	4.6
EV (A\$m)	60	63	61	59	49
EV/EBITDA	33	-ve	26	7	3
ROE (%)	na	-ve	4%	35%	42%

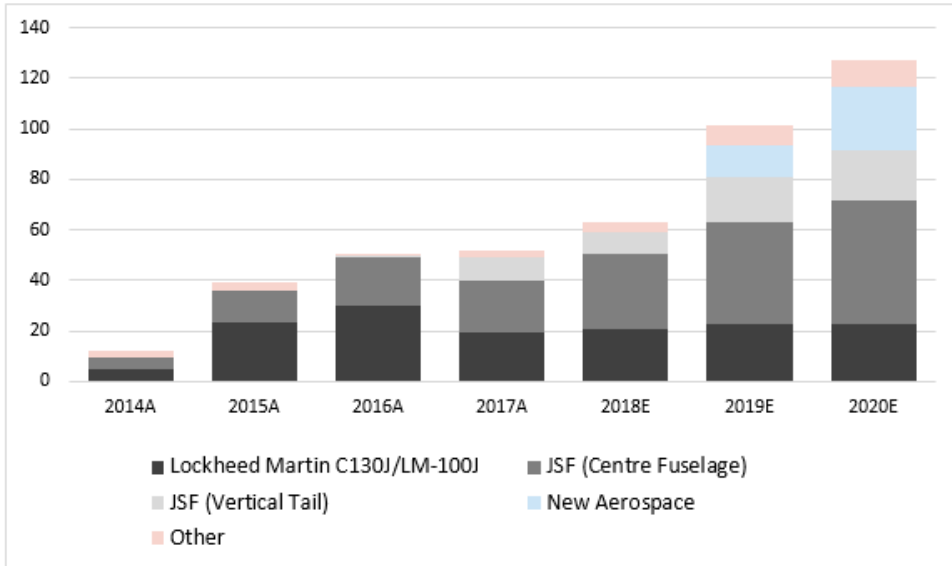
Weighted Target Price

Valuation method	Target value (A\$)	Weighting (%)	Share price (A\$)		Capital gain (%)
			Target	Current	
Base-case NPV	0.20	50%	0.16	0.10	86%
Base-case EPS/PER	0.12	50%			
"Blue sky" @ 10% of base-case valuation			0.02		
Target Price (A\$)			0.18		

EPS/PER TP based on two-year EPS of A\$1.0c (rounded) and a PE multiple of 12x

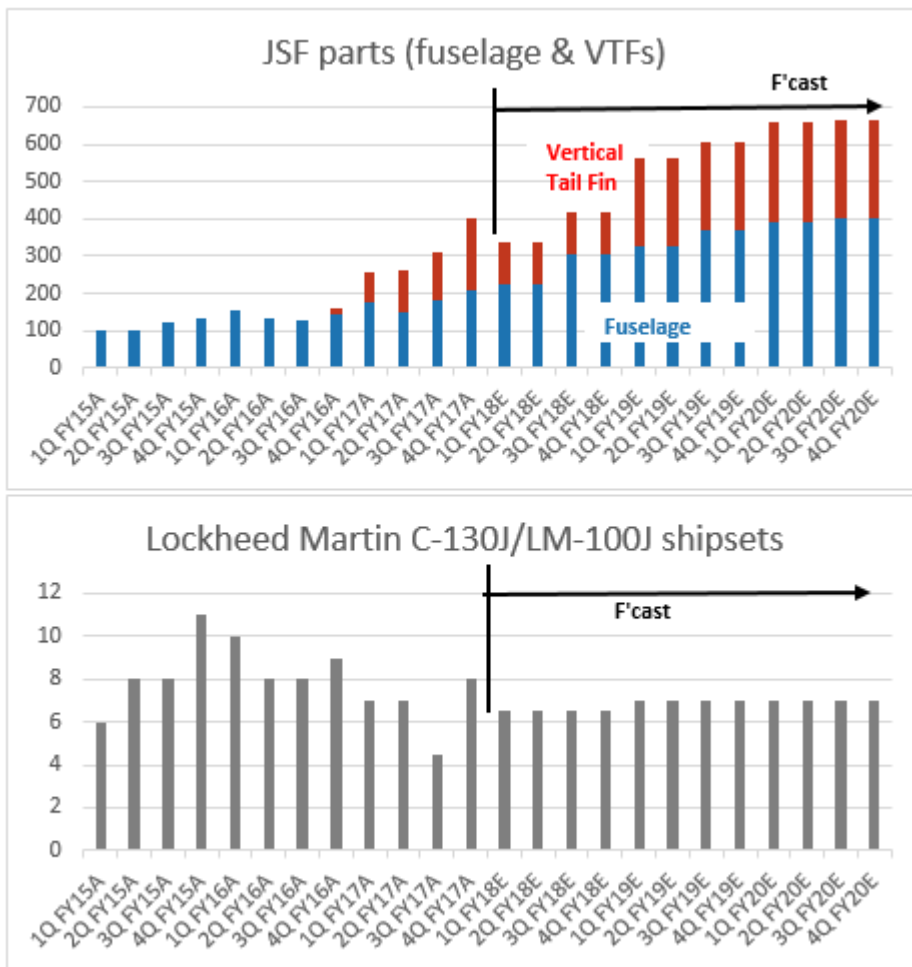
Company Overview: Quickstep (QHL) is the largest independent aerospace-grade advanced composite manufacturer in Australia. QHL is the sole provider of carbon fibre wing flap parts for the Lockheed Martin C-130J and LM-100J transport planes, and is a parts supplier to Northrop Grumman and BAe/Marand for the JSF F-35.

Figure 1: Forecast revenue profile to FY20E (A\$m)



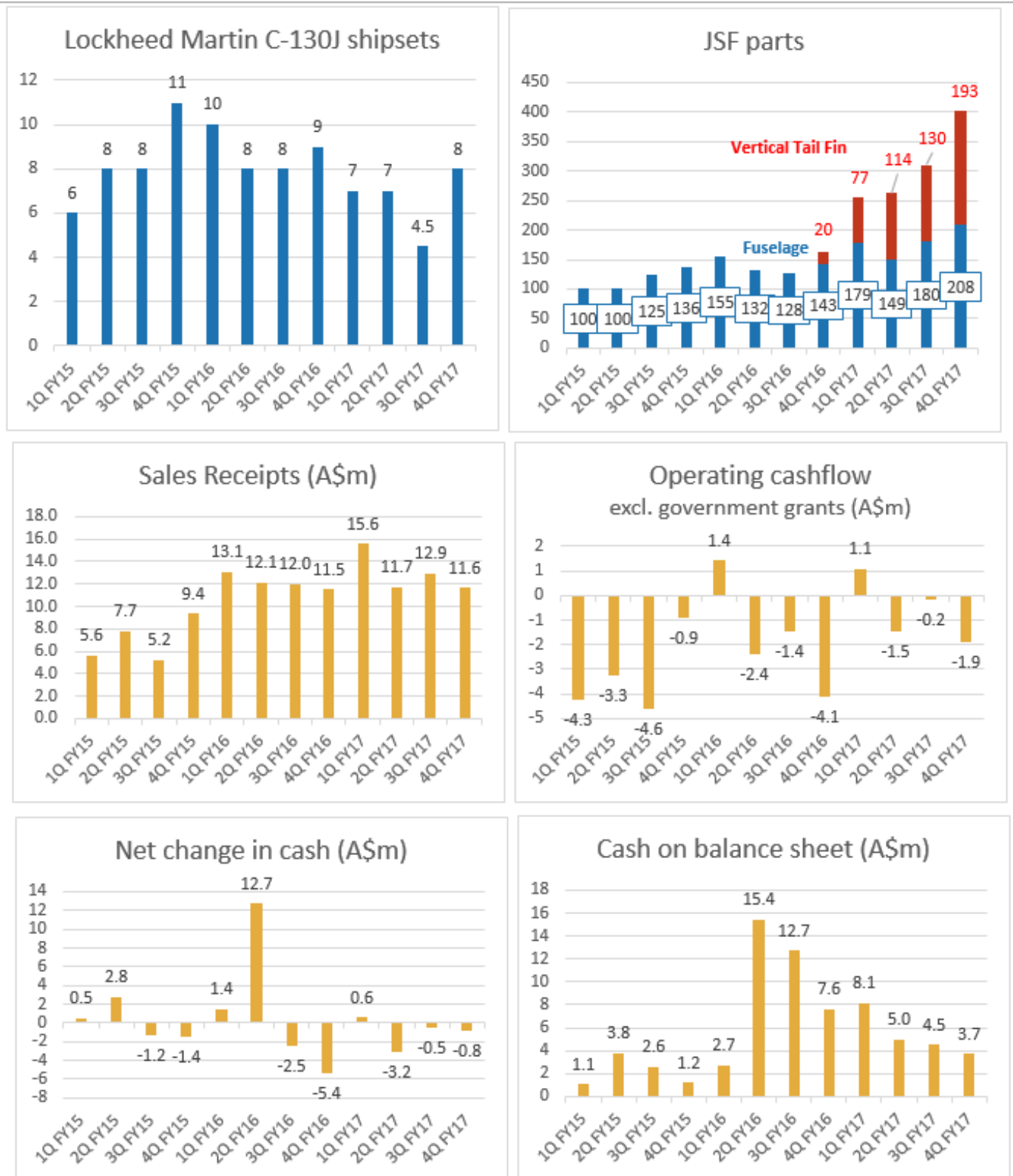
Source: Company, State One Stockbroking forecasts

Figure 2: Forecast quarterly JSF and C-130J/LM-100J volume sales to 4Q FY20E



Source: Company, State One Stockbroking forecasts

Figure 3: Selected historical quarterly metrics: 1QFY15- 4QFY17



Source: Company, compiled by State One Stockbroking

With President Trump looking to boost US military spend, while urging US allies (NATO/Japan) to increase their own military budgets, we suggest that Defence, as an investment thematic, will benefit from increasing global geopolitical concerns (i.e., the recent tensions between Trump and North Korea’s Kim Jong-un). We note that [Lockheed Martin \(LMT.NYSE\) reported in its June quarterly results](#) that US demand for its F-35 jets had increased with the Pentagon announcing on July 10 that it would add 13 jets to its planned purchase. Reflecting the strong investment thematic, Lockheed Martin and Northrop Grumman (NOC.NYSE) share prices have doubled and tripled respectively over the past five years.

Figure 4: Lockheed Martin 5-year share price history



Source: IRESS

Figure 5: Northrop Grumman 5-year share price history



Source: IRESS

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