

Small but active defence sector on the ASX

James Dunn Oct 13, 2020

The Australian Securities Exchange (ASX) has a small but thriving defence sector, which is rolling out some impressive technology into big addressable markets – which means export success.



A Littoral combat ship built by Austal for the US Navy. **Supplied**

The grand-daddy of the ASX's defence stocks is the remarkable story of Perth-based aluminium ship building giant Austal, which, from its beginnings making aluminium dinghies in the late 1980s, has grown to become the world's largest aluminium shipbuilder, Australia's largest defence exporter, and the only foreign-owned prime contractor to have designed and built ships for the US Navy.

In the last 30 years, Austal has built more than 300 vessels for more than 100 commercial and defence operators, in 54 countries.

Austal has delivered 12 of the *Spearhead*-class Expeditionary Fast Transport (EPF) ships and 12 of the *Independence*-class Littoral Combat Ship (LCS) class to the US Navy, making a total of 24 ships in just over 10 years, including three this year. The company has an order book of \$4.3 billion, with 45 vessels under construction or scheduled, and 31 ships to be delivered to the US and Australian Navies (and Australian Customs) over the next three years.

Austral has committed to a US\$100 million (\$139 million) extension to its Mobile, Alabama, shipyard to build steel warships (50 per cent funded by the US Government) – the company says this will increase its naval shipbuilding opportunities threefold.

Austral is also a major builder of high-speed aluminium ferries – commercial vessels represent 10 per cent of its business, and ASB says it has a pipeline of \$1.39 billion of potential work for which it will bid over the next three years.

The stock has generated total return (share price gains plus dividends) of 30 per cent a year over the last three years, on its way to a \$1.2 billion valuation – but has failed to regain the ground it lost in the COVID crash, after disappointing the market in May, when it failed to win a contract to build guided-missile frigates for the US Navy.

Against a current share price of \$3.31, FN Arena gives an analysts' consensus valuation of Austral at \$3.97: Thomson Reuters' collation of analysts' estimates is higher, at \$4.38.

Another ASX-listed contractor that has a much bigger profile in the defence world than on the stock market is advanced-materials manufacturer Quickstep Holdings (QHL), which makes carbon-fibre composites parts in Australia for Northrop Grumman for the F-35 Joint Strike Fighter, as well as wing flaps for Lockheed Martin, for the C-130J Super Hercules, and work for Boeing across the F-15, F/A-18 and AV-8B aircraft platforms.

Outside its military work, Quickstep does work in the commercial aerospace market, as well as the rail, medical and electric vehicles (EVs) areas.

Then there is materials and systems maker XTEK, which is focused in two areas, ballistic solutions and actionable intelligence, in the military, law enforcement and security areas. The ballistics business leverages XTEK's proprietary XTclave technology to make ballistic shields, helmets and body armour plates.

XTEK's other main business is its XTatlas arm, which provides software and systems to small unmanned aerial systems (SUAS) – otherwise known as drones – and robots, which provide real-time, geo-referenced 3D mapping data that can be used by soldiers for protection, threat identification and targeting. This business also supplies SUAS systems to the Australian Defence Force, as well as the training and ongoing support and maintenance to go with the hardware.

The Canberra-based Electro Optic Systems Holdings Limited (EOS), capitalised at \$900 million, says it is Australia's largest aerospace entity, and the largest defence exporter in the southern hemisphere. It develops remotely controlled weapon and fire-control systems for military vehicles, and has extended that capability into remotely operated combat vehicles, manufacturing both in Australia and the US, with offshore plants in Singapore and the Middle East planned. EOS says the total addressable market for its defence sector products is expected to be about \$33 billion a year, over the decade to 2030.

Other stocks in the defence sector include Codan, which sells communications systems to the military and first-responder sectors, and Orbital Corporation, which designs and makes engine systems for tactical unmanned aerial vehicles (UAVs): OEC is the primary engine supplier to Boeing's UAV arm Insitu, and has engine design and development contracts with Northrop Grumman and a large (as-yet-unnamed) Singapore defence company.

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