

RADA Electronic Industries

Quarterly results

Positive dynamics

RADA Electronic Industries' (RADA) strong third quarter results and upwardly revised outlook of at least \$75m in revenues in 2020 (from \$70m) reflect its successful execution of initial orders and participation in major US Army programs. This is illustrated by RADA's inclusion in the \$1.2bn contract recently awarded to General Dynamics for delivery of Interim Maneuver Short-Range Air Defense (IM-SHORAD) systems to the US Army. We increase our EPS forecasts by 37.5% in 2020 and 5.3% in 2021. The 2020–24 forecast EPS CAGR of 25.4% supports our DCF valuation of \$10. The company also trades at a significant PEG discount to the peer group despite a higher growth rate.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/18	28.0	1.1	4.4	0.0	165.9	N/A
12/19	44.3	(1.1)	(2.0)	0.0	N/A	N/A
12/20e	75.9	7.4	17.1	0.0	42.7	N/A
12/21e	113.8	11.8	27.1	0.0	26.9	N/A

Note: *PBT and EPS are normalized, excluding amortization of acquired intangibles, exceptional items and share-based payments.

Q3 results illustrate operating leverage

RADA's third quarter revenues of \$20.4m grew by an impressive 81% year-on-year and 16% quarter-on-quarter. Gross margins of 38% were higher than the 36% reported in recent quarters due to economies of scale and manufacturing efficiencies. With operating expenses stable, EBITDA margins expanded to 15% from 10% in the previous quarter, illustrating the operating leverage within the business.

Raising forecasts and rising conviction

We upgrade our FY20 revenue forecasts to \$75.9m from \$71.6m and continue to expect a 50% increase in 2021 revenues. Our increasing confidence is supported by a growing backlog (\$20m in new orders announced since September), initial General Dynamics contract orders expected before the year end and company guidance that calls for continued quarterly sequential revenue growth into 2021. We increase gross and EBITDA margin expectations due to stabilizing opex and manufacturing efficiencies.

Valuation: Remains compelling

RADA's valuation in relation to its peer group remains compelling. Despite earnings growth 58% higher than the peer group, RADA trades at a PEG ratio of 1.05x, a 43% discount to peers. To smooth near-term distortions, we use RADA's five-year (2020–24e) compound average EPS growth rate of 25.4% and compare it to the 2021 peer group average. Based on forecasts until 2024 and a terminal growth rate of 2%, our DCF suggest a value of \$10 per share.

Aerospace & defence

8 November 2020

Price **US\$7.3**

Market cap **US\$318m**

NIS3.38/US\$

Net cash (\$m) at 31 October 2020 23.7

Shares in issue 43.5m

Free float 84.3%

Code RADA

Primary exchange Nasdaq

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 10.5 4.3 44.7

Rel (local) 7.6 (2.7) 25.0

52-week high/low US\$7.7 US\$2.2

Business description

RADA Electronic Industries develops, manufactures, markets and sells defence electronics to various armed forces and companies worldwide. It offers military avionic systems and land-based tactical radars for defence forces and critical infrastructure protection solutions.

Next events

Full year results March 2021

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Near-term outlook

Raising forecasts and rising conviction

- Forecasts upgraded due to a growing order backlog and margin improvement.
- Level of conviction up as RADA is included in long-term programs.
- Change of administration in the US and pandemic could pressurize medium-term defence investment budgets but would likely lead to increased asset protection requirements.

On 2 November, RADA announced the receipt of new orders of \$79m since the start of the year (vs \$41m during the same period last year) and \$20m since September, to be delivered during the first half of 2021. All new orders are software-defined tactical radars for the US market in the areas of counter small unmanned aerial systems (C-sUAS), short range air defense (SHORAD), counter rockets, artillery and mortars (C-RAM) and vehicle protection solutions (VPS). The new orders are mostly follow-ons after a comprehensive testing and evaluation phase.

Receipt of orders from the General Dynamics IM-SHORAD program, expected by management before the year-end, continue the positive trend of moving to long-term programs from an urgent needs basis, thereby bolstering confidence in future growth. RADA's participation in the General Dynamics program is expected to last for the next three years. As a reminder, RADA has a number of other long-term programs in various testing phases, both in the US and worldwide.

Exhibit 1: Forecast revisions

	Revenue (\$m)			EBITDA (\$m)			EPS (c)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2020e	71.6	75.9	6.1	7.4	9.6	29.7	12.4	17.1	37.5
2021e	107.4	113.8	5.9	13.4	14.2	5.7	25.7	27.1	5.3

Source: PBT and EPS are normalized, excluding amortization of acquired intangibles, exceptional items and share-based payments.

Building for growth

Net cash and equivalents dropped by \$5.7m during the third quarter to \$23.7m. This in part reflects the strategic inventory build to \$29.3m from \$26.5m in Q2 to support future growth and ensure continuing supply during the pandemic. We expect the inventory to sales ratio to drop from 40% this year to 30% next year and a move to being cash flow positive in 2021 as the excess inventory unwinds.

Valuation

RADA's valuation in relation to the peer group remains compelling. Despite earnings growth 58% higher than the peer group, RADA trades at a PEG ratio of 1.05x, a 43% discount to peers. To smooth the near-term distortions, we use RADA's five-year (2020–24e) compound average EPS growth rate of 25.4% and compare it to the 2021 peer group average.

A share price of \$10 would suggest an undemanding PEG of 1.2x, which is still a 35% discount to the peer group.

Exhibit 2: RADA versus the peer group

	Ticker	Price (US\$)	EPS 2020e (\$)	EPS 2021e (\$)	2020e P/E (x)	2021e P/E (x)	2021e EPS growth (%)	PEG ratio (x)
L3 Harris	LHX	186.0	11.56	13.07	16.1	14.2	13.1	1.09
Teledyne Technologies	TDY	364.0	9.89	11.26	36.8	32.3	13.9	2.33
Mercury Systems	MRCY	68.7	2.28	2.6	30.1	26.4	14.0	1.88
Cubic	CUB	59.8	2.5	3.2	23.9	18.5	29.6	0.62
Kratos Defence and Security	KTOS	18.5	0.4	0.5	44.0	39.4	11.9	3.31
AeroVironment	AVAV	78.0	1.9	2.2	41.5	36.1	14.9	2.42
Aerojet Rocketdyne	AJRD	35.2	1.7	1.96	20.7	17.9	15.3	1.17
Average					30.45	26.40	16.1	1.83
RADA		7.3	17.1	27.1	42.5	26.8	25.4	1.05
Premium/(discount)							58.0%	(42.5%)

Source: Edison Investment Research, Refinitiv. Note: Prices as at 9 November 2020.

Our DCF model implies a share price of \$10 using a WACC of 7%. The assumptions used to support this are a 22.9% CAGR in revenues (2020–24e) during our explicit forecast period and terminal growth of 2% pa. RADA produced better than expected margins in the third quarter and noted continued potential for operational efficiencies as capacity increases. Note that the risk to our expectation of stable gross margins is therefore on the upside, while EBITDA margins of 15.4% in Q3 are trending towards our medium-term expectations faster than initially expected.

Exhibit 3: DCF sensitivity table

	6.0%	7.0%	8.0%	9.0%	10.0%	11.0%
0.0%	8.93	7.55	6.53	5.74	5.11	4.60
1.0%	10.38	8.54	7.24	6.26	5.51	4.91
2.0%	12.55	9.92	8.18	6.94	6.01	5.29
3.0%	16.18	12.00	9.50	7.83	6.65	5.77

Source: Edison Investment Research

Exhibit 4: Financial summary

	\$m	2018	2019	2020e	2021e
Year end 31 December		US GAAP	US GAAP	US GAAP	US GAAP
PROFIT & LOSS					
Revenue		28.0	44.3	75.9	113.8
Cost of Sales		(17.8)	(28.4)	(47.8)	(70.5)
Gross Profit		10.2	15.9	28.1	43.2
EBITDA		1.8	0.3	9.6	14.2
Operating Profit (before amort. and except.)		1.0	(1.0)	7.4	11.3
Intangible Amortisation		0.0	0.0	(0.5)	0.0
Exceptionals		(0.9)	(1.1)	(2.1)	(2.4)
Other		0.0	0.0	0.0	0.0
Operating Profit		0.1	(2.1)	4.9	8.9
Net Interest		0.1	(0.1)	0.5	0.5
Profit Before Tax (norm)		1.1	(1.1)	7.4	11.8
Profit Before Tax (US GAAP)		0.2	(2.2)	5.3	9.4
Tax		0.0	0.0	0.0	0.0
Profit After Tax (norm)		1.1	(1.1)	7.4	11.8
Profit After Tax (US GAAP)		0.2	(2.2)	5.3	9.4
Average Number of Shares Outstanding (m)		33.2	38.1	43.4	43.5
EPS (c)		4.41	(2.01)	17.05	27.07
EPS - normalised fully diluted (c)		4.34	(1.97)	16.70	26.52
EPS - (US GAAP) (c)		1.71	(5.02)	12.30	21.55
Dividend per share (c)		0.00	0.00	0.00	0.00
Gross Margin (%)		36.4	36.0	37.0	38.0
EBITDA Margin (%)		6.3	0.8	12.7	12.4
Operating Margin (before GW and except.) (%)		3.4	-2.2	9.8	9.9
BALANCE SHEET					
Fixed Assets		4.6	16.8	18.6	20.6
Intangible Assets		0.0	0.0	0.0	0.0
Tangible Assets		4.6	9.1	11.0	12.9
Right of use asset		0.0	7.7	7.7	7.7
Investments		0.0	0.0	0.0	0.0
Current Assets		48.1	46.6	76.6	92.2
Stocks		11.2	17.2	30.3	34.1
Debtors		13.6	13.5	20.1	26.9
Cash		21.2	14.1	23.9	28.4
Other		2.1	1.8	2.2	2.8
Current Liabilities		(10.2)	(13.4)	(15.9)	(21.7)
Creditors		(10.2)	(13.4)	(15.9)	(21.7)
Short term borrowings		0.0	0.0	0.0	0.0
Long Term Liabilities		(0.7)	(8.5)	(7.1)	(7.1)
Long term borrowings		0.0	0.0	1.4	1.4
Lease liabilities		0.0	(7.7)	(7.7)	(7.7)
Other long-term liabilities		(0.7)	(0.8)	(0.8)	(0.8)
Net Assets		41.9	41.4	72.3	84.0
CASH FLOW					
Operating Cash Flow		(3.7)	(3.6)	(7.6)	8.8
Net Interest		(0.2)	0.1	(0.1)	0.5
Tax		0.0	0.0	0.0	0.0
Capex		(0.9)	(4.1)	(4.6)	(4.8)
Acquisitions/disposals		0.0	(0.5)	0.0	0.0
Financing		13.1	1.5	23.5	0.0
Dividends		0.0	0.0	0.0	0.0
Other		0.2	(0.5)	0.0	0.0
Net Cash Flow		8.5	(7.1)	11.2	4.4
Opening net debt/(cash)		(12.7)	(21.2)	(14.1)	(25.3)
HP finance leases initiated		0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0
Closing net debt/(cash)		(21.2)	(14.1)	(25.3)	(29.8)
Net financial Liabilities		(21.2)	(6.4)	(17.6)	(22.1)

Source: Company accounts, Edison Investment Research

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