

RADA Electronic Industries

FY20 results

Rising profitability drives upgrade

With a growing order backlog, significant operating leverage, improving working capital and an eye on new vertical markets, RADA is in our view a compelling proposition. Our revenue forecasts remain broadly unchanged following full year results. However, we have increased our EPS forecasts by 64.5% in 2021 and by 66.3% in 2022 as operating leverage becomes increasingly apparent. We raise our valuation to \$17 from \$12, supported by our DCF model and PEG ratio analysis.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/19	44.3	(1.1)	(2.0)	0.0	N/A	N/A
12/20	76.2	7.1	16.4	0.0	78.1	N/A
12/21e	120.8	21.3	48.7	0.0	26.2	N/A
12/22e	157.1	30.1	66.5	0.0	19.3	N/A

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

Confidence grows with backlog

Management struck a bullish tone in the 10 February full year results call, stating that visibility has improved as the backlog reaches a higher level than in previous years, new orders are coming in quicker than expected and the pipeline is healthy. Revenue guidance of at least \$120m in 2021 remains unchanged, but management confidence has risen as the momentum seen in H220 continues into 2021.

Rising profitability

The business's operating leverage was apparent in Q4 as revenues increased by \$2.9m sequentially, while operating expenses rose by just \$446k. Margin expansion is expected to continue to be a theme through 2021. We are increasing our gross margin forecast for 2021 to 39% from 38% and forecast EBITDA margins to rise to 19.7% this year from the 12.8% we previously expected.

A radar hub

With the full year results, RADA announced that it has signed a term sheet to invest \$3m for a 12% stake in RADSee Technologies, an early-stage, Israel-based company focused on radars for the automotive market. RADA sees technological synergies and has the option to increase its stake. This move signals RADA's intention to become a leader in radar technologies addressing multiple verticals.

Valuation: Increasing fair value to \$17

Our DCF model uses a WACC of 6.9% to support a valuation of \$17 (previously \$12) assuming a 2% terminal growth rate. The increase in valuation is largely driven by the rapid and sustainable improvement in profitability. As a sense check, we look at RADA's PEG ratio – although its 2022 earnings growth of 37% is almost double that of the peer group, the PEG ratio stands at 0.7x vs 1.8x for peers. A share price of \$17 reflects a reasonable 2022 PEG ratio of 1.0.

Aerospace & defence

12 February 2021

Price **US\$12.8**
Market cap **US\$557m**

US\$/NIS3.4

Net cash (\$m) at 31 December 2020 36.4

Shares in issue 43.5m

Free float 84.3%

Code RADA

Primary exchange Nasdaq

Secondary exchange TASE

Share price performance



% 1m 3m 12m

Abs 33.5 72.8 113.1

Rel (local) 29.6 57.6 82.7

52-week high/low US\$12.8 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

Q1 results May 2021

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Turning free cash flow positive

In addition to improving profitability, which is driving our estimate upgrades (see Exhibit 1), the improvement in the cash conversion cycle that is helping the turnaround in free cash flow this year is worth noting.

Overall working capital as a percentage of sales dropped to 40% in 2020 from 51.5% in 2019. In working capital, the major improvement was in receivables, as days sales outstanding dropped significantly from 127 in 2019 to 77 in 2020 due to the growing presence in the US (in Q4 US accounted for approximately 60% of revenues vs 50% in FY19), where the collection cycle is quicker than in Israel and the other geographies in which RADA operates. Inventory days also fell to 190 in 2020 from 230 in 2019, although we do not expect a significant reduction as RADA aims to keep a buffer of a year's supplies in components like semiconductors to protect against potential global shortages. Additionally, RADA likes to maintain stock to enhance turnaround times for customers.

We expect RADA to generate free cash flow of \$7.7m in 2021 following a reduction of \$2.1m in 2019. The turnaround is due to rising EBITDA, improved working capital trends and the absence of major capex programmes.

Below we revise our full year 2021 estimates and include full year 2022 estimates for the first time.

Exhibit 1: 2021 estimate revisions and new FY22 estimates

	Revenue (\$m)			EBITDA (\$m)			EPS (c)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2021e	120.2	120.8	0.5	15.4	23.8	54.5	29.6	48.7	64.5
2022e		157.1			31.7			66.5	

Source: Edison Investment Research

Valuation

Our DCF model implies a share price of \$17 explained by the more rapid expansion in EBITDA margins than previously expected, while our other assumptions are broadly unchanged, ie WACC of 6.9% (previously 7.0%), a revenue CAGR (2021–25e) of 15.5% during our explicit forecast period and terminal growth of 2% pa.

Exhibit 2: DCF sensitivity table (\$/share)

Terminal growth	WACC					
	6%	7%	8%	9%	10%	11%
0%	14.83	12.58	10.90	9.60	8.57	7.72
1%	17.24	14.22	12.08	10.48	9.24	8.25
2%	20.85	16.52	13.65	11.60	10.07	8.89
3%	26.86	19.97	15.84	13.10	11.15	9.69

Source: Edison Investment Research

Relative to its peers, RADA's valuation is compelling on a PEG basis. Its 2022e PEG multiple of 0.7x is at a 60% discount to the peer group despite earnings growing almost twice as fast, and its 2021e P/E ratio of 26.2x is at a c 25% discount to peers.

Exhibit 3: Peer group comparison

	Ticker	Price (US\$)	EPS 2021e (\$)	EPS 2022e (\$)	2021e P/E (x)	2022e P/E (x)	2022e EPS growth (%)	PEG ratio (x)
L3 Harris	LHX	186.2	12.92	14.44	14.4	12.9	11.8	1.10
Teledyne Technologies	TDY	389.7	11.55	12.95	33.7	30.1	12.1	2.48
Mercury Systems	MRCY	74.9	2.4	2.8	31.2	26.8	16.7	1.61
Cubic	CUB	69.4	3.32	3.7	20.9	18.9	10.5	1.79
Kratos Defence and Security	KTOS	32.8	0.3	0.4	96.4	74.5	29.4	2.53
AeroVironment	AVAV	138.0	1.9	2.6	74.2	53.3	39.2	1.36
Aerojet Rocketdyne	AJRD	52.5	1.68	1.94	31.2	27.0	15.5	1.75
Peer group average					43.2	34.8	19.3	1.80
RADA		12.8	48.7	66.5	77.8	26.2	36.6	0.72
RADA premium/discount						(24.6)	89.6%	(60.3)

Source: Edison Investment Research, Refinitiv. Note: Prices as at 9 February 2021

Exhibit 4: Financial summary

	\$m	2019	2020e	2021e	2022e
Year end 31 December		US GAAP	US GAAP	US GAAP	US GAAP
PROFIT & LOSS					
Revenue		44.3	76.2	120.8	157.1
Cost of Sales		(28.4)	(47.9)	(73.7)	(95.0)
Gross Profit		15.9	28.3	47.1	62.0
EBITDA		0.4	9.7	23.8	31.7
Operating Profit (before amort. and except.)		(0.8)	7.4	20.8	28.6
Intangible Amortisation		(0.1)	(0.5)	0.0	0.0
Exceptionals		(1.1)	(1.5)	(1.7)	(2.1)
Other		0.0	0.0	0.0	1.0
Operating Profit		(2.1)	5.5	19.1	27.5
Net Interest		(0.1)	0.2	0.5	0.5
Profit Before Tax (norm)		(1.1)	7.1	21.3	30.1
Profit Before Tax (US GAAP)		(2.2)	5.6	19.5	27.0
Tax		0.0	0.0	0.0	0.0
Profit After Tax (norm)		(1.1)	7.1	21.3	29.1
Profit After Tax (US GAAP)		(2.2)	5.6	19.5	28.0
Average Number of Shares Outstanding (m)		38.1	43.3	43.7	43.7
EPS - normalised (c)		(2.01)	16.40	48.65	66.47
EPS - normalised fully diluted		(1.97)	15.99	47.47	64.85
EPS - (US GAAP) (c)		(5.02)	13.02	44.71	64.03
Dividend per share (c)		0.00	0.00	0.00	0.00
Gross Margin (%)		36.0	37.2	39.0	39.5
EBITDA Margin (%)		0.9	12.7	19.7	20.2
Operating Margin (before GW and except.) (%)		-1.8	9.7	17.2	18.2
BALANCE SHEET					
Fixed Assets		16.8	24.5	27.6	31.9
Intangible Assets		0.0	0.0	0.0	0.0
Tangible Assets		9.1	14.0	17.0	21.3
Right of use asset		7.7	10.6	10.6	10.6
Investments		0.0	0.0	0.0	0.0
Current Assets		46.6	80.0	111.3	143.8
Stocks		17.2	28.8	39.3	47.1
Debtors		13.5	12.5	20.9	26.1
Cash		14.1	36.9	48.7	67.9
Other		1.8	1.9	2.4	2.7
Current Liabilities		(13.4)	(21.1)	(29.6)	(34.8)
Creditors		(13.4)	(20.7)	(29.6)	(34.8)
Short term borrowings		0.0	(0.5)	0.0	0.0
Long Term Liabilities		(8.5)	(11.4)	(16.0)	(18.5)
Long term borrowings		0.0	0.0	(4.6)	(7.1)
Lease liabilities		(7.7)	(10.6)	(10.6)	(10.6)
Other long-term liabilities		(0.8)	(0.8)	(0.8)	(0.8)
Net Assets		41.4	72.0	93.3	122.4
CASH FLOW					
Operating Cash Flow		(3.6)	6.5	13.6	23.7
Net Interest		0.1	(0.1)	0.2	0.5
Tax		0.0	0.0	0.0	0.0
Capex		(4.1)	(8.5)	(6.0)	(7.5)
Acquisitions/disposals		(0.5)	0.0	0.0	0.0
Financing		1.5	23.5	0.0	0.0
Dividends		0.0	0.0	0.0	0.0
Other		(0.5)	0.8	0.0	0.0
Net Cash Flow		(7.1)	22.3	7.7	16.7
Opening net debt/(cash)		(21.2)	(14.1)	(36.4)	(44.1)
HP finance leases initiated		0.0	0.0	0.0	1.0
Other		0.0	0.0	(0.0)	0.0
Closing net debt/(cash)		(14.1)	(36.4)	(44.1)	(61.8)

Source: RADA Electronic, Edison Investment Research

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