

ASX: OEC

Equity Research

4 April 2023

BUY

Share Price	\$0.16
Price Target	\$0.45

Overview:

52-Week Range	\$0.15 - \$0.38
OEC Shares on Issue	117.0m
Listed Options (\$35c, 07 Feb 2026)	17.5m
Unlisted Options	430.5k
Market Capitalisation	\$18.1m
Cash (31 Dec 2022)	\$4.1m
Enterprise Value	\$22.5m

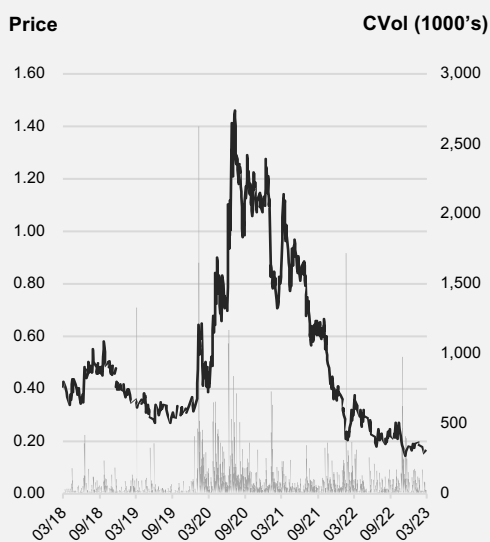
Substantial Shareholders:

ICM Limited	29.9%
First Sentier Investors IM Ltd	11.9%
Annapurna Pty Ltd	2.6%
Morgan Stanley	2.0%

Board & Management:

John Welborn	Non-Executive Chair
Todd Alder	MD & CEO
Steve Gallagher	Non-Executive Director
Kyle Abbott	Non-Executive Director
Thomas Spencer	CFO & Company Secretary

5-year Share Price History:



Orbital Corporation Ltd

Investment Thesis

Orbital Corporation (OEC) specialises in the design and manufacturing of propulsion systems and engine solutions for both commercial and military unmanned aerial vehicles ("UAVs" or drones).

The global market for military UAVs is estimated to be \$11 billion (with the tactical UAV production market valued at \$3 billion) and is expected to grow at a CAGR of 14.3% from 2021 to 2026. Recent conflicts have demonstrated the importance of drones in the military theatre, with many governments around the world rapidly expanding their capabilities. The most prominent example of this being the US Army's Future Tactical Unmanned Aircraft System (FTUAS) program, which seeks to replace the US Army's existing Textron RQ-7 Shadow UAVs. Currently, two of Orbital's partners, AeroVironment and Textron Systems, are considered frontrunners for the FTUAS program alongside competitors Griffon Aerospace, Northrop Grumman, and Sierra Nevada Corp. Additionally, Boeing's Insitu (a current engine customer of Orbital) has also indicated it has submitted a bid for the project. Given that engine and propulsion systems typically make up 10% of the global tactical UAV spend, Orbital is well-positioned to capitalise on the increased interest in UAV technology for many years to come.

Orbital's patented proprietary technology is particularly well-suited to the heavy fuel requirements of military and defence forces, providing industry leading performance in terms of operational range, launch times and maintenance requirements. This IP creates competitive advantages and barriers to entry.

Historically, Orbital was largely reliant on Boeing Insitu as its dominant customer, however, company-specific issues at Insitu led to a decline in revenue for Orbital. Consequently, Orbital has embarked on a customer diversification strategy in recent years and sought to deliver a broad customer portfolio and future sales pipeline. This pipeline is actively being converted into new engine development contracts with world leading defence companies. Although these contracts often take years to win, once established, Orbital expects a solid mix of both growing and recurring future revenue streams.

Our forecasts are aligned with short-term management guidance with FY23 showing a return to EBITDA profitability, and medium-term aspirations of \$60m+ revenue in FY27. Based on our DCF valuation we have derived a base case valuation of \$0.45 per share and an upside scenario of \$0.82 per share. Over the next year we expect Orbital to move into profitability and thereafter show impressive growth in both revenues and profit as the Orbital engine becomes the de facto standard for drone engines for allied forces.

Valuation Multiples	2023E	2024E	2025E	2026E	2027E
EV/Sales	1.3x	0.9x	0.7x	0.5x	0.4x
EV/EBITDA	51.5x	8.2x	8.2x	3.3x	1.8x
EV/EBITA	NM	9.5x	9.7x	3.5x	1.9x
P/E (NPATA)	NM	9.2x	9.4x	2.7x	1.3x
P/E (Target)	NM	26.7x	27.4x	7.8x	3.9x

Market Information	Value
Number of Issued Shares	117.0
Listed Options (@ \$0.35, 7 Feb '26)	17.5
Unlisted Options	0.4
Fully Diluted	134.9
Share Price	0.16
12 month High-Low	0.15 - 0.38
Market Capitalisation	18.1
Cash (31 Dec 2022)	4.1
Debt (31 Dec 2022)	8.5
Enterprise Value	22.5

Profit & Loss (A\$m)	2021A	2022A	2023E	2024E	2025E
Total Revenue	31.2	18.2	23.3	27.0	32.7
Gross Profit (incl. Gov. Grants)	16.0	6.2	4.0	9.6	13.1
Gross Margin (on trading rev)	51.2%	39.5%	23.0%	40.0%	40.0%
Operating Expenses	23.6	13.9	9.4	9.9	10.4
EBITDA	(7.6)	(5.2)	0.4	2.8	2.7
Depreciation	1.6	1.0	0.5	0.4	0.4
Net Interest	1.5	0.7	0.0	0.0	0.0
Tax and Other	1.0	4.1	0.0	0.0	0.0
NPAT	(12.0)	(11.2)	(0.8)	1.7	1.6

Financials	2021A	2022A	2023E	2024E	2025E
Reported EPS	(0.15)	(0.13)	(0.01)	0.01	0.01
DPS	0.00	0.00	0.00	0.00	0.00
Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%

Valuation	2021A	2022A	2023E	2024E	2025E
EV/Sales	0.7x	1.4x	1.3x	0.9x	0.7x
EV/EBITDA	NM	NM	51.5x	8.2x	8.2x
EV/EBIT	NM	NM	NM	9.5x	9.7x
P/E (NPAT)	NM	NM	NM	9.2x	9.4x

Performance Ratios	2021A	2022A	2023E	2024E	2025E
ROE	(163.2%)	(507.4%)	(12.3%)	21.6%	17.4%
ROIC	(31.8%)	(28.4%)	(4.0%)	9.5%	8.3%

Cash Flow (A\$m)	2021A	2022A	2023E	2024E	2025E
Net Profit	(12.0)	(11.2)	(0.8)	1.7	1.6
+/- Adjustments	1.9	1.3	1.2	1.1	1.1
+/- Working Capital	(4.3)	6.0	2.4	0.7	(1.3)
+/- Other	12.7	(0.2)	0.0	0.0	0.0
Cash Flow from Operations	(1.7)	(4.1)	2.8	3.4	1.4
Net Capital Expenditure	(0.7)	(0.5)	(0.3)	(0.5)	(0.5)
Purchase of Intangibles	(1.4)	(1.7)	(0.7)	(0.7)	(0.7)
Cash Flow from Investing	(2.1)	(2.2)	(1.0)	(1.2)	(1.2)
Net proceeds from Debt	0.0	0.0	(5.8)	(2.7)	0.0
Changes in Share Capital	0.0	6.6	4.7	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Other Financing Cashflow	(1.1)	(1.0)	0.0	0.0	0.0
Cash Flow from Financing	(1.1)	5.6	(1.1)	(2.7)	0.0
Net Cash Change	(4.9)	(0.7)	0.8	(0.4)	0.3

Balance Sheet (A\$m)	2021A	2022A	2023E	2024E	2025E
Cash	3.1	2.4	3.1	2.7	3.0
Other Current Assets	17.9	13.0	8.7	8.1	9.8
Total Current Assets	21.1	15.4	11.8	10.7	12.7
Property, Plant & Equipment	1.6	1.7	1.5	1.6	1.7
Other Non-Current Assets	7.1	5.5	5.5	5.5	5.5
Total Non-Current Assets	8.7	7.2	7.0	7.1	7.2
Total Assets	29.8	22.6	18.8	17.9	20.0
Equity	31.3	37.7	42.4	42.4	42.4
Reserves	3.0	2.6	2.6	2.6	2.6
Retained Earnings	(27.0)	(38.1)	(38.8)	(37.1)	(35.5)
Total Equity	7.3	2.2	6.1	7.8	9.5
Current Debt	10.0	8.5	2.7	0.0	0.0
Account Payables	1.7	3.1	1.1	1.2	1.6
Other Liabilities (incl. lease)	9.8	8.8	8.8	8.8	8.8
Total Current Liabilities	21.5	20.4	12.6	10.0	10.4
Long-term Debt	0.8	0.0	0.0	0.0	0.0
Provisions	0.1	0.0	0.0	0.0	0.0
Total Non-current Liabilities	0.9	0.0	0.0	0.0	0.0
Total Liabilities	22.4	20.4	12.7	10.0	10.5
Total Equity + Liabilities	29.8	22.6	18.8	17.9	20.0

Source: Evolution Capital estimates

For important information, please see the Disclosure & Disclaimer section at the end of this document.



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All dollar amounts are in Australian dollars unless otherwise specified.



Company Overview

Orbital Corporation Ltd (OEC) is an Australian-based company that designs, develops, and delivers propulsion systems and solutions for a variety of customers in the aviation, defence, and space industries. The company is widely considered to be a global leader in the design and manufacturing of propulsion and fuel systems for both commercial and military UAV applications.

Orbital's expertise in engineering and design has enabled it to develop a range of propulsion systems that are reliable, efficient, and high performing. The company offers UAV engine design, development, production, engineering services, and maintenance and support services.

The company is committed to innovation, quality, and customer satisfaction. It invests heavily in research and development to ensure that its products and services meet the needs of its customers and stay ahead of the competition. Orbital also maintains strong relationships with its customers, working closely with them to understand their specific requirements and provide solutions that meet their needs. The company's commitment to innovation and customer service has made it a leader in the industry and a preferred partner for many commercial and government customers around the world.

History

Designed and developed by Ralph Sarich in the late 1960s, the orbital engine initially sought out to overcome some of the drawbacks faced by traditional engines of the time. The engine composed a central piston that would move orbitally with series of combustion cambers around the inner wall of the cylinder. In 1972, BHP agreed to fund the project and bought 50 percent of the Orbital Engine Company.

However, the experimental engine was not without its drawbacks. Mechanically, the engine suffered from overheating and an inability to lubricate some components. Whilst from a production perspective, the engine had become too complex for mass manufacturing – a key flaw that eventually sunk the initial orbital engine concept.

Following this, Orbital's engineers set to developing direct fuel injection technology and the Orbital Combustion Process (OCP). After some experimentation with direct injection in a modified Suzuki two stroke engine, Sarich took his half of the company public in 1984. Over the following years Orbital struck deals with Mercury Marine, Ford, Volkswagen, and General Motors to supply OCP engines.

However, by the early 1990s Orbital's engine technology was widely considered too unreliable for production vehicles and offered little advantages over the competition. Since then, Orbital has pivoted to developing propulsion systems for UAV applications carrying over the direct fuel injection technology that the company pioneered during its automotive years.

Today, Orbital continues to innovate and provide advanced engine solutions for prime defence contractors in the tactical UAV space. With over 30 years of dedicated engine experience and a team of skilled engineers and technicians, the company remains at the forefront of engine technology and is committed to delivering world class solutions to its commercial and government partners.

Industry Overview

Military Drones

The military drone industry is a rapidly growing sector within the broader defence industry. Military drones, or unmanned aerial vehicles (UAVs), are increasingly being used for a variety of military purposes, including surveillance, reconnaissance, and targeted strikes.

According to the Oxford Economics Country Forecast, the global market for military drones is expected to continue to grow at 14.3% from 2021 to 2026, driven by increasing demand from military and security agencies around the world. This growth is due to several factors, including the increasing threat of terrorism, the need for effective surveillance and intelligence gathering, and the potential for cost savings through automation.

The military drone industry is highly competitive, with multiple companies vying for a share of the market. Key players in the industry include General Atomics, Northrop Grumman, and Boeing, AeroVironment, Textron among others.

In addition to military applications, there are also a growing number of commercial uses for drones, such as in agriculture, infrastructure inspection, and disaster response. This has led to the development of a separate industry focused on the production and sale of commercial drones.

Despite the potential benefits of military drones, there are also concerns around their use, particularly in relation to targeted strikes and civilian casualties. As a result, there is increasing scrutiny around the use of military drones, and it is likely that we will see continued debate and regulation in this area in the years to come.

Military Drone Engines

Military drone engines are a critical component of UAVs. As the use of military drones continues to expand, the demand for reliable and efficient engines has also increased. The military drone engine industry is highly specialized and competitive. Some of the key players in this industry include Orbital, Honeywell Aerospace, and GE Aviation, among others.

These companies specialise in designing and manufacturing engines that can operate in extreme conditions and provide the necessary power-to-weight ratio for effective drone operations. Military drone engines require high levels of precision and reliability, as well as the ability to operate in challenging environments, including extreme temperatures and high altitudes.

Efforts are being made to develop more efficient and environmentally friendly military drone engines, with a focus on reducing fuel consumption and emissions. This is driven in part by the increasing cost of fuel and the growing awareness of the environmental impact of aviation.

Overall, military drone engines play a critical role in the performance and effectiveness of military drones, and the industry is likely to continue to innovate and improve in the coming years as demand for drone technology increases.

NATO Single Fuel Policy

The NATO Single Fuel Concept (SFC) is a policy that aims to streamline and simplify the logistics and operational processes for fuel supply within the North Atlantic Treaty Organization (NATO). The policy requires all NATO forces to use

a single type of fuel, specifically NATO F-34 (also known as JP-8), in military aircraft, ground vehicles, and other equipment.

Throughout the 1970s NATO air forces began to substitute the kerosene-based fuel F-40 with a safer, less flammable fuel F-34 (with F-34 being based on the widely available civil aircraft fuel, Jet A-1). In 1986, an agreement was reached to establish the SFC and standardise the use of F-34 fuel by NATO forces. The SFC did not include maritime vehicles, which continued to rely on F-76 (Naval Distillate) as the primary fuel throughout NATO naval vessels.

The use of F-34 had several key advantages over existing fuels at the time. With regards to technical advantages, F-34 is less prone to microbiological pollution and allows for improved stability in storage, has a lower freezing point, and posed a lower ignition risk compared to gasoline and F-40. In terms of economics and logistics, the SFC allowed for simplified supply chains and dramatically reduced infrastructure and transport costs.

However, the SFC is not without its drawbacks. By requiring the use of one fuel, there is little incentive to experiment with alternative fuels in large scale and has led to a significant bias against overhauling existing equipment and infrastructure in favour of an F-34 alternative. Despite this, the U.S. Department of Defence (DoD) has been experimenting with hybrid technology, synthetic fuels, ammonia-based fuels, nuclear power, and hydrogen as potential alternatives, however, these have yet to be deployed in quantity.

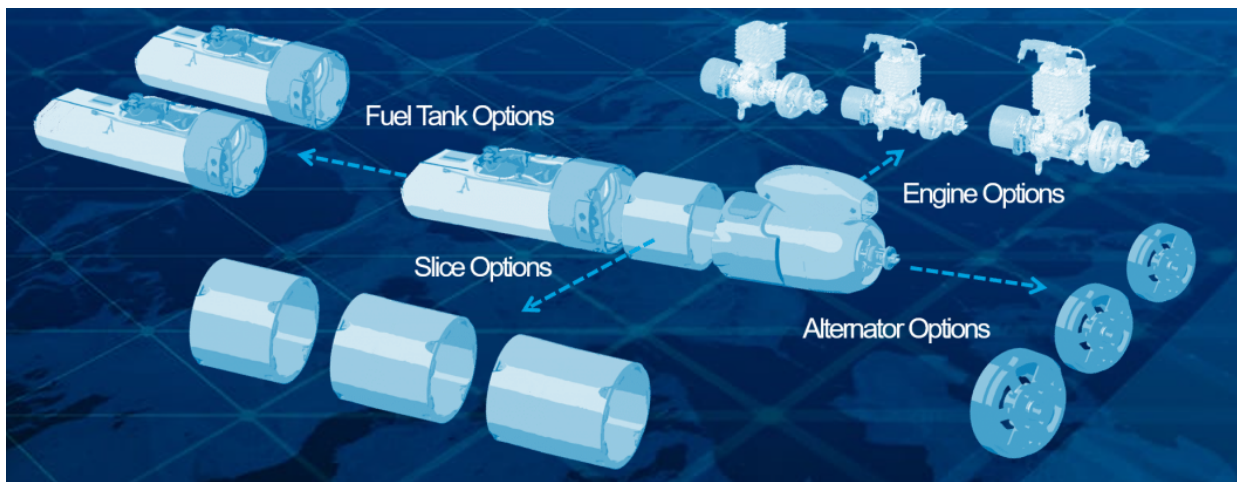
Despite these drawbacks, the U.S. DoD continues to place an emphasis on all military aircraft aligning to the established single fuel policy.

Orbital's propulsion and fuel injection solutions are particularly well-suited to heavy fuel, compared to competitors which have traditionally focused on standard non-military fuel types. As such, we believe Orbital will continue to maintain its competitive advantage due to its heavy fuel technology over the medium and longer-term time horizons.

Product Offering & Competitive Advantage

Orbital offers world class UAV engine development, testing, validation, production, and refurbishment services at both their Western Australian and Oregon based facilities. The company specialises in the production of Modular Propulsion Solutions (MPS) that can be customised to fit a multitude of customer requirements. By focussing on modular systems, Orbital can offer an unrivalled range of fuel tanks, engines, alternators, and overall sizes, providing a strategic advantage over competitors. Additionally, the firm's in-house design, development, and production capabilities have led to reduced lead times, strong quality controls, and flexibility unmatched by competitors.

Exhibit 1: Stylised Modular Propulsion Solution



Orbital's flagship direct fuel injection system, FlexDI™, is a multi-fuel system designed to provide advanced spark ignition for UAV engines including gasoline, and military grade JP-5 (F-44), JP-8 (F-34), and Jet A. With FlexDI™, Orbital has been able to achieve improved atomisation of fuel droplets (8µm compared to 120µm with traditional port injection) to produce increased fuel surface area and improved vaporisation. In addition to this, a spray guided, stratified charge combustion system further enhances engine performance. This makes Orbital's engines particularly well suited to work with NATO F-34 heavy fuel.

In particular, when packaged with FlexECU™, Orbital's engines are;

- Up to 40% more fuel efficient,
- Provide up to 500hrs between overhaul (compared to ~50hrs), and
- Able to cold start in 2 minutes (compared to 20 minutes).
- Additionally, Orbital engines have passed the U.S. FAR33.49 engine endurance test back-to-back three times.

As such, the company's competitive advantage lies in its unique expertise for developing innovative, reliable, and highly customisable, engines.



Exhibit 2: Boeing Insitu integrator



Exhibit 3: Textron Aerosonde® SUAS



Exhibit 4: AeroVironment JUMP@20



Exhibit 5: Skyways V2.6

Customers & Future Opportunities

Contracted Work / Production Phase

Insitu Inc (USA) & Insitu Pacific Pty Ltd (Australia), Boeing subsidiaries: Insitu is a world leader in the supply of tactical Uncrewed Aircraft System (UAS) to military, civil and commercial customers. They provide a range of systems, including the ScanEagle, Integrator and Blackjack and have multiple contracts with US and allied defence forces. Orbital has two different engine models in production for Insitu to service the company's fleet of UAVs. In March 2022, Insitu Pacific was announced as the preferred supplier to the Australian Defence Force (ADF) for its new tactical UAS under the Land 129 Phase 3 program.

Textron Systems: is a US-based company that provides a range of defence and aerospace products and services, and is one of the world's largest suppliers of tactical UAVs. The firm's RQ-7B Shadow UAV system is the current standard reconnaissance and target acquisition drone operated by the United States, Australia, Italy, Sweden, Turkey, and Romania. In March 2021, Orbital signed an initial 5-year agreement (with the option to extend to 10-years) to develop an engine, followed by another agreement in October 2021 to develop upgrades for Textron's existing fleet of UAV engines. Under these agreements, Orbital will develop engines for Textron's Aerosonde platform – a frontrunner in the U.S. Army's FTUAS program.

Major Singaporean Customer: In July 2022, Orbital signed a A\$3.5 million contract with a leading Singaporean defence contractor to further design, develop, and verify three prototype engine systems set to be delivered in FY23. As of March 2023, the Orbital has signed a \$2m continuation contract with its Singaporean customer to take the design and development phase of the program through to completion, with production scheduled to commence in the first half of FY24.

Engine Development Programs

AeroVironment Inc: Founded in 1971, AeroVironment engages in the design, development, and manufacturing of unmanned aircraft systems, unmanned ground systems and tactical missile systems. The company is widely considered to be a global leader in UAS technology, recently acquiring Arcturus UAV in 2021. In September 2022, Orbital announced a contract to provide AeroVironment with a heavy fuel engine for testing for the JUMP@20 – a leading candidate in the U.S. Army's FTUAS program..

Animal Dynamics: is a UK-based uncrewed aerial logistics company specialising in heavy lift parafoil vehicles. In December 2022, Orbital signed an MoU to explore an advanced propulsion system for Animal Dynamic's flagship UAS, the Stork-STM. Under the MoU, Orbital and Animal Dynamics are exploring engine concepts for extreme environments and capable of lifting 135kg up to 400km. In March 2022, Animal Dynamics was selected to participate in the next phase of the Royal Navy's UAS Heavy Lift Challenge with its Stork STM parafoil UAV.

Skyways: Founded in 2017, Skyways is an emerging leader in the unmanned cargo transport space, recently being selected to provide a UAS prototype for the US Navy's Blue Water Unmanned Aircraft System (BWUAS) program. BWUAS has the objective of accelerating the identification and evaluation of UAS capable of performing autonomous logistical replenishment from shore-to-ship, ship-to-ship, and ship-to-shore. Under a recently signed MoU, Orbital will deliver a pre-production heavy fuel engine to Skyways, before being returned to Orbital for evaluation. While the MoU does not have a current material impact, the

partnership represents a key opportunity for Orbital to further diversify its revenue streams.

Anduril Industries: Founded in 2017, Anduril is a defence product company that specialises in force protection, AI powered systems, and autonomous air and naval systems. The company has secured a US\$1 billion contract with the U.S. Special Operations Command and has recently expanded into Australia. In May 2022, a MoU was signed, with Orbital providing an engineering team to work on an engine upgrade pathway. Orbital UAV expects to be contracted and complete this development work in the second half of FY23. At this time both Anduril and Orbital UAV will evaluate the potential production responsibilities and volume requirements of the engine.

In summary, Orbital has a diverse range of customers, including several prominent leaders in the aerospace and defence sector. With these established relationships, Orbital has been able to compete for some of the largest defence mandates worldwide, furthering its position as the de facto market leader in military drone propulsion technology.



Exhibit 6: L3 Harris FVR-90



Exhibit 7: General Atomics MQ-9B



Exhibit 8: Northrop Grumman Bat

Potential Future Partners

L3Harris Technologies, Inc. (Revenue US\$17.0b, MCap US\$37.3b): engages in the provision of defence technology, covering land, sea, air, space, and cyber warfare. With regards to its UAV solutions, L3Harris operates the VTOL-capable FVR-90 platform.

General Atomics Aeronautical Systems, Inc. (Revenue US\$ 86.6m): is a US-based company that provides a range of aerospace and defence products and services, including the MQ-9A Reaper, MQ-9B SkyGuardian, and the Avenger platforms.

Shield AI, Inc. (Revenue US\$ 35.3m): is a US-based company that develops intelligent systems for use in the defence industry. Since its founding in 2015, the company has provided the first and only autonomous AI pilot deployed in combat, and developed various AI enabled UAV systems. The company's flagship V-Bat represents a potential clean sheet engine design program moving forward.

Lockheed Martin (Revenue US\$65.9b, MCap US\$121.2b): is a US-based global security and aerospace company, which engages in the research, design, development, manufacture, and serving of various military systems. The company is major supplier to the U.S. Government, with 64.0% of revenues coming from U.S. contracts. Additionally, the company has a growing portfolio of UAVs, including the flagship, VTOL-capable, Stalker VXE30.

Raytheon Technologies (Revenue US\$67.1b, MCap US\$145.2b): is a US-based aerospace and defence company that operates through four main segments: Collins Aerospace Systems, Pratt and Whitney, Raytheon Intelligence systems, and Raytheon Missiles and Defence. With regards to UAV technology, the firm currently produces the Coyote counter-UAS system – a tube launched unmanned aircraft designed to identify and eliminate UAVs. However, the firm does not have any active UAV engine development programs.

Northrop Grumman (Revenue US\$36.6b, MCap US\$152.6b): is a US-based company that provides a range of aerospace and defence products and services, including propulsion systems and engines. The company currently operates the jet engine based MQ-4 Triton and RQ-4 Global Hawk for the US Air Force, and the heavy fuel based Bat unmanned air system.

Financial Projections

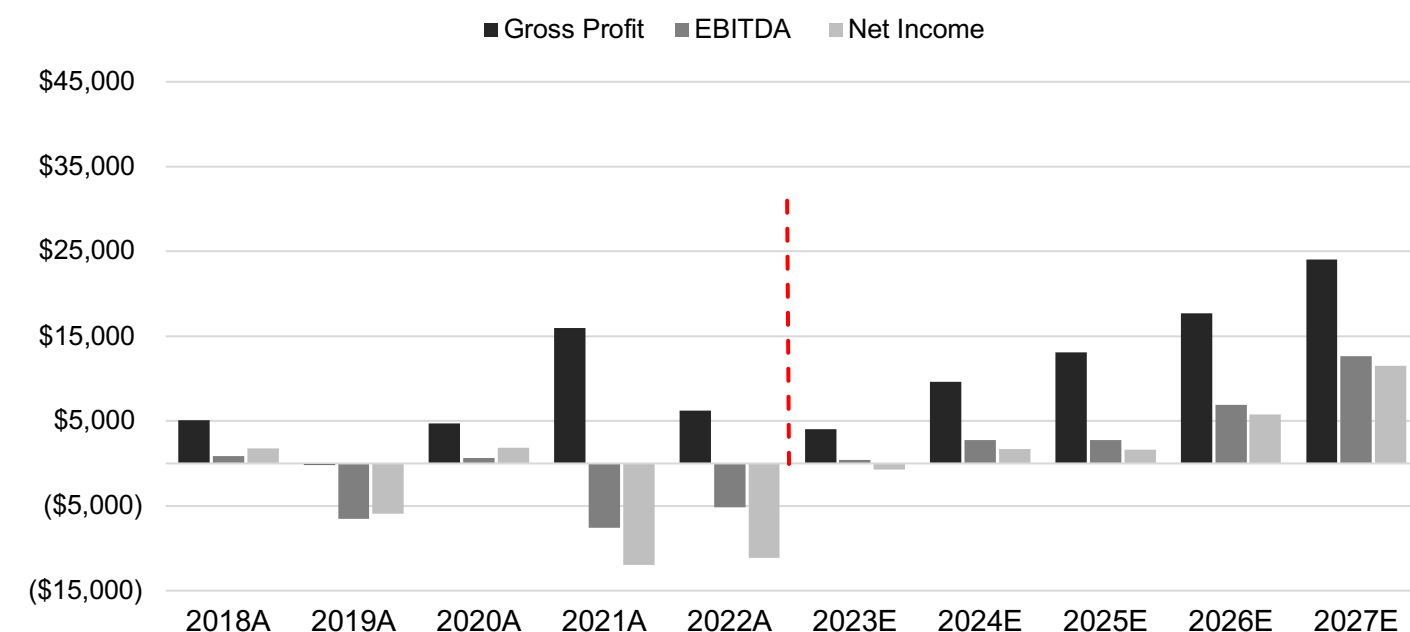
Despite a large decline in full year revenue in FY22, we believe Orbital is set to embark on a renewed period of significant growth fuelled by a steady adoption of Orbital's modular systems and an increasingly diversified customer base spanning both the military and commercial UAV sectors. Our financial projections are aligned with management's short-term guidance, with headline sales revenue estimated to reach \$17.5m in FY23 (\$23.3m after government grant revenue), and profitability set to be achieved by 2024 under our base case assumptions. Beyond FY25, our forecasts are aligned with management's aspirations to reach \$60m in revenue by FY27 (20% of the UAV engine market).

Importantly, the return to profitability and future growth forecast imply that the Company will not need to raise equity as the business will be self-funding. This typically is a key turning point for companies and provides a re-rating opportunity for the shares.

Figure 1: Headline Financial Figures

	2021A	2022A	2023E	2024E	2025E	2026E	2027E
Total Sales	31,202	15,695	17,506	24,022	32,721	44,344	60,062
Total Income	31,202	18,238	23,306	27,022	32,721	44,344	60,062
EBITDA	(9,163)	(6,142)	(74)	2,378	2,333	6,440	12,166
NPAT	(11,982)	(11,158)	(754)	1,693	1,648	5,756	11,482
Cash	3,116	2,363	3,132	2,699	2,968	7,142	16,760

Figure 2: Illustrative Revenue, EBITDA, Net Income Chart (Base Scenario)



Regarding projected revenues, we have forecast an initial 17.0% decrease in production engine sales in FY23, followed by sharp rise (35% growth predicted) in FY24 as the firm's existing engine development customers transition to engine production customers. This trend is expected to continue over subsequent years, gradually increasing to \$27.5m in FY27. In addition to this, we have estimated a 12.5% decrease in engine development and engineering work revenue for FY23, followed by significant revenue growth expected to leading up to FY27 (totalling \$17.6m). There is also a predicted increase in revenues derived from the company's maintenance / engine overhaul program, which we expect to grow to \$8.8m in revenue by FY27.

Additionally, as of 22 March, the firm was granted \$3m by the Western Australian Government for achieving its agreed performance milestones under its legacy government loan. The company expects the remainder of this loan to be forgiven by December 2024, and this has been reflected in the financial projections.

The company's gross margin is expected to initially decrease because of the company's engine cancellation settlement with Insitu and attempts to recover development costs. However, we expect gross margins to return to ~40.0% across the forecast period, while SG&A expenses are expected to remain fixed after an initial decline of 32.5% under the base case scenario.

Given the company's large accumulated losses, it has been assumed that Orbital will not pay taxes until 2030, after which the firm will pay 25% in tax (a result of blending its estimated US and Australian tax liabilities)

For the forecasted cash balance, we have assumed Orbital will accrue all cash on the balance sheet after meeting its capital expenditure targets. Whilst we would normally anticipate capital management initiatives including the payment of dividends, this is currently outside of the forecast period.

Valuation

Our base case valuation is predominately based on a detailed 10-year discounted free cash flow model (DCF) and further supported by two sets of FY24 forward trading multiples from the domestic defence and large cap defence & aerospace sectors. The model assumed a conservative weighted average cost of capital (WACC) of 15.0%, and a terminal growth rate (TGR) of 2.50%. Under each of the valuation scenarios, a $\pm 1\%$ change in WACC and TGR formed the basis of their respective DCF ranges. The forward multiples provided in the comparable analysis were constructed using consensus estimates for both pools. However, due to the lack of direct listed competitors and comparable companies, we chose to favour the DCF model over a comparable analysis for valuation.

A summary of the various valuation methods and market reference points can be found in the charts below:

Figure 3: Illustrative Valuation Summary

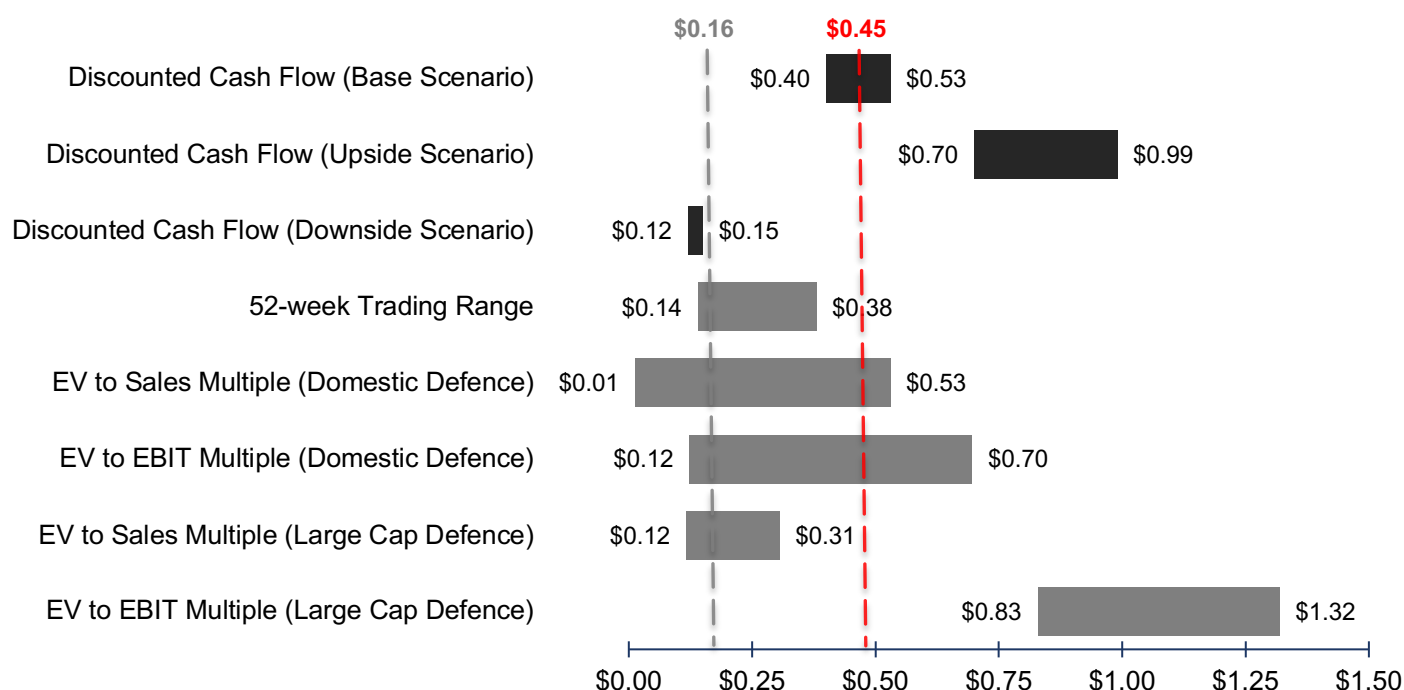


Figure 4: Valuation Sensitivity Table (Base Scenario)

		OEC Share Price				
		Perpetual growth rate				
		1.5%	2.0%	2.5%	3.0%	3.5%
WACC	14.0%	0.48	0.49	0.50	0.51	0.53
	14.5%	0.46	0.47	0.48	0.49	0.50
	15.0%	0.43	0.44	0.45	0.46	0.47
	15.5%	0.41	0.42	0.43	0.44	0.45
	16.0%	0.40	0.40	0.41	0.42	0.43

Investment Risks

Failure to retain existing clients and attract new customers: Failure to attract new customers whilst retaining its existing partnerships and production programs would severely impact the company's future revenues and its ability to achieve a profit by FY24. Additionally, the reputational damage suffered by the loss of existing contracts would greatly setback Orbital's customer diversification strategy moving forward.

In-house engine development programs from larger competitors: Competition from larger defence contractors in the UAV engine development space would likely weaken Orbital's position as the market leader in engine design and production. Given the size of these large-cap defence contractors, an expansion into the production of proprietary engines would pose a significant threat to Orbital's ability to secure significant contracts with the likes of the U.S. and Australia.

Failure to convert development work into production revenues: As stated in the company's FY22 Annual Report, Orbital believes that its various development programs will transition into revenue generating production lines within the next 18-24 months. With this lag between development and production in mind, any changes in the global UAV landscape or engine specifications have the potential to affect Orbital's planned development cycle and its future production revenue.

Failure to scale up production: Given the importance of supply chain management in recent years, it is vital Orbital can secure materials and is prepared to scale up its production to meet its future production commitments from an increasingly large customer pool. Failure to do so would result in a backlog of orders and negatively impact the firm's future revenue streams.

Changing fuel requirements for UAV engines: Although NATO and its allies have no official plans or timeline to replace the Single Fuel Concept, there has been an increasing demand for the use of alternative fuels in the defence sector. Experimentation with various biofuels, hydrogen, hybrid, and fully electric powered systems is likely to increase in the coming years, and as such, Orbital may have to invest heavily in R&D in order to respond to the changing demand.

Appendix

Orbital Corporation Management & Board



John Welborn

Chairman | Non-Executive Director

John Welborn is an industry leader with extensive experience in the resources sector as a senior executive and in corporate management, finance and investment banking. John is currently Managing Director & CEO of Equatorial Resources Limited and a Non-Executive Director of Apollo Minerals Limited. He was previously the Head of Specialised Lending in Western Australia for Investec Bank. As a Director and Chief Executive, he has been responsible for driving growth in a number of ASX listed companies.

John is a Chartered Accountant with a Bachelor of Commerce degree from the University of Western Australia and is a Fellow of the Institute of Chartered Accountants in Australia, a Fellow of the Australian Institute of Management and is a member of the Australian Institute of Mining and Metallurgy and the Australian Institute of Company Directors.

In addition to his extensive corporate career, Mr Welborn is a former Wallaby Rugby player, Director of Rugby WA Ltd and Commissioner of Tourism in Australia.



Steve Gallagher

Non-Executive Director

Steve is Principal of Agere Pty Ltd, an advisory and investment company drawing on his capability and professional networks established over 30 years as a CEO and Director of global businesses.

Steve held Director positions with HKEX Hang Seng listed CCRTT, ASX listed ERG Ltd and CEO/GM positions with Vix Technology and global engineering powerhouse Siemens. He has operated in various business sectors including Industrial Automation, Building Technology and Power Systems, having spent 15 years living and working in Asia (China, Hong Kong and Singapore) and Europe (Switzerland).

Steve is currently a Non-Executive Director with Optal Ltd (an innovative global payment solutions company), Vix Technology Ltd (an industry leader in transport ticketing, fare collection/payments), Ventura Bus Lines Pty Ltd (a leading public transport and charter bus service provider in Australia) and Transact1 Pty Ltd (a financial services provider for cash management optimisation).

Steve holds a Bachelor of Engineering (Honors) degree from the University of Melbourne and a Bachelor of Commerce degree majoring in marketing from Monash University, and is a member of the Australian Institute of Company Directors



Kyle Abbott

Non-Executive Director

Kyle joined the Orbital Board as a Non-Executive Director on 1 May 2018.

Kyle is an experienced aerospace and defence industry executive who brings vast relevant experience to the Board of Orbital. Kyle was Managing Director of Western Australian Specialty Alloys (WASA) from 1996 to 2015. During this period, WASA grew from a Western Australian specialised alloy manufacturer to become a major supplier to the global aerospace industry with key customers in the United States, the United Kingdom, and Japan.

In 2000, Kyle managed the successful sale of WASA to United States based Precision Castparts Corporation (PCC), an S&P 500 company. PCC was subsequently acquired by Berkshire Hathaway in 2015.



Todd Alder

Managing Director & CEO

Todd has a strong background in financial and corporate services management in the mining, steel manufacturing and energy industries. His previous role was Chief Financial Officer and Company Secretary at Toro Energy Limited where he was responsible for financial and management accounting, company secretarial functions, investor relations and information technology. Todd has also worked with Capgemini Consulting (previously Ernst & Young) and Origin Energy Limited.

Todd is a qualified CPA and holds a Bachelor of Economics and Accounting Degree from Flinders University in South Australia as well as a Graduate Diploma in Applied Corporate Governance through Chartered Secretaries Australia.



Thomas Spencer

CFO & Company Secretary

Thomas was appointed as Chief Financial Officer and Company Secretary in November 2022. He is a senior finance executive with experience in structuring private and public organisations for growth with scalability.

A qualified CPA with a Bachelor of Business Accounting & Information Systems, Thomas has held previous CFO roles at ASX-listed NeuroScientific Biopharmaceuticals and investment and private equity company Macrae Investments.

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