

Australian Equity Research

17 May 2017

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HOLD

unchanged

PRICE TARGET A\$2.50↑

from A\$2.36

Price (17-May) A\$2.35

Ticker CDA-ASX

52-Week Range (A\$):	0.53 - 1.65
Avg Daily Vol (000s) :	300.0
Market Cap (A\$M):	417
Shares Out. (M) :	177.1
Dividend /Shr (AUC):	3.5
Dividend Yield (%) :	148.9
Net Debt (Cash) (A\$M):	(20)
Enterprise Value (A\$M):	396
Cash (A\$M):	20.0
Long-Term Debt (A\$M):	0.0

FYE Jun	2016A	2017E	2018E	2019E
Sales (A\$M)	169.5	220.5↑	200.5↑	217.0
Previous	-	183.1	194.1	-
EBITDA (A\$M)	41.9	74.3↑	54.4↑	57.1
Previous	-	61.3	52.1	-
Net Income Adj (A\$M)	21.1	44.5↑	30.0↑	32.7
Previous	-	35.0	28.5	-
EPS Adj&Dil (AUC)	11.9	25.1↑	16.9↑	18.5
Previous	-	19.8	16.1	-
DPS (AUC)	6.00	10.00	8.00	9.00
P/E (x)	19.7	9.4	13.9	12.7
EV/EBITDA (x)	10.2	5.1	6.8	6.2
Div. Yield (%)	2.6	4.3	3.4	3.8



Source: FactSet

Priced as of close of business 17 May 2017

CDA designs and manufactures a range of electronic products including radio communication products, metal detection products and mining technology

Raising Target Price

Detecting another upgrade

CDA has upgraded FY17 NPAT guidance by 27% from ~\$35m to ~\$44m driven largely by continued strength in gold detector sales into Africa. The guidance implies a similar NPAT in 2H17 as reported in 1H17 (\$22.2m) but the outlook statement noted that gold detector sales so far in 2H17 had already exceeded 1H17, suggesting that there may be some longevity to demand and that there is also some upside to the guidance should momentum continue into May and June. We have increased our FY17 and FY18 EPS estimates by 27% and 5% respectively and our Target Price to \$2.50 per share. We retain our HOLD rating.

Key points

Metal detection – Metal Detection sales for 10 months ended 30 April 2017 (YTD) are 52% higher than the pcp to \$124m. The main driver has been an increase in demand for gold detecting equipment in Africa as customers upgrade from the GPX range. Pleasingly, management noted that (i) the demand is not being driven by gold surges in isolated markets and (ii) Sales into first world consumer markets has also performed well. Both of these factors suggest there could be some sustainability to demand.

Communications – Radio Communications sales YTD were around \$61m, up 6% on the pcp. This is a good result in our view given we are cycling a reasonably good year. We had been expecting sales to be mildly down in FY17 on the pcp but the update suggests that they should comfortably beat the pcp by 5-10%.

Outlook commentary – The outlook commentary was strong with the company stating its base line business is revenue of \$160m-\$180m and NPAT of \$20-\$25m. This equates to \$40-45m EBITDA and is a material lift from what we had considered it to be previously of \$30-35m. This says to us that management is seeing a change in the sustainability of sales as well as a decent lift in the margin, which is being driven by a mix shift to the GPZ7000.

Still some upside still from here we think – One of the things that stood out in the business update was the comment that 2H17 gold detector sales have exceeded 1H17, yet with 2 months to go, guidance for 2H17 is only meeting profitability in 1H17 at the NPAT level. This suggests there's some upside should strong demand continue in May/June.

Earnings changes

We have upgraded our EPS estimates for FY17 and FY18 to 25.1c and 16.9c respectively, with FY18 estimates reflecting the expectation that metal detection sales will moderate.

Valuation and recommendation

We have upgraded our Target Price on CDA to \$2.50 per share (\$2.36 previously). This is based on a FY18 7.5x EBITDA multiple (20% discount to the Small Industrials average). We reiterate our HOLD rating. We continue to retain a positive view on CDA. With management indicating that the base line business is increasing and guidance appearing somewhat conservative, we believe there is a strong likelihood of an upgrade in FY17 and potentially an upgrade to our estimates in FY18 in time. Also with cash of \$20m as at 30 April, which is likely to grow, the company is in an enviable position to

grow the business via acquisition, which could lift the base line business and improve predictability.

Codan Limited

Year end 30 June

Profit & Loss (\$m)						Valuation ratios					
	2015A	2016A	2017F	2018F	2019F		2015A	2016A	2017F	2018F	2019F
Sales Revenue	143.9	169.5	220.5	200.5	217.0	EPS (cps)	7.2	11.9	25.1	16.9	18.5
EBITDA	29.9	41.9	74.3	54.4	57.1	P/E (x)	32.8	19.7	9.4	13.9	12.7
Depreciation	-2.7	-2.3	-2.8	-2.8	-2.8	PER Rel - All Ind.	61%	-6%	-54%	-27%	-27%
EBITA	27.2	39.6	71.5	51.6	54.4	PER Rel - Small Ind.	78%	8%	-51%	-22%	-25%
Amortisation	-7.9	-10.4	-11.2	-11.9	-12.2	Enterprise Value (\$m)	451.7	428.9	382.6	368.5	355.8
EBIT	19.3	29.2	60.3	39.7	42.2	EV / EBITDA (x)	15.1	10.2	5.1	6.8	6.2
Net Interest Expense	-2.5	-1.7	-0.5	0.4	1.5	EV / EBIT (x)	23.4	14.7	6.3	9.3	8.4
NPBT	16.8	27.5	59.7	40.1	43.7	DPS (cps)	3.5	6.0	10.0	8.0	9.0
Tax expense	-4.1	-6.4	-15.2	-10.1	-11.0	Dividend Yield (%)	1.5%	2.6%	4.3%	3.4%	3.8%
NPAT - underlying	12.7	21.1	44.5	30.0	32.7	Franking (%)	100%	100%	100%	100%	100%
Significant items	-0.3	-5.6	0.0	0.0	0.0	CFPS (cps)	17.3	27.0	37.5	20.6	25.9
Reported NPAT	12.4	15.5	44.5	30.0	32.7	P / CFPS (x)	13.6	8.7	6.3	11.4	9.1
Cash Flow (\$m)						Profitability ratios					
	2015A	2016A	2017F	2018F	2019F		2015A	2016A	2017F	2018F	2019F
Operating EBITDA	29.9	41.9	74.3	54.4	57.1	EBITDA Margin (%)	20.8	24.7	33.7	27.1	26.3
- Interest & Tax Paid	-5.8	-5.8	-6.9	-14.8	-8.6	EBIT Margin (%)	13.4	17.2	27.3	19.8	19.5
+/- change in Work. Cap.	3.5	9.4	-0.5	1.6	-1.3	ROE (%)	9.9	15.2	22.7	14.1	14.3
- other	3.0	2.4	-0.5	-4.6	-1.3	ROA (%)	9.6	14.7	28.4	18.8	19.5
Operating Cashflow	30.7	47.9	66.4	36.6	45.9	ROIC (%)	9.5	16.4	27.7	18.1	19.0
- Capex	-12.9	-12.0	-15.0	-12.0	-12.0	Balance Sheet ratios					
- Acquisitions/divestments	1.9	-4.7	-5.0	-5.0	-5.0		2015A	2016A	2017F	2018F	2019F
- other	-2.4	-1.5	-1.5	-1.5	-1.5	Net Debt (cash)	35.4	12.6	-33.7	-47.8	-60.5
Free Cashflow	17.2	29.8	44.9	18.1	27.4	Net Gearing (%)	27.6	9.1	-17.2	-22.4	-26.5
- Ord Dividends	-5.3	-7.1	-13.1	-16.5	-14.7	Interest Cover (x)	7.6	17.2	110.0	-99.3	-28.1
- Equity/other	0.0	0.0	0.0	0.0	0.0	NTA per share (\$)	0.22	0.29	0.64	0.73	0.82
Net Cashflow	11.9	22.7	31.8	1.6	12.7	Price / NTA (x)	10.6	8.1	3.7	3.2	2.9
Cash at beginning of period	13.0	7.2	14.3	46.2	47.8	EFPOWA (m)	177.1	177.1	177.1	177.1	177.1
+/- borrowings / other	-17.8	-15.5	0.0	0.0	0.0	Growth ratios					
Cash at end of period	7.2	14.3	46.2	47.8	60.5		2015A	2016A	2017F	2018F	2019F
Balance Sheet						Sales revenue (\$m)	8.8%	17.8%	30.1%	-9.1%	8.2%
	2015A	2016A	2017F	2018F	2019F	EBITDA (\$m)	32.2%	40.1%	77.4%	-26.8%	5.0%
Cash	7.2	14.3	46.2	47.8	60.5	EBIT (\$m)	42.3%	51.0%	106.4%	-34.1%	6.3%
Inventories	31.3	28.5	28.7	26.1	28.2	NPAT (\$m)	68.0%	66.1%	110.9%	-32.6%	9.0%
Debtors	20.4	19.1	22.1	20.1	21.7	EPS (cps)	67.8%	66.1%	110.9%	-32.6%	9.0%
PPE	16.0	10.8	25.3	25.1	24.8	DPS (cps)	16.7%	71.4%	66.7%	-20.0%	12.5%
Intangibles	89.3	87.6	84.6	85.8	86.9	Interim Analysis					
Other assets	44.5	52.1	51.3	54.6	54.9		1H15A	1H16A	2H16A	1H17A	2H17E
Total Assets	208.7	212.5	258.1	259.5	277.1	Revenues	68.2	64.9	104.6	103.9	116.6
Borrowings	42.5	26.9	12.5	0.0	0.0	EBITDA	13.7	14.7	25.7	37.5	36.9
Trade Creditors	25.2	30.4	33.1	30.1	32.5	EBITDA margin (%)	20.1%	22.7%	24.6%	36.1%	31.6%
Other Liabilities	12.6	16.2	16.2	16.2	16.2	EPS	3.4	3.9	8.0	12.5	12.6
Total Liabilities	80.3	73.5	61.7	46.2	48.7	DPS	1.5	2.0	4.0	6.0	4.0
NET ASSETS	128.4	138.9	196.4	213.2	228.4	Valuation					
Board of Directors / Substantial Shareholders							2018				
Board of Directors						Normalised EBITDA multiple (x)					
	Shareholding										
David Simmonds - Chairman	0.0					EBITDA (\$m)					54.4
Donald McGurk - Managing Director	0.8					Target EBITDA multiple (x)					7.5
Peter Griffiths - Non-Executive Director	0.1					Net Debt (cash) (\$m)					-33.7
David Klingberg - Non Executive Director	0.1					Implied Valuation					442.8
Brian Burns - Non-Executive Director	0.0					Per Share					2.50
James McDowell - Non-Executive Director	0.0					Target PE Multiple					
Lt Gen Peter Leahy - Non Executive Director	0.4					EPS (c)					16.9
Graeme Barclay - Non Executive Director	0.0					PE Target (x)					14.7
Substantial Shareholders						Per Share					2.50
	Shareholding										
IB Wall and PM Wall (Founder)	34.8										
Starform Pty Ltd	11.4										
Griffina Pty Ltd	10.6										
Otterpaw Pty Ltd	10.6										
A.J Wood	10.6										
JP Morgan Trus Co (SJ Wood)	10.6										
Top 20 Shareholders	109.6										

Source: Canaccord Genuity

Business update – earnings upgrade

- **Guidance upgraded** – CDA has provided a business update upgrading FY17 NPAT guidance by 27% from ~\$35m to ~\$44m. The guidance implies a similar NPAT in 2H17 as reported in 1H17 (\$22.2m). The key driver has been the continued strength in gold detector sales into Africa. The Communications division has also performed well and looks likely to beat the expectation of a flat year on the pcp.
- **Metal detection** – Metal Detection sales for 10 months ended 30 April 2017 are 52% higher than the pcp to \$124m. The main driver has been an increase in demand for gold detecting equipment in Africa as customers upgrade from the GPX range. Pleasingly, management noted that (i) the demand is not being driven by gold surges in isolated markets and (ii) Sales into first world consumer markets have also performed well. Both of these factors suggest there could be some sustainability to demand.
- **Communications** – Radio Communications sales for the 10 months to 30 April 2017 were around \$61m, up 6% on the pcp. This is a good result in our view given we are cycling a reasonably good year. We had been expecting sales to be mildly down in FY17 on the pcp but the update suggests that they should comfortably beat the pcp by 5-10%.
- **Tracking solutions** – The guidance implies sales for the 10 months to 30 April of \$6m, which implies \$1.9m in the 4 months to April and compares to \$4m in 1H17. We are forecasting \$4m revenue in 2H17.
- **Outlook commentary** – The outlook commentary was strong with the company stating its base line business is revenue of \$160m-\$180m and NPAT of \$20-\$25m. This equates to \$40-45m EBITDA. Which is a material lift from what we had considered it to be previously of \$30-35m. This says to us that management is seeing a change in the sustainability of sales as well as a decent lift in the margin, which is being driven by a mix shift to the GPZ7000.
- **Still some upside still from here we think** – Probably one of things that stood out in the business update was the comment saying that gold detector sales so far in 2H17 have exceeded 1H17, yet with 2 months to go, guidance for 2H17 is only meeting profitability in 1H17 at the NPAT level. This suggests there's some upside should strong demand continue in May and June. It's either that or margins have declined but given the volume increase it's more likely that margins have increased and management has kept a bit of room in the numbers for a beat in August when it release its full year results.

Changes to forecasts and valuation

- We have made a number of changes to our forecasts to reflect the better performance across Metal Detection and Communications.
- We have upgraded our EPS estimates for FY17 and FY18 to 25.1c and 16.9c respectively with FY18 estimates reflecting the expectation that metal detection sales will moderate.

- Our FY17 estimates more or less reflect guidance at the NPAT level, while the small upgrade to FY18 reflects the expectation that the strong momentum currently will feed into 1Q18.
- We outline our changes in Figure 1 below.

Figure 1: Forecast changes

(\$M)	FY17			FY18		
	Old	New	% Change	Old	New	% Change
Communications	63.7	69.9	9.8%	71.9	71.9	0.0%
Metal Detection	111.5	142.8	28.0%	112.3	118.7	5.7%
Mine Technology	8.0	8.0	0.0%	10.1	10.1	0.0%
Total Revenue	183.1	220.5	20.5%	194.1	200.5	3.3%
EBITDA (\$m)	61.3	74.3	21.4%	52.1	54.4	4.4%
Underlying NPAT	35.0	44.5	27.1%	28.5	30.0	5.1%
EPS (¢) –normalised	19.8	25.1	27.1%	16.1	16.9	5.1%
DPS (¢)	10.0	10.0	0.0%	8.0	8.0	0.0%
EBITDA margin (%)	33.5%	33.7%		26.8%	27.1%	

Source: Company reports

Outlook and recommendation

- We have upgraded our Target Price on CDA to \$2.50 per share (\$2.36 previously). This is based on a FY18 7.5x EBITDA multiple (20% discount to the Small Industrials average).
- We continue to retain a positive view on CDA. With management indicating that the base line business is increasing and guidance appearing somewhat conservative, we believe there is a strong likelihood of an upgrade in FY17 and potentially an upgrade to our estimates in FY18 in time.
- Also with cash of \$20m as at 30 April, which is likely to grow, the company is in an enviable position to grow the business via acquisition, which could lift the base line business and improve predictability.
- We retain our HOLD rating.

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Investment Recommendation

Date and time of first dissemination: May 17, 2017, 16:30 ET

Date and time of production: May 17, 2017, 09:01 ET

Target Price / Valuation Methodology:

Codan Limited - CDA

Our \$2.36 Target Price is based on a FY17 EV/EBITDA of 7.5x, which is a 20% discount to the Small Industrials average.

Risks to achieving Target Price / Valuation:

Codan Limited - CDA

CDA is exposed to a number of risks including: Counterfeit product: CDA's metal detection products have been subject to counterfeit product. CDA has been countering this by applying a number of security initiatives unique to CDA's products. If CDA is not successful minimising counterfeit product is could impact on demand and margins. Gold price: Increases or decreases in the gold price could impact demand for CDA's gold detection products, a key driver of group profitability. Our view is that the gold price would need to move significantly lower for demand to be impacted. Competition: CDA's success is based around having market leading products in HF Radio Communications and Metal Detection. A superior product on the market by a competitor would have an impact on the demand for CDA's products. Acquisition risk: CDA acquired 2 small businesses in FY12 and further acquisitions are part of the company's strategy. If acquisitions are poorly integrated or the company overpays, then this would impact on the company's earnings.

Distribution of Ratings:

Global Stock Ratings (as of 05/17/17)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	575	60.59%	39.13%
Hold	276	29.08%	19.20%
Sell	26	2.74%	15.38%
Speculative Buy	72	7.59%	69.44%
	949*	100.0%	

*Total includes stocks that are Under Review

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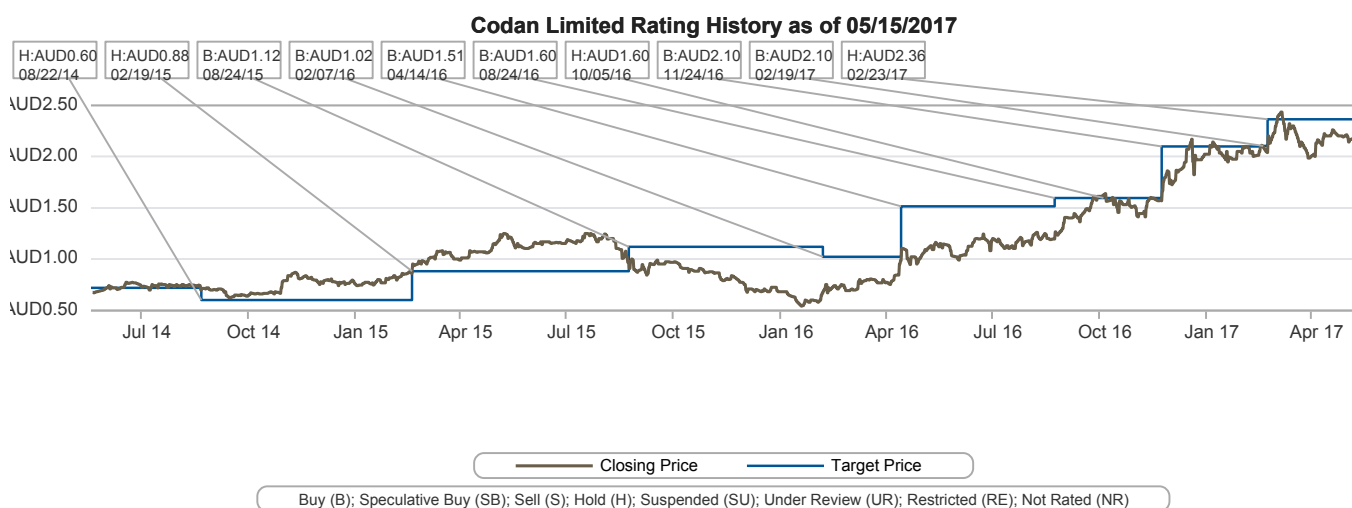
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