



## Codan Ltd (CDA)

*Solid first half momentum, positioned for even better second*

### Event:

- 1H18a result; FY18e guidance maintained; Caterpillar agreement.

### Investment Highlights:

- CDA has announced 1H18a results with highlights including \$15.8M NPAT on \$94.7M revenue; ahead of recently upgraded NPAT guidance of \$15M for the half. Management remain confident that 2H18e will be stronger than 1H18a, and have an unchanged FY18e NPAT guidance of at least \$30M.
- Metal Detection segment performed soundly in 1H18a though the segment result was impacted by deliberate product diversification into more affordable products to reduce reliance on flagship GPZ 7000. Early trading in 2H18e in a number of products in Metal Detection a good signal for stronger half, in particular GPZ 7000, Equinox, and Countermines products.
- Currently working on a number of Radio Comms projects to be delivered in 2H18e suggest improvement over the half for this segment, too. Major contract win in Radio Comms in 1H17a was the difference between the two periods.
- Option value from Tracking Solutions on the verge of fruition; CDA's tracking division Minetec has entered into a global licensing, technology development, and marketing agreement with Caterpillar Inc. to expand and develop Caterpillar's Minestar technology solution for underground mining operations. Minetec's suite of proprietary products including SMARTS task management, TRAX precision tracking and wireless comms, and SafeDetect proximity detection will be integrated into an expanded Caterpillar Minestar solution. No material revenue expected is in FY18e, with revenue expected to flow from FY19e, and rollout in the next 12-18 months; unlocks option value for Minetec business as management hope to scale up rapidly in the near term.

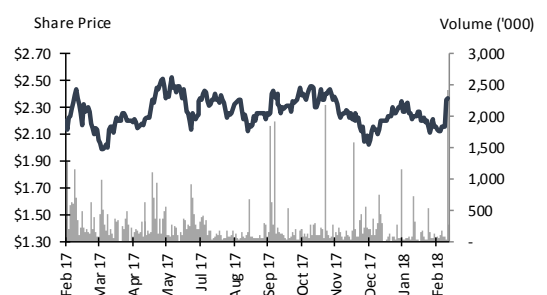
### Earnings and Valuation:

- We have an increased valuation of \$3.30 per CDA share (previously \$3.20).
- We have made minor revisions to our FY19e and FY20e earnings forecasts of \$35.5M and \$39.9M (previously \$35.2 and \$39.2M). We continue to forecast FY18e NPAT of \$34.6M (unchanged) noting the profit upgrade and strong trading conditions at the start of 2H18e.
- We continue to hold the view there is considerable option value that is in the process of being unlocked given the Caterpillar announcement; share continues to demonstrate undemanding valuation in our view. The company has a strong and evolving product suite, demonstrable IP, global dealer network, and optionality in both its Tracking Solutions and its Defence Electronics.

### Recommendation:

- We maintain coverage of CDA with an unchanged BUY recommendation and a price target of \$3.30 per share (previously \$3.20).
- Catalysts for the share price include: 1) updates on trading conditions, particularly Metal Detection and Caterpillar progress; 2) further contract wins in Radio Comms and Minetec; and 3) higher gold prices.

Recommendation		BUY		
Previous		Buy		
Risk		High		
Price Target		\$3.30		
Previous		\$3.20		
Share Price (A\$)		\$2.37		
ASX Code		CDA		
52 week low - high (A\$)		1.99-2.52		
Capital structure				
Shares on Issue (M)		178.1		
Market Cap (A\$M)		422		
Net Cash/(Debt) (A\$M)		-4		
EV (A\$M)		427		
12mth Av Daily Volume ('000)		246		
Y/e Jun US\$	FY17A	FY18E	FY19E	FY20E
Sales \$M	226.1	204.9	220.7	242.6
EBITDA \$M	75.8	61.4	63.0	69.4
NPAT Adj. \$M	44.9	34.6	35.5	39.9
EPS adj c	24.2	19.2	19.5	21.7
PER (x)	9.8	12.3	12.1	10.9
Dividend c	10.0	9.6	9.8	10.9
Div Payout Ratio %	41%	50%	50%	50%
Dividend yield %	4.2%	4.1%	4.1%	4.6%
Board				
David Simmons		Chairman		
Donald McGurk		CEO		
Lt-Gen Peter Leahy		Non-Executive Director		
Jim McDowell		Non-Executive Director		
Graeme Barclay		Non-Executive Director		
Kathy Gramp		Non-Executive Director		
Major Shareholders				
I M Wall and P M Wall		19.5%		
Pinara Group Pty Ltd		14.5%		
HSBC Custody Nominees		8.2%		
Kynola Pty Ltd		5.5%		



Matthew Chen, CFA +61 2 9993 8130

matthew.chen@fostock.com.au

The analyst does not own CDA securities.

Foster Stockbroking and associated entities (excluding

Cranport Pty Ltd) do not own CDA securities.

Cranport Pty Ltd owns 6,298 CDA shares.

This report was prepared by Foster Stockbroking Pty Ltd.



## Codan Ltd (CDA)

Full Year Ended, 30 June

Profit and Loss A\$M	2017a	2018e	2019e	2020e	Financial Metrics	2017a	2018e	2019e	2020e
Sales revenue	226.1	204.9	220.7	242.6	Sales growth %	33%	-9%	8%	10%
Operating Costs	150.3	143.5	157.7	173.2	EPS growth %	nm	-21%	1%	11%
<b>EBITDA</b>	<b>75.8</b>	<b>61.4</b>	<b>63.0</b>	<b>69.4</b>	EBITDA margin	34%	30%	29%	29%
D&A	14.1	14.7	15.4	16.2	EBIT margin	27%	23%	22%	22%
<b>EBIT</b>	<b>61.7</b>	<b>46.7</b>	<b>47.6</b>	<b>53.2</b>	Gearing (ND/ND+E)	n/a	n/a	n/a	n/a
Net Interest exp / (income)	0.9	0.5	0.3	0.0	Interest Cover (EBIT/net int)	>10	>10	>10	>10
<b>Profit before tax</b>	<b>60.8</b>	<b>46.2</b>	<b>47.4</b>	<b>53.2</b>	Average ROE %	26%	19%	18%	18%
Tax exp / (benefit)	16.0	11.5	11.8	13.3	Average ROA %	19%	14%	13%	14%
<b>Rep. NPAT</b>	<b>44.9</b>	<b>34.6</b>	<b>35.5</b>	<b>39.9</b>	Wtd ave shares diluted (M)	180	180	182	184
Significant items	-1.4	0.0	0.0	0.0					
<b>NPAT attributable reported</b>	<b>43.5</b>	<b>34.6</b>	<b>35.5</b>	<b>39.9</b>					
<b>EPS diluted, cps</b>	<b>24.2</b>	<b>19.2</b>	<b>19.5</b>	<b>21.7</b>					
<b>DPS, cps</b>	<b>10.0</b>	<b>9.6</b>	<b>9.8</b>	<b>10.9</b>					
Cashflow A\$M	2017a	2018e	2019e	2020e	Valuation multiples	2017a	2018e	2019e	2020e
<b>EBITDA</b>	<b>75.8</b>	<b>61.4</b>	<b>63.0</b>	<b>69.4</b>	P/E x	9.8	12.3	12.1	10.9
Change in WC / Other	2.1	-3.0	-5.1	-6.7	EV/EBITDA x	5.3	6.7	6.5	5.8
Tax paid	-1.5	-20.0	-11.7	-12.8	EV/EBIT x	5.9	7.9	7.7	6.9
Share-based expense	0.0	0.0	0.0	0.0	EV/sales x	1.8	2.0	1.9	1.7
Net interest	-0.8	0.5	0.3	0.0	Dividend yield %	4.2%	4.1%	4.1%	4.6%
<b>Operating Cashflow</b>	<b>75.6</b>	<b>38.9</b>	<b>46.5</b>	<b>49.9</b>					
Purchase of PP&E	-4.1	-4.0	-4.0	-4.0	Valuation				
Payments Intangibles	-19.6	-18.3	-18.3	-18.3	<b>FCF Valuation</b>				
Payments For Acquisitions	0.0	0.0	0.0	0.0	Total NPV of FCF				598
<b>Investing Cashflow</b>	<b>-23.7</b>	<b>-22.3</b>	<b>-22.3</b>	<b>-22.3</b>	Less Net Debt/(Cash)				4
Dividends Paid	-17.7	-19.8	-17.4	-17.8	Equity Value - A\$				594
Proceeds from borrowings	0.0	15.0	0.0	0.0	<b>FCF Valuation, WACC 10.7%</b>				<b>3.30</b>
Repayment of borrowings	-26.9	-5.0	-10.0	0.0	<b>Sum of Parts Valuation</b>	<b>1yr fwd EBIT</b>	<b>EBIT, x</b>	<b>EV</b>	
<b>Financing Cashflow</b>	<b>-44.7</b>	<b>-9.8</b>	<b>-27.4</b>	<b>-17.8</b>	Radio Comms	22	12	259	
<b>Net Cashflow</b>	<b>7.3</b>	<b>6.8</b>	<b>-3.2</b>	<b>9.7</b>	Metal Detection	44	9	401	
					Tracking Solutions	1	25	37	
					Corporate Costs	-20	6	-120	
					<b>Total</b>			<b>577</b>	
					<b>Sum of Parts Valuation, A\$/sh</b>			<b>3.32</b>	
Balance Sheet A\$M	2017a	2018e	2019e	2020e	Shares on issue	<b>M</b>			
Cash / (Debt)	21.4	15.3	19.9	30.3	Ordinary shares	178.1			
Current Assets (Excl Cash)	58.9	59.2	63.5	65.5	Performance Rights /Options	2.3			
PPE	12.0	13.5	14.9	16.2	<b>Fully Diluted</b>	<b>180.4</b>			
Intangibles / Other	140.4	159.2	170.0	181.8					
<b>Total Assets</b>	<b>232.7</b>	<b>247.2</b>	<b>268.3</b>	<b>293.8</b>	Substantial shareholders				
Accounts payable	36.6	38.4	41.4	45.5	I M Wall and P M Wall	19.5%			
Other Liabilities	31.1	26.5	26.8	28.2	Pinara Group Pty Ltd	14.5%			
<b>Total Liabilities</b>	<b>67.7</b>	<b>64.9</b>	<b>68.2</b>	<b>73.7</b>	HSBC Custody Nominees	8.2%			
Reserves and capital	105.9	105.9	105.9	105.9	Kynola Pty Ltd	5.5%			
Retained earnings	59.1	76.4	94.1	114.1					
<b>Total Equity</b>	<b>165.0</b>	<b>182.3</b>	<b>200.1</b>	<b>220.0</b>					
<b>Total Equity &amp; Liabilities</b>	<b>232.7</b>	<b>247.2</b>	<b>268.3</b>	<b>293.8</b>					

Source: Foster Stockbroking estimates



## 1H18a RESULT HIGHLIGHTS

- CDA has announced 1H18a results with highlights including \$15.8M NPAT from \$94.7M revenue; ahead of recently upgraded NPAT guidance of \$15M for the half. While the result was not quite at the bumper level of 1H17a, it was well ahead of base level NPAT guidance (\$20-25M).
- Management remain confident that 2H18e will be stronger than 1H18a, and have an unchanged FY18e NPAT guidance of at least \$30M. The strong first half puts the company on track to meet this guidance, as strong initial trading to the half in a number of Metal Detection products as well as strong pipeline in Radio Communications should set up the company for a strong finish to FY18.
- The company reported revenue of \$94.7M for the half, down 9% on an excellent 1H17a, although within expectations. Metal Detection products continued to perform strongly, while a \$6M contract in 1H17a was the difference between the two halves for Radio. Underlying EBITDA was \$27.4M for the half, down 26.1%, as the company deliberately focussed on a different product mix – including more affordable Metal Detection products – and to reduce reliance on top of the line GPZ7000 model. Pleasingly, costs were controlled and delivered NPAT of \$15.8M, ahead of recently upgraded guidance of \$15M for the half.
- With a minor drawdown of debt of \$15M during the half, the company had net debt of \$4.4M at 31 December. Operating cash flow for the half was –\$1M, impacted by tax payments, which will normalise in 2H18e.
- The company declared a fully franked interim dividend of 4cps (3cps in 1H17a) and reconfirmed 50% payout of base level earnings.

## Radio Communications

- Radio communications revenue pulled back 17% to \$29M in 1H18a from \$35M in the pcp with the main difference a large contract in 1H17a. Cycling off a very strong half, the segment result was down 43% to \$5.6M from \$10.2M.
- Nevertheless, management note a number of projects are on foot in 2H18e, and is currently seeing a very strong order book and accordingly expect an improvement from this segment in 2H18e. Management also noted reasonably strong orders intake during 1H18a although projects were large scale sophisticated orders. Management are targeting the lower end of base level sales range of \$65-75M for Radio Communications FY19e revenue (FSBe \$70M).

## Metal Detection

- Metal Detection segment performed soundly in 1H18a with roughly flat revenue (down 2% on pcp). The segment result of \$23.0M (down 19% on pcp) was impacted by a deliberate move to diversify product mix into more affordable, lower margin models (Gold Monster and SDC 2300), and reduce reliance on higher margin, flagship GPZ 7000.
- Management have noted encouraging early indications of trading in 2H18e across a number of products in Metal Detection, with the GPZ 7000, Equinox, and Countermine models called out as performing strongly so far. CDA observe seasonality among Metal Detection products, with 2H typically stronger for gold detection products in particular. GPZ 7000 sales have started 2H18e strongly and comparable to 2H17 sales, while the release of consumer product Equinox on 1 February 2018 has similarly been strong in trading so far, and been well received among the dealer network to date.



## CATERPILLAR AGREEMENT – MINETEC OPTION VALUE IN PLAY

- CDA's Minetec business has announced it has entered into a global licensing, technology development and marketing agreement with Caterpillar Inc. to expand and develop Caterpillar's Minestar technology solution for underground mining operations.
- Minetec's suite of proprietary products including SMARTS task management, TRAX precision tracking and wireless communications, and SafeDetect proximity detection were particularly sought after as technology solutions to Caterpillar's existing capability. Minetec's product suite offer superior precision in remote control of autonomous underground equipment, as well as bandwidth to allow real time video monitoring of the same equipment. Minetec's product also offers an upgradeable platform for successive iterations and advancement of the proprietary Wifi system developed by CDA.
- The exclusive agreement will proceed on a profit share model with an undisclosed split between the two parties, although we assume weighting towards Minetec due to the specialised nature and desirable properties of its product suite to address the gaps in current Caterpillar technology.
- Integration and testing is currently ongoing, with CDA planning a roll out of its solution over the Caterpillar network over the next 12-18 months; no material revenue contribution is envisaged for FY18e, with benefits to flow from FY19 on. CDA have acknowledged good margins and hold aspirational targets for segment revenue, noting a large opportunity to scale up over the extensive Caterpillar network (172 dealers across 190 countries). CDA and Caterpillar will initially target 12 underground mines and the top ten dealers as the initial scope for the execution of the agreement.
- This agreement is welcome news as the Minetec business had been threatening to scale up for a number of years. We believe the latest agreement with Caterpillar is a strong endorsement of CDA's technology offering, and keenly anticipate the business executing on the rapid scaling of this business.

## EARNINGS FORECASTS AND VALUATION

- We have an unchanged FY18e forecast NPAT of \$34.6M, and have made minor revisions to FY19e and FY20e NPAT of \$35.5M and \$39.9M (previously \$35.2M and \$39.2M).
- While we had previously ascribed some growth to the Minetec business in FY18e and FY19e, we now have greater visibility and confidence of income generation from this asset in the near term after the recent Caterpillar agreement announcement, and have upgraded outer year earnings forecasts accordingly.

## RECOMMENDATION – MAINTAIN BUY, PT INCREASED TO \$3.30

- We maintain a Buy recommendation on CDA and have increased our price target to \$3.30 from \$3.20, based on our DCF valuation.
- We view the Caterpillar deal as the initial step to realising the Minetec option value, as the company scales up for a significant customer with a vast network and application opportunity.



## FOSTER STOCKBROKING DIRECTORY

Name	Role	Phone	Email
<b>Stuart Foster</b>	Chief Executive Officer	+61 2 9993 8131	stuart.foster@fostock.com.au
<b>Haris Khaliqi</b>	Executive Director	+61 2 9993 8152	haris.khaliqi@fostock.com.au
<b>Martin Carolan</b>	Executive Director	+61 2 9993 8168	martin.carolan@fostock.com.au
<b>Mark Fichera</b>	Executive Director	+61 2 9993 8162	mark.fichera@fostock.com.au
<b>Mark Hinsley</b>	Executive Director	+61 2 9993 8166	mark.hinsley@fostock.com.au
<b>Rob Telford</b>	Corporate – Perth	+61 2 9993 8132	rob.telford@fostock.com.au
<b>Matthew Chen</b>	Research	+61 2 9993 8130	matthew.chen@fostock.com.au
<b>James Gore</b>	Institutional Dealing	+61 2 9993 8121	james.gore@fostock.com.au
<b>George Mourtzouhos</b>	Execution & Dealing	+61 2 9993 8136	george.mourtzouhos@fostock.com.au

Foster Stockbroking Pty Ltd  
A.B.N. 15 088 747 148 AFSL No. 223687  
Level 25, 52 Martin Place, Sydney, NSW 2000 Australia  
General: +612 9993 8111 Equities: +612 9993 8100 Fax: +612 9993 8181  
Email: [contact@fostock.com.au](mailto:contact@fostock.com.au)  
PARTICIPANT OF ASX GROUP

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