Canaccord Genuity Capital Markets

Codan Limited

Communications Equipment

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Australian Equity Research
21 February 2019

BUY
unchanged

PRICE TARGET	A$3.68↑
from A$3.65	
Price (20-Feb)	A$3.20
Ticker	CDA-ASX

52-Week Range (A$):	2.11 - 3.39
Avg Daily Vol (000s) :	300.0
Market Cap (A$M):	573
Shares Out. (M) :	177.1
Dividend /Shr (AUc):	13.0
Dividend Yield (%) :	4.1
Net Debt (Cash) (A$M):	(20)
Enterprise Value (A$M):	550
Cash (A$M):	20.0
Long-Term Debt (A$M):	0.0

FYE Jun	2017A	2018A	2019E	2020E
Sales (A$M)	226.1	229.9	242.0↑	262.1↑
Previous	-	-	*225.2*	*244.2*
EBITDA (A$M)	75.6	70.4	72.7↑	81.2↑
Previous	-	-	*70.9*	*81.0*
Net Income Adj (A$M)	44.7	39.8	42.0↑	47.3↑
Previous	-	-	*39.9*	*46.5*
EPS Adj&Dil (AUc)	25.2	22.3	23.6↑	26.6↑
Previous	-	-	*22.4*	*26.1*
P/E (x)	12.7	14.3	13.6	12.0
EV/EBITDA (x)	7.3	7.7	7.4	6.4
DPS (AUc)	13.00	12.50	13.00↑	13.00
Previous	-	-	*12.00*	-
Div. Yield (%)	4.1	3.9	4.1	4.1

Source: FactSet

Priced as of close of business 20 February 2019

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

Raising Target Price

Strong result sets up for another solid year

CDA reported a result that was a touch above the guidance and better than our expectations. Revenue was ahead of our estimates by 15%, while earnings were a 4% beat at the EBITDA line and 6% at the NPAT line. The result demonstrated strong revenue growth (+35%) and EBITDA growth (+40%). The result, which had been well flagged to the market, was underpinned by product and geographic diversification in Metal Detection and the delivery of some HF contracts that boosted revenue and margins in Communications.

While no guidance has been provided for FY19 management, we don't expect the usual seasonal skew to 2H19. This mainly relates to some of the one-off wins in 1H19. There is some conservatism to this in our view given the momentum across each of the businesses. We have made some small revisions to our earnings – FY19 and FY20 NPAT +5.3% and +1.8%, respectively.

We increase our target price to A$3.68 per share and retain our BUY rating.

Key points

Solid result, comfortable beat – CDA produced a result that came in above guidance and beat our EBITDA estimate by 6%. This was driven by a strong performance from Metal Detection, which saw a broader product portfolio lift revenue 15% above our expectations. Entry into new markets also helped with initial orders giving a boost during 1Q19. Communications also rebounded after an ordinary FY18. A number of contracts that were due for delivery in 2H18 slipped into 1H19. Meanwhile, Minetec underperformed our expectations with management delivering a breakeven result compared to our expectations for a small profit. Management noted that it had been investing in the growth of the business, which impacted profitability. Nonetheless, management retained guidance for FY19 for $15m.

Outlook – The outlook for CDA remains strong in our view with good momentum across each of the businesses as new products gain traction. As is usually the case, however, management refrained from providing definitive guidance at this stage given the low level of visibility. What it did say though is that it does not expect 2H19 to exceed 1H19, given the Tactical HF contracts from 1H19 may not be repeated and the new market penetration by Metal Detection, which came with strong initial demand. This implies 2H19 NPAT of less than $22m. We have revised our 2H19 estimate to $20m, which is a small upgrade. We believe our estimates could prove conservative based on the momentum in Metal Detection and the expectation of an improved performance from Communications and Mine Technology. Our estimates for 2H19 NPAT of $19.8m compare to 2H18 NPAT of $24m.

Earnings changes – FY19 EPS ↑5.3%, FY20 EPS ↑1.8%

Valuation and recommendation

As a result of our earnings revisions, we have raised our target price to A$3.68 per share, up 1% from A$3.65 per share previously. We have arrived at our TP by applying an 8.5x multiple (20% discount to Small Industrials average) to our FY19E EBITDA of $72.7m. We retain our BUY rating.

For important information, please see the Important Disclosures beginning on page 7 of this document.

Figure 1: Codan Ltd (CDA); Canaccord Genuity estimates

Profit & Loss ($m)	2017A	2018A	2019F	2020F
Sales Revenue	**226.1**	**229.9**	**242.0**	**262.1**
EBITDA	**75.6**	**70.4**	**72.7**	**81.2**
Depreciation	-2.4	-2.8	-2.2	-2.4
EBITA	**73.1**	**67.5**	**70.5**	**78.8**
Amortisation	-11.6	-13.8	-13.2	-14.3
EBIT	**61.5**	**53.7**	**57.3**	**64.5**
Net Interest Expense	-0.8	-0.5	0.0	0.0
NPBT	**60.7**	**53.2**	**57.3**	**64.5**
Tax expense	-16.0	-13.4	-15.2	-17.2
NPAT - underlying	**44.7**	**39.8**	**42.0**	**47.3**
Significant items	-1.2	1.7	0.0	0.0
Reported NPAT	**43.5**	**41.5**	**42.0**	**47.3**
Cash Flow ($m)	2017A	2018A	2019F	2020F
Operating EBITDA	**75.6**	**70.4**	**72.7**	**81.2**
- Interest & Tax Paid	-7.2	-16.5	-13.4	-15.2
+/- change in Work. Cap.	2.2	-0.1	10.2	2.2
- other	5.0	-5.6	-16.0	-3.7
Operating Cashflow	**75.6**	**48.3**	**53.4**	**64.5**
- Capex	-16.4	-16.5	-18.0	-18.0
- Acquisitions/divestments	-7.0	-5.4	-7.0	-7.0
- other	-0.3	-0.5	0.0	0.0
Free Cashflow	**51.9**	**25.8**	**28.4**	**39.5**
- Ord Dividends	-17.7	-20.0	-21.7	-23.2
- Equity /other	0.0	0.4	0.4	0.4
Net Cashflow	**34.2**	**6.2**	**7.2**	**16.7**
Cash at beginning of period	14.3	21.4	27.7	34.9
+/- borrowings / other	-27.1	0.1	0.0	0.0
Cash at end of period	**21.4**	**27.7**	**34.9**	**51.6**
Balance Sheet	2017A	2018A	2019F	2020F
Cash	21.4	27.7	34.9	51.6
Inventories	31.0	31.6	38.7	39.3
Debtors	20.6	29.8	24.2	26.2
PPE	12.0	12.5	13.0	14.4
Intangibles	86.2	86.6	97.3	95.8
Other assets	61.5	66.1	67.8	73.0
Total Assets	**232.7**	**254.3**	**275.9**	**300.3**
Borrowings	0.0	0.0	0.0	0.0
Trade Creditors	36.6	46.3	58.1	62.9
Other Liabilities	31.1	19.9	19.9	19.9
Total Liabilities	**67.7**	**66.2**	**78.0**	**82.8**
NET ASSETS	**165.0**	**188.1**	**198.0**	**217.5**

Board of Directors / Substantial Shareholders		
Board of Directors	**Shareholding**	**%**
David Simmonds - Chairman	0.0	0.0%
Donald McGurk - MD	0.8	0.5%
Peter Griffiths - N-E Director	0.1	0.1%
David Klingberg - N-E Director	0.1	0.0%
Brian Burns - N-E Director	0.0	0.0%
Lt Gen Peter Leahy - N-E Director	0.4	0.3%
Graeme Barclay - N-E Director	0.0	0.0%
Substantial Shareholders	**Shareholding**	**%**
IB Wall and PM Wall	34.8	19.7%
Starform Pty Ltd	11.4	6.4%
Griffina Pty Ltd	10.6	6.0%
Otterpaw Pty Ltd	10.6	6.0%
A.J Wood	10.6	6.0%
JP Morgan Trus Co	10.6	6.0%
Top 20 Shareholders	**109.6**	**66.8%**

Valuation ratios	2017A	2018A	2019F	2020F
EPS (cps)	25.2	22.3	23.6	26.6
P/E (x)	12.7	14.3	13.6	12.0
PER Rel - All Ind.	-38%	-31%	-34%	-35%
PER Rel - Small Ind.	-34%	-25%	-29%	-29%
Enterprise Value ($m)	548.8	542.5	535.3	518.6
EV / EBITDA (x)	7.3	7.7	7.4	6.4
EV / EBIT (x)	8.9	10.1	9.3	8.0
DPS (cps)	13.0	12.5	13.0	13.0
Dividend Yield (%)	4.1%	3.9%	4.1%	4.1%
Franking (%)	100%	100%	100%	100%
CFPS (cps)	42.6	27.1	30.0	36.2
P / CFPS (x)	7.5	11.8	10.7	8.8
Profitability ratios	2017A	2018A	2019F	2020F
EBITDA Margin (%)	33.4	30.6	30.0	31.0
EBIT Margin (%)	27.2	23.4	23.7	24.6
ROE (%)	27.1	21.2	21.2	21.8
ROA (%)	29.1	23.7	23.8	25.9
ROIC (%)	31.8	25.8	26.5	29.2
Balance Sheet ratios	2017A	2018A	2019F	2020F
Net Debt (cash)	-21.4	-27.7	-34.9	-51.6
Net Gearing (%)	-13.0	-14.7	-17.6	-23.7
Interest Cover (x)	76.9	107.4	nm	nm
NTA per share ($)	0.44	0.57	0.65	0.76
Price / NTA (x)	7.2	5.6	5.0	4.2
EFPOWA (m)	177.3	178.2	178.2	178.2
Growth ratios	2017A	2018A	2019F	2020F
Sales revenue ($m)	33%	2%	5%	8%
EBITDA ($m)	80%	-7%	3%	12%
EBIT ($m)	111%	-13%	7%	13%
NPAT ($m)	112%	-11%	6%	13%
EPS (cps)	112%	-11%	6%	13%
DPS (cps)	117%	-4%	4%	0%
Interim Analysis	1H18A	2H18A	1H19A	2H19E
Communications	29.0	27.6	40.7	29.7
Metal Detection	63.5	100.3	82.0	74.4
Tracking Solutions	2.3	5.9	5.7	9.4
Total revenue	94.7	133.9	128.4	113.6
EBITDA	27.4	43.0	38.0	34.7
EBITDA margin (%)	28.9%	32.1%	30%	31%
NPAT ($m)	15.8	24.0	22.2	19.8
EPS	8.8	13.5	12.3	11.3
DPS	4.0	8.5	6.5	6.5

Valuation	2019
EBITDA multiple (x)	
EBITDA ($m)	72.7
Target multiple (x)	8.5
Net Debt (cash) ($m)	-34.9
Implied Valuation	656.0
Per Share	**3.68**
Target PE Multiple	
EPS (c)	23.6
PE Target (x)	15.6
Per Share	**3.68**

Source: Company Reports, Canaccord Genuity estimates

1H19 Result Summary

CDA reported a result that was a touch above the guidance range of NPAT of $20-22m and better than our expectations. Revenue was ahead of our estimates by 15%, while earnings were a 4% beat at the EBITDA line and 6% at the NPAT line. The result demonstrated strong revenue growth (+35% on pcp) and EBITDA growth (+40%)

The strong result was well flagged to the market with guidance provided at the AGM. Both Metal Detection and Communications contributed to the outperformance with both showing strong topline growth.

While no guidance has been provided for FY19, management does not expect the usual seasonal skew to 2H19. Therefore, we are forecasting 2H19 NPAT of $20m taking our FY19 estimate to $42m (previously $40m).

We outline the 1H19 financial performance in Figure 1 and provide commentary below.

Figure 2: 1H19 results summary

($M)	1H17	2H17	1H18	2H18	1H19	% Change on pcp	CG Est	Beat/(miss)
REVENUE								
Communications products	35.0	35.9	29.0	27.5	40.7	40.3%	34.0	20%
Metal detection	64.8	83.2	63.4	100.6	82.0	29.3%	71.1	15%
Tracking solutions	4.1	3.1	2.3	7.1	5.7	147.7%	6.3	-9%
Total revenue	103.9	122.2	94.7	135.2	128.4	35.6%	111.4	15%
EBITDA	37.1	38.5	27.4	43.0	38.0	38.7%	36.7	4%
Depreciation and Amort	-7.0	-7.1	-6.5	-10.2	-7.6	16.9%	-8.5	-11%
EBIT	30.1	31.4	20.9	32.8	30.4	45.5%	28.2	8%
Interest Expense	-0.3	-0.5	-0.2	-0.3	0.0	nm	0.3	nm
PBT	29.8	30.9	20.7	32.5	30.4	46.9%	28.5	7%
Tax expense	-7.6	-8.4	-4.9	-8.5	-8.2	67.3%	-7.4	10%
NPAT (Underlying)	22.2	22.5	15.8	24.0	22.2	40.5%	21.0	6%
NPAT (Reported)	22.2	21.3	15.8	25.7	22.2	40.5%	21.0	6%
EPS (¢) – Underlying	12.5	12.4	8.9	13.2	12.3	37.9%	11.8	4%
DPS (¢)	6.0	7.0	4.0	8.5	6.5	62.5%	5.0	30%
EBITDA Margin	35.7%	31.5%	28.9%	31.8%	29.6%		32.9%	

Source: Company Reports, Canaccord Genuity estimates

Key Points

Revenue of $128m was up 36% on the pcp and ahead of our expectations. The uplift came from all divisions with Metal Detection representing 55% of the growth and Communications ~35%. Metal Detection benefited from its broader product range and also a new market in Saudi Arabia, while Communications had some contracts from 2H18 fall into 1H19, which saw a very strong uplift in revenue. We discuss the divisional performance in more detail later in the report.

Underlying EBITDA was $38m, up 39% on the pcp ($27.4m). EBITDA margins moderated to 29.6% largely driven by the mix shift in Metal Detection, which was offset by a recovery in margins in Communications.

Underlying NPAT of $22.2m was ahead of guidance of $20-22m and ahead of our estimate for $21m. Underlying EPS was 12.3 cents. Growth on the pcp was 40.5% and 38%, respectively.

An interim dividend of 6.5c was declared, which included an ordinary dividend of 4.0c and a special of 2.5c. We wouldn't be surprised to see a similar dividend in 2H19 based on our revised estimates.

Operating cash flow of $12.5m was well up on the pcp (-$1.0m) but lower than we'd expected. Management noted that it had increased inventory across the Metal Detection product range to ensure there was sufficient product in stock coming into 2H19. There had been a shortage in 2H18, which had impacted sales and management is looking to ensure this isn't repeated.

Balance sheet remains in a strong position with CDA ending the period with net cash of $13m. The company remains in a good position to capitalize on any acquisition opportunities, although given the company has been looking for some time, it doesn't appear like it's an easy task. In the interim, we'd expect special dividends to continue.

Figure 3: Result was down on the pcp but was largely expected. Earnings were better than expected

$M	1H18	2H18	FY18	1H19	% Change on pcp	CG Est	Beat/(Miss)
Revenue							
Communications	29.0	27.6	56.5	40.7	40.6%	34.0	19.7%
Metal Detection	63.5	100.3	163.8	82.0	29.2%	71.1	15.3%
Tracking solutions	2.3	5.9	8.3	5.7	144.5%	6.3	-9.5%
Total	94.7	133.9	228.6	128.4	35.5%	111.4	15.2%
Segment result							
Communications	5.6	1.2	6.8	10.3	84.3%	7.0	47.4%
Metal Detection	23.0	41.1	64.1	29.6	28.6%	28.5	3.8%
Tracking solutions	-0.3	1.0	0.7	0.0	nm	1.9	nm
Total	28.3	43.2	71.5	39.9	41.0%	37.4	6.7%
Segment margin							
Communications	19.3%	4.2%	12.0%	25.4%		20.6%	
Metal Detection	36.2%	40.9%	39.1%	36.1%		40.1%	
Tracking solutions	-12.9%	17.0%	8.5%	0.1%		30.2%	

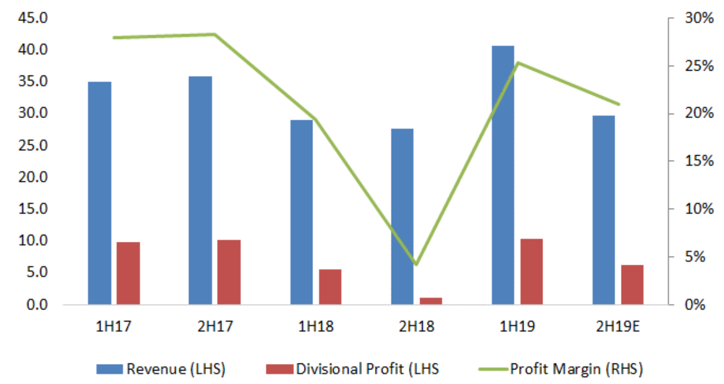
Source: Company Reports, Canaccord Genuity estimates

Communications (32% revenue and 26% of segment profit)

Communications performed strongly in 1H19 with revenue up 40% on the pcp. Margins also recovered well to 25.4% at the divisional level, which helped the overall result. Part of the improved result was due to some HF contracts that should have been included in 2H19 but slipped into 1H19. This is unlikely to be repeated in 2H19 according to management, so it's likely that revenue and earnings will normalise to base level sales. We're forecasting 2H19 revenue of $29.7m and segment profit of $6.2m.

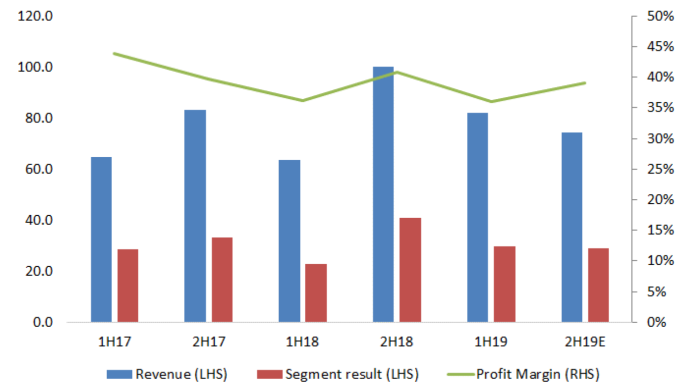
Overall, the outlook for the division looks positive with Tactical Communications (HF) looking to benefit from a wider product range broadening the offering, while Land Mobile Radio continues to develop the Cascade, which has a significant addressable market in North America.

Figure 4: Radio Communications performed well in 1H19 with strong revenue growth coupled by margin expansion. Without further large contracts in 2H19, we expect sales to pull back



Source: Company Reports

Figure 5: Metal Detection comfortably beat our expectations. Product diversification was again a feature but despite this, margins held. GPZ sales were strong with new markets helping, including Saudi Arabia.



Source: Company Reports

Metal Detection

Revenue from Metal Detection was up 29% on the pcp and a 15% beat to our expectations. The result was helped by the entry into new markets, particularly Saudi Arabia, where initial high demand drove above-average sales of the GPZ7000. A positive feature of the result was the continued diversification of sales across the GPX5000, SDC2300 and the Gold Monster. In addition, the coin and treasure product, the EQUINOX, continues to have success and this has driven the consumer market to be ~$50m revenue and therefore a larger part of the base level business of ~$110m revenue. This should help with continued diversification and better predictability of Metal Detection over time.

The outlook remains positive for Metal Detection, although management is not expecting the usual 2H skew given the strength of 1H19. Management noted that demand in new markets entered into in 1H19 had moderated to normalised levels. That said, the inventory build does appear to be a positive sign around management's confidence heading into 2H19. It was noted on the conference call that YTD GPZ7000 sales were down on the pcp during the first six weeks of 2H19; however, we think it's too early to determine any particular trend.

We believe we've been relatively conservative in 2H19 assuming revenue of $74.4m and divisional profit of $29.1m. These figures are 26% and 29% below the pcp.

Tracking Solutions

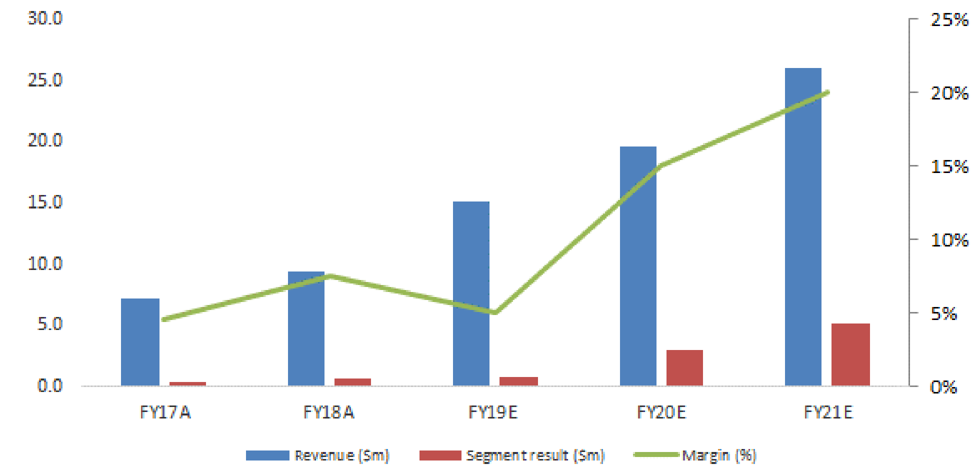
The result from Tracking Solutions came in below our expectations. While revenue was thereabouts compared to our estimates, the division broke even for the period. Management pointed to the investment in people within the business to fast track the development.

Notably, Minetec's technology has now been integrated with Caterpillar and is now being offered in its catalogue, which should deliver benefits in 2H19. With Caterpillar's network within 190 countries, it's expected that Minetec will be able to scale quickly.

Management reaffirmed guidance for Tracking Solutions, expecting $15m revenue in FY19. This would obviously require a meaningful lift into 2H19, but management appears confident that this is achievable based on the Caterpillar distribution and

BHP's Olympic Dam contract, which continues to be installed. With the higher cost base, however, we have pulled back our divisional profit estimates looking forward.

Figure 6: We have pulled back our expectations for MineTec



Source: Company Reports, Canaccord Genuity estimates

Changes to forecasts

- We have made some small revisions to our forecasts for FY19 and FY20 to reflect our commentary above regarding each division. We increased our FY19 NPAT estimates by 5.3% to $42.0m. This implies $19.8m NPAT in 2H19. This is consistent with management guidance for 2H19 to not be stronger than 1H19.
- We believe our estimates could prove conservative based on the momentum in Metal Detection and the expectation of an improved performance from Communications and Mine Technology. Our estimates for 2H19 NPAT of $19.8m compare to 2H18 NPAT of $24m.
- We outline our changes in Figure 7 below.

Figure 7: Forecast changes

	FY19			FY20		
($M)	Old	New	% Change	Old	New	% Change
Communications	70.4	70.4	0.0%	75.0	75.0	0.0%
Metal Detection	139.7	156.4	12.0%	149.6	167.4	11.9%
Mine Technology	15.1	15.1	0.0%	19.6	19.6	0.0%
Total Revenue	225.2	242.0	7.4%	244.2	262.1	7.3%
EBITDA ($m)	70.9	72.7	2.4%	81.0	81.2	0.3%
Underlying NPAT	39.9	42.0	5.3%	46.5	47.3	1.8%
EPS (¢) –normalised	22.4	23.6	5.3%	26.1	26.6	1.8%
DPS (¢)	12.0	13.0	8.3%	13.0	13.0	0.0%
EBITDA margin (%)	31.5%	30.0%		33.2%	31.0%	

Source: Canaccord Genuity estimates

Appendix: Important Disclosures

Analyst Certification

Each authoring analyst of Canaccord Genuity whose name appears on the front page of this research hereby certifies that (i) the recommendations and opinions expressed in this research accurately reflect the authoring analyst's personal, independent and objective views about any and all of the designated investments or relevant issuers discussed herein that are within such authoring analyst's coverage universe and (ii) no part of the authoring analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the authoring analyst in the research.

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Sector Coverage

Individuals identified as "Sector Coverage" cover a subject company's industry in the identified jurisdiction, but are not authoring analysts of the report.

Investment Recommendation

Date and time of first dissemination: February 20, 2019, 14:33 ET

Date and time of production: February 20, 2019, 11:25 ET

Target Price / Valuation Methodology:

Codan Limited - CDA

Our target price is based on applying a 8.5x multiple (20% discount to Small Industrials average) to FY19E EBITDA estimate.

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 02/20/19)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	543	60.81%	46.78%
Hold	207	23.18%	30.43%
Sell	19	2.13%	21.05%
Speculative Buy	124	13.89%	70.97%
	893*	100.0%	

*Total includes stocks that are Under Review

Canaccord Genuity Ratings System

BUY: The stock is expected to generate risk-adjusted returns of over 10% during the next 12 months.

HOLD: The stock is expected to generate risk-adjusted returns of 0-10% during the next 12 months.

SELL: The stock is expected to generate negative risk-adjusted returns during the next 12 months.

NOT RATED: Canaccord Genuity does not provide research coverage of the relevant issuer.

"Risk-adjusted return" refers to the expected return in relation to the amount of risk associated with the designated investment or the relevant issuer.

Risk Qualifier

SPECULATIVE: Stocks bear significantly higher risk that typically cannot be valued by normal fundamental criteria. Investments in the stock may result in material loss.

12-Month Recommendation History (as of date same as the **Global Stock Ratings** table)

A list of all the recommendations on any issuer under coverage that was disseminated during the preceding 12-month period may be obtained at the following website (provided as a hyperlink if this report is being read electronically) http://disclosures-mar.canaccordgenuity.com/EN/Pages/default.aspx

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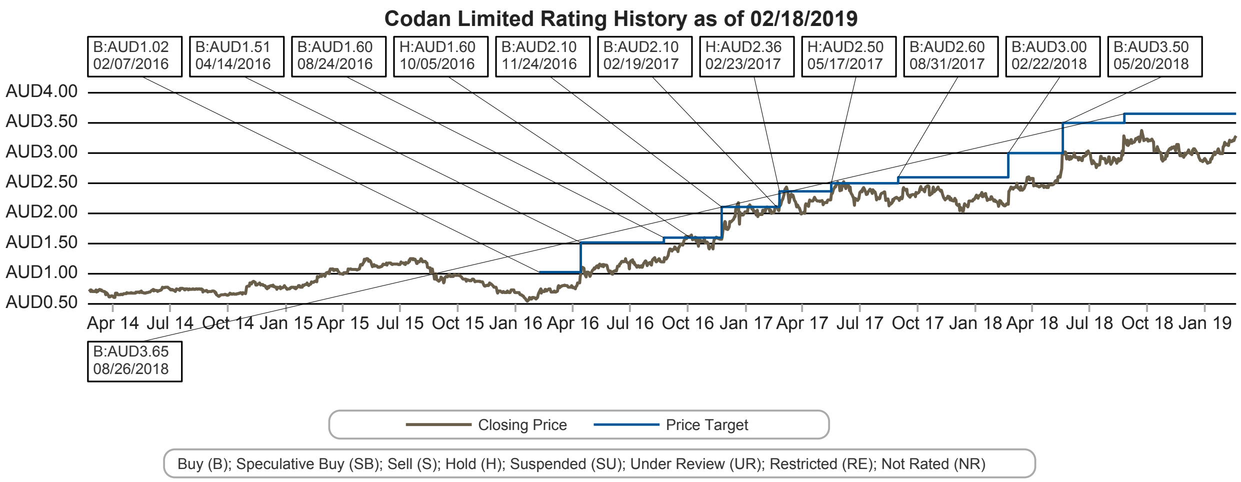

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