

Australian Equity Research
 20 May 2018

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BUY

unchanged

PRICE TARGET A\$3.50↑

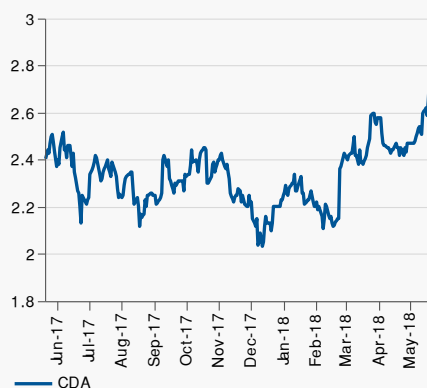
from A\$3.00

Price (20-May) A\$2.99

Ticker CDA-ASX

| | |
|--------------------------|-------------|
| 52-Week Range (A\$): | 1.96 - 3.12 |
| Avg Daily Vol (000s) : | 300.0 |
| Market Cap (A\$M): | 417 |
| Shares Out. (M) : | 177.1 |
| Dividend /Shr (AUc): | 3.5 |
| Dividend Yield (%) : | 117.1 |
| Net Debt (Cash) (A\$M): | (20) |
| Enterprise Value (A\$M): | 510 |
| Cash (A\$M): | 20.0 |
| Long-Term Debt (A\$M): | 0.0 |

| FYE Jun | 2016A | 2017A | 2018E | 2019E |
|-----------------------|-------|-------|--------|--------|
| Sales (A\$M) | 169.5 | 226.1 | 220.3↑ | 221.7↑ |
| Previous | - | - | 201.9 | 220.3 |
| EBITDA (A\$M) | 41.9 | 75.6 | 66.4↑ | 70.5↑ |
| Previous | - | - | 61.6 | 69.8 |
| Net Income Adj (A\$M) | 21.1 | 44.7 | 38.0↑ | 40.8↑ |
| Previous | - | - | 34.5 | 40.0 |
| EPS Adj&Dil (AUc) | 11.9 | 25.2 | 21.5↑ | 23.0↑ |
| Previous | - | - | 19.5 | 22.5 |
| P/E (x) | 25.1 | 11.9 | 13.9 | 13.0 |
| EV/EBITDA (x) | 13.0 | 6.7 | 7.6 | 6.9 |
| DPS (AUc) | 6.00 | 13.00 | 10.00↑ | 12.00 |
| Previous | - | - | 9.00 | - |
| Div. Yield (%) | 2.0 | 4.3 | 3.3 | 4.0 |



Priced as of close of business 20 May 2018

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

Raising Target Price

Detecting a re-rating

CDA provided positive earnings guidance on Friday, which was ~10% ahead of our estimates. Strong demand for its metal detection products was a key driver. In addition, CDA announced that its Tracking Solutions division, Minetec, was awarded a significant contract with BHP. As a result, the company has guided to FY18 NPAT of \$38.0m. We believe that the momentum in metal detection and the emergence of Minetec will drive base line earnings higher in FY18. This should continue to drive a re-rating, in our view. We have upgraded our target price to A\$3.50 per share and retain our BUY rating.

Key points

Earnings guidance – CDA has announced strong earnings guidance that was approximately 9%-10% ahead of our estimates and consensus. The company provided FY18 guidance for NPAT “to be in the region of \$38m” compared to our estimates of \$34.5m. The strong guidance has been driven by continued demand for metal detectors. The pleasing aspect was the spread across a number of new products. This is a positive sign for base level NPA, which the company has previously flagged as \$20-25m. We suspect that with a broader product range this is likely to increase to \$25-30m. It appears from the implied 2H18 performance that base line earnings are improving.

Strong cash generation a highlight – The profit guidance also noted that the balance sheet was in a net cash position of \$20m as at 30 April. This compares to a \$4.4m net debt position at 31 December and following the \$7.0m dividend payment in April means cash generation in excess of \$30m during the four months to 30 April.

Minetec secures major contract – CDA also announced that Minetec, which provides tracking, productivity and safety solutions to the underground mining industry, has been awarded a major contract with BHP Billiton (BHP). Minetec will supply BHP’s Olympic Dam mine in South Australia with an underground Fleet Management System under a contract estimated at \$9.5m over a 12-18 month period. This compares to 1H18 divisional revenue of \$2.3m and therefore is a significant contract win. We understand the tender was very competitive, and in addition to the recent distribution agreement with Caterpillar, will assist in Minetec being able to expand rapidly, in our view.

Forecast changes

FY18 EPS ↑10.3% to 21.5c and FY19 EPS ↑2.1% to 23.0

Valuation and recommendation

We have increased our valuation on CDA to A\$3.50 per share (A\$3.00 per share previously). We have maintained our methodology of pricing CDA at a 20% discount to the Small Industrials average; however, we have rolled forward our valuation to our FY19 estimate. Our revised valuation and target price are based on an 8.4x FY19 EBITDA multiple. We view the discount as warranted at this point but expect the discount to narrow as further evidence of sustainability and growth is demonstrated. This could be from the existing businesses or from an acquisition which could further bolster the company’s earnings profile. We continue with a BUY rating. We are of the view that we are seeing an increase in the base level earnings, which should continue to drive a re-rating, in our view.

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

| Profit & Loss (\$m) | 2017A | 2018F | 2019F | 2020F | Valuation ratios | 2017A | 2018F | 2019F | 2020F |
|---|--------------|-------|-------|-------|------------------------|-------|-------|--------|--------|
| Sales Revenue | 226.1 | 220.3 | 221.7 | 240.0 | EPS (cps) | 25.2 | 21.5 | 23.0 | 25.3 |
| EBITDA | 75.6 | 66.4 | 70.5 | 77.1 | P/E (x) | 11.9 | 13.9 | 13.0 | 11.8 |
| Depreciation | -2.4 | -1.9 | -2.1 | -2.3 | PER Rel - All Ind. | -42% | -33% | -37% | -36% |
| EBITA | 73.1 | 64.6 | 68.4 | 74.8 | PER Rel - Small Ind. | -38% | -27% | -32% | -30% |
| Amortisation | -11.6 | -12.3 | -12.9 | -14.3 | Enterprise Value (\$m) | 508.7 | 502.7 | 485.9 | 466.3 |
| EBIT | 61.5 | 52.2 | 55.5 | 60.5 | EV / EBITDA (x) | 6.7 | 7.6 | 6.9 | 6.1 |
| Net Interest Expense | -0.8 | -0.4 | 0.1 | 0.5 | EV / EBIT (x) | 8.3 | 9.6 | 8.8 | 7.7 |
| NPBT | 60.7 | 51.8 | 55.6 | 61.0 | DPS (cps) | 13.0 | 10.0 | 12.0 | 13.0 |
| Tax expense | -16.0 | -13.8 | -14.8 | -16.2 | Dividend Yield (%) | 4.3% | 3.3% | 4.0% | 4.3% |
| NPAT - underlying | 44.7 | 38.0 | 40.8 | 44.8 | Franking (%) | 100% | 100% | 100% | 100% |
| Significant items | -1.2 | 0.0 | 0.0 | 0.0 | CFPS (cps) | 42.6 | 23.4 | 29.7 | 32.6 |
| Reported NPAT | 43.5 | 38.0 | 40.8 | 44.8 | P / CFPS (x) | 7.0 | 12.8 | 10.1 | 9.2 |
| Cash Flow (\$m) | 2017A | 2018F | 2019F | 2020F | Profitability ratios | 2017A | 2018F | 2019F | 2020F |
| Operating EBITDA | 75.6 | 66.4 | 70.5 | 77.1 | EBITDA Margin (%) | 33.4 | 30.1 | 31.8 | 32.1 |
| - Interest & Tax Paid | -7.2 | -16.4 | -13.7 | -14.3 | EBIT Margin (%) | 27.2 | 23.7 | 25.0 | 25.2 |
| +/- change in Work. Cap. | 2.2 | -11.5 | -0.2 | -2.2 | ROE (%) | 27.1 | 21.3 | 20.3 | 19.8 |
| - other | 5.0 | 2.9 | -4.1 | -2.7 | ROA (%) | 29.1 | 24.5 | 25.4 | 26.6 |
| Operating Cashflow | 75.6 | 41.4 | 52.6 | 57.9 | ROIC (%) | 31.8 | 25.5 | 26.1 | 27.4 |
| - Capex | -16.4 | -17.0 | -17.0 | -17.0 | Balance Sheet ratios | 2017A | 2018F | 2019F | 2020F |
| - Acquisitions/divestments | -4.1 | 0.0 | 0.0 | 0.0 | Net Debt (cash) | -21.4 | -27.5 | -44.2 | -63.8 |
| - other | -3.2 | 0.0 | 0.0 | 0.0 | Net Gearing (%) | -13.0 | -15.4 | -22.0 | -28.2 |
| Free Cashflow | 51.9 | 24.4 | 35.6 | 40.9 | Interest Cover (x) | 76.9 | 130.6 | -555.0 | -121.1 |
| - Ord Dividends | -17.7 | -18.4 | -18.8 | -21.3 | NTA per share (\$) | 0.44 | 0.54 | 0.66 | 0.81 |
| - Equity /other | 0.0 | 0.0 | 0.0 | 0.0 | Price / NTA (x) | 6.7 | 5.6 | 4.5 | 3.7 |
| Net Cashflow | 34.2 | 6.0 | 16.8 | 19.6 | EFPOWA (m) | 177.3 | 177.3 | 177.3 | 177.3 |
| Cash at beginning of period | 14.3 | 21.4 | 42.5 | 44.2 | Growth ratios | 2017A | 2018F | 2019F | 2020F |
| +/- borrowings / other | -27.1 | 15.0 | -15.0 | 0.0 | Sales revenue (\$m) | 33% | -3% | 1% | 8% |
| Cash at end of period | 21.4 | 42.5 | 44.2 | 63.8 | EBITDA (\$m) | 80% | -12% | 6% | 9% |
| Balance Sheet | 2017A | 2018F | 2019F | 2020F | EBIT (\$m) | 111% | -15% | 6% | 9% |
| Cash | 21.4 | 42.5 | 44.2 | 63.8 | NPAT (\$m) | 112% | -15% | 7% | 10% |
| Inventories | 31.0 | 30.8 | 31.0 | 33.6 | EPS (cps) | 112% | -15% | 7% | 10% |
| Debtors | 20.6 | 26.4 | 26.6 | 28.8 | DPS (cps) | 117% | -23% | 20% | 8% |
| PPE | 12.0 | 13.9 | 15.2 | 16.4 | Interim Analysis | 1H17A | 2H17A | 1H18A | 2H18E |
| Intangibles | 86.2 | 85.8 | 85.6 | 85.4 | Communications | 35.0 | 35.9 | 29.0 | 36.4 |
| Other assets | 61.5 | 56.0 | 60.3 | 63.3 | Metal Detection | 64.8 | 83.2 | 63.5 | 83.2 |
| Total Assets | 232.7 | 255.5 | 263.0 | 291.2 | Tracking Solutions | 4.1 | 3.1 | 2.3 | 5.9 |
| Borrowings | 0.0 | 15.0 | 0.0 | 0.0 | Total revenue | 103.9 | 122.2 | 94.7 | 125.5 |
| Trade Creditors | 36.6 | 30.8 | 31.0 | 33.6 | EBITDA | 37.5 | 38.1 | 27.4 | 39.0 |
| Other Liabilities | 31.1 | 31.1 | 31.1 | 31.1 | EBITDA margin (%) | 36.1% | 31.2% | 28.9% | 31.1% |
| Total Liabilities | 67.7 | 76.9 | 62.1 | 64.7 | NPAT (\$m) | 22.2 | 22.5 | 15.8 | 22.2 |
| NET ASSETS | 165.0 | 178.6 | 200.9 | 226.6 | EPS | 12.5 | 12.7 | 8.8 | 12.5 |
| Board of Directors / Substantial Shareholders | | | | | DPS | 6.0 | 7.0 | 4.0 | 5.0 |
| Board of Directors | Shareholding | | | % | Valuation | | | 2018 | 2019 |
| David Simmonds - Chairman | 0.0 | | | 0.0% | EBITDA multiple (x) | | | 66.4 | 70.5 |
| Donald McGurk - MD | 0.8 | | | 0.5% | EBITDA (\$m) | | | 66.4 | 70.5 |
| Peter Griffiths - N-E Director | 0.1 | | | 0.1% | Target multiple (x) | | | 8.9 | 8.4 |
| David Klingberg - N-E Director | 0.1 | | | 0.0% | Net Debt (cash) (\$m) | | | -27.5 | -27.5 |
| Brian Burns - N-E Director | 0.0 | | | 0.0% | Implied Valuation | | | 619.7 | 619.7 |
| James McDowell - N-E Director | 0.0 | | | 0.0% | Per Share | | | 3.50 | 3.50 |
| Lt Gen Peter Leahy - N-E Director | 0.4 | | | 0.3% | Target PE Multiple | | | 3.50 | 3.50 |
| Graeme Barclay - N-E Director | 0.0 | | | 0.0% | EPS (c) | | | 21.5 | 23.0 |
| Substantial Shareholders | Shareholding | | | % | PE Target (x) | | | 16.3 | 15.2 |
| IB Wall and PM Wall | 34.8 | | | 19.7% | Per Share | | | 3.50 | 3.50 |
| 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 (SJ Wood) | 10.6 | | | 6.0% | | | | | |
| Top 20 Shareholders | 109.6 | | | 66.8% | | | | | |

Source: Company Reports, Canaccord Genuity estimates

Profit guidance points to positive trend

Earnings guidance – CDA has announced strong earnings guidance that was approximately 9%-10% ahead of our estimates and consensus. The company provided FY18 guidance for NPAT “to be in the region of \$38m” compared to our estimates of \$34.5m.

Figure 2: Earnings downgrade comes shortly following guidance in late February

| | CG est | Consensus est | Company guidance | Upgrade |
|-----------------|--------|---------------|------------------|---------|
| FY18 NPAT (\$m) | \$34.5 | \$34.9 | \$38.0 | 9%-10% |

Source: Company Reports, Canaccord Genuity estimates

2H18 implies a positive trend – The strong guidance has been driven by continued demand for metal detectors. The pleasing aspect was the spread across a number of new products rather than being driven solely by demand for Minelab’s high value, high margin, GPZ7000 or any ‘gold rush’ demand. Management noted that product releases, including the Equinox coin and treasure detector, as well as lower and mid-priced gold detector products (Gold Monster and SDC) has meant that demand has been more broad based. This is a positive sign for base level NPAT in our view, which the company has previously flagged as \$20-25m. We suspect that with a broader product range this is likely to increase to \$25-30m. It certainly appears from the implied 2H18 performance that base line earnings are improving.

Figure 3: Baseline earnings appear to be shifting above \$20-25m NPAT for a full year

| | 1H17 | 2H17 | 1H18 | 2H18E* |
|-----------------------|------|------|------|--------|
| Underlying NPAT (\$m) | 22.2 | 22.5 | 15.8 | 22.3 |

*Implied by FY18 guidance

Source: Company Reports, Canaccord Genuity estimates

Strong cash generation a highlight – The profit guidance also noted that the balance sheet was in a net cash position of \$20m as at 30 April. This compares to a \$4.4m net debt position at 31 December and following the \$7.0m dividend payment in April means cash generation in excess of \$30m during the four months to 30 April.

Minetec secures major contract – CDA also announced that Minetec, which provides tracking, productivity and safety solutions to the underground mining industry, has been awarded a major contract with BHP Billiton (BHP). Minetec will supply BHP’s Olympic Dam mine in South Australia with an underground Fleet Management System under a contract estimated at \$9.5m over a 12-18 month period. This compares to 1H18 divisional revenue of \$2.3m and therefore is a significant contract win. We understand the tender was very competitive and in addition to the recent distribution agreement with Caterpillar, will assist in Minetec being able to expand rapidly in our view.

Forecast changes

We outline our changes in Figure 4 below. We have increased FY18 NPAT in line with guidance to \$38m. In FY19, there are some small changes to reflect the BHP contract within Minetec.

Figure 4: Forecast changes

| (\$M) | FY18 | | | FY19 | | |
|----------------------|-------|-------|----------|-------|-------|----------|
| | Old | New | % Change | Old | New | % Change |
| Communications | 65.4 | 65.4 | 0.0% | 71.4 | 71.4 | 0.0% |
| Metal Detection | 130.7 | 146.9 | 12.4% | 134.0 | 134.0 | 0.0% |
| Mine Technology | 6.1 | 8.3 | 36.3% | 14.9 | 16.3 | 9.2% |
| Total Revenue | 201.9 | 220.3 | 9.1% | 220.3 | 221.7 | 0.6% |
| EBITDA (\$m) | 61.6 | 66.4 | 7.9% | 69.8 | 70.5 | 0.9% |
| Underlying NPAT | 34.5 | 38.0 | 10.3% | 40.0 | 40.8 | 2.1% |
| EPS (\$) –normalised | 19.5 | 21.5 | 10.3% | 22.5 | 23.0 | 2.1% |
| DPS (\$) –normalised | 9.0 | 10.0 | 11.1% | 12.0 | 12.0 | 0.0% |
| EBITDA margin (%) | 30.5% | 30.1% | | 31.7% | 31.8% | |

Source: Canaccord Genuity estimates

Valuation and recommendation

Valuation – We have increased our valuation on CDA to A\$3.50 per share (A\$3.00 per share previously). We have maintained our methodology of pricing CDA at a 20% discount to the Small Industrials average; however, we have rolled forward our valuation to our FY19 estimate. Our revised valuation and target price are based on an 8.4x FY19 EBITDA multiple. We view the discount as warranted at this point but expect the discount to narrow as further evidence of sustainability and growth is demonstrated. This could be from the existing businesses or from an acquisition which could further bolster the company's earnings profile.

Recommendation – We continue with a BUY rating on CDA. We are of the view that we are seeing an increase in the base level earnings, which should continue to drive a re-rating, in our view.

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Investment Recommendation

Date and time of first dissemination: May 20, 2018, 16:29 ET

Date and time of production: May 20, 2018, 14:55 ET

Target Price / Valuation Methodology:

Codan Limited - CDA

Our A\$3.50 target price is based on applying a 8.4x multiple (20% discount to Small Industrials average) to FY19 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 05/20/18)

| Rating | Coverage Universe | | IB Clients |
|-----------------|-------------------|--------|------------|
| | # | % | % |
| Buy | 573 | 61.55% | 41.71% |
| Hold | 229 | 24.60% | 24.45% |
| Sell | 22 | 2.36% | 18.18% |
| Speculative Buy | 107 | 11.49% | 64.49% |
| | 931* | 100.0% | |

*Total includes stocks that are Under Review

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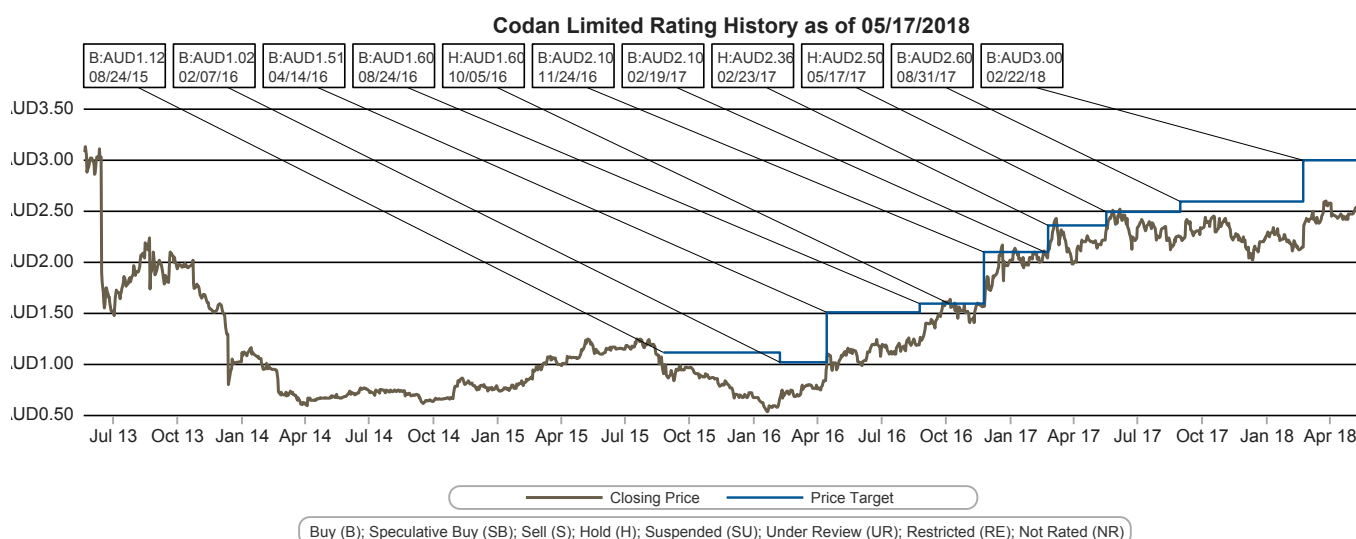
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