

## Codan Limited

Buy

## Golden Era Continues for the GPZ7000

Technology Hardware &amp; Equipment / Electronic Equipment &amp; Instruments

24 February 2017

## Company Update

Ticker	CDA
Stock Price	\$2.15
Target Price	\$2.40
Forecast Capital Return	11.6%
Forecast Dividend Yield	4.9%
Estimated Total Return - 12 Mth Forward	16.5%

## Company market data

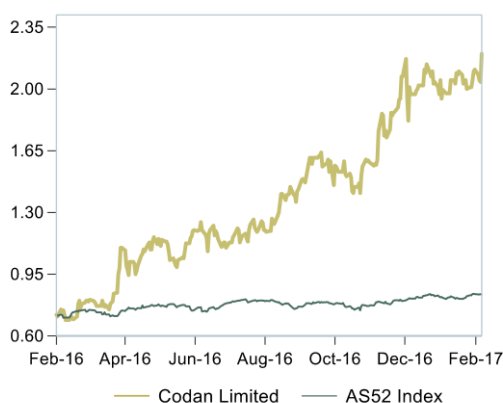
Market Cap.	\$381.0m
Enterprise Value	\$380.6m
52 Week Range	\$0.69 - \$2.20
Shares Out.	177.2m

Estimates changes	2016a	2017e	2018e	2019e
Core NPAT - <i>old</i>	21.1	34.3	28.6	28.8
Core NPAT - <i>new</i>	21.1	37.5	30.9	31.2
% Change	0.0	9.2	8.1	8.4
Core EPS dil. (¢) - <i>old</i>	11.9	19.4	16.1	16.3
Core EPS dil. (¢) - <i>new</i>	11.9	21.1	17.5	17.6
% Change	0.0	9.2	8.1	8.4
DPS (¢) - <i>old</i>	6.0	10.1	8.4	8.9
DPS (¢) - <i>new</i>	6.0	10.5	9.1	9.7
% Change	0.0	4.3	7.8	8.9

All figures are in AUD unless otherwise specified.

## Share price performance

Codan Limited vs. AS52 (rebased index)



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## Event

CDA 1H17 Result & updated FY17 guidance.

We maintain our **BUY** rating with a revised **target price of \$2.40**.

## Key Takeaways

CDA has reported its strongest 1H17 result in 4 years, led by continued sales momentum within the Metal Detection division.

Management has **upgraded FY17 Underlying NPAT guidance to be "in the region of \$35m"** (vs. previous guidance: \$30-\$32m), following a strong final 2 months to 1H17 and improved visibility of 2H earnings since its last company update in Nov'16.

Key takeaways from the 1H17 result include:

- **1H17 Underlying NPAT of \$22.2m:** Ahead of guidance (\$20-\$22m) and Moelis est. (\$21.4m).
- **Interim dividend of 3.0c, plus special dividend of 3.0c.**
- **Metal Detection: EBIT of \$28.5m** (vs. Moelis est. \$26.4m) led by strong sales of the flagship detector (GPZ7000) into Africa and expanding EBIT margins showcasing the division's significant operating leverage.
- **Radio Communications: EBIT of \$9.8m** (vs. Moelis est. \$9.8m) buoyed by a large HF contract delivered in 1Q17. 2H17 is forecast to be down on 1H17.
- **Mining Technology: Revenue of \$4.1m** (vs. Moelis est. \$4m) with the division posting a positive contribution of \$0.3m. A small profit remains forecast for FY17 (vs. \$1.2m loss in FY16).
- **CDA remains net cash and well positioned for further investment & acquisitions.**

## Investment View

We again believe that management's guidance is conservative and have therefore provided estimates ahead of their guided range.

We now estimate FY17 NPAT of \$37.5m (vs. prev. Moelis est. \$34.3m).

We note that our estimates contain a ~60% skew towards 1H17, reflecting a slight easing in Metal Detection sales and management guiding to a lower 2H for the Radio Communications division.

Our target price of \$2.40 implies an undemanding ~11.3x FY17 P/E multiple (~25% discount to the ASX Small Industrials).

Y/E Jun 30	2016a	2017e	2018e	2019e
EBITDA	41.9	63.2	54.5	56.1
EV/EBITDA	9.1x	6.0x	7.0x	6.8x
Core NPAT	21.1	37.5	30.9	31.2
Core EPS (Diluted) (¢)	11.9	21.1	17.5	17.6
P/E	18.0x	10.2x	12.3x	12.2x
EPS growth	65.6%	77.4%	(17.4%)	1.0%
DPS (¢)	6.0	10.5	9.1	9.7
Yield	2.8%	4.9%	4.2%	4.5%
DPS growth	71.4%	74.9%	(13.8%)	7.6%
Dividend Payout Ratio	50.4%	49.7%	51.9%	55.3%

All figures are in AUD.

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## 1H17 Result - Key Takeaways

- **1H17 Underlying NPAT of \$22.2m:** Ahead of guidance (\$20-\$22m) and Moelis est. \$21.4m, led by strong performance of the Metal Detection division which has maintained its 2H16 sales momentum.
- **Interim dividend of 3.0c, plus special dividend of 3.0c,** with payout ratio maintained at ~50%.
- **Underling FY17 Underlying NPAT guidance upgraded to be “in the region of \$35m”** (vs. previous guidance of \$30-32m). We again believe management guidance may be conservative as would appear to assume metal detection sales reducing towards a more normalised run-rate in 2H17. While we agree that a moderation in Metal Detection sales is likely, we still expect to see some momentum carry through into 2H17 and elevate sales beyond normalised levels.
- **Metal Detection 1H17: Revenue \$65m / EBIT \$28.4m** (vs. Moelis est. Revenue \$67m / EBIT \$26m)
  - i. Metal Detection demand in Nov & Dec’16 remained at the approx. monthly run rate of Jul-Oct’16, suggesting momentum is likely to continue into 2H17.
  - ii. Revenues were underpinned by sales of the flagship GPZ7000 detector (~\$10,000 per unit), particularly into Africa.
  - iii. Encouragingly, management commented that “Demand for the GPZ7000 is being driven by its superior performance rather than gold surges in isolated markets, giving us confidence that this is driving replacement sales as customers upgrade their existing GPX equipment”.
    - ◆ Refer to page 5 of this report (section titled ‘Metal Detection – can the GPZ7000’s impressive run continue?’) for our analysis on the sustainability of sales.
- **Radio Communications 1H17: Revenue \$35m / EBIT \$9.8m** (vs. Moelis est. Revenue \$35m / EBIT \$10m)
  - i. Buoyed by a large contract delivered in 1Q17. 2H17 forecast to be lower than 1H17.
  - ii. We estimate FY17 should be ~\$5m lower at the revenue line YoY, but just ~\$4m lower at the EBIT line. This is principally driven by a slowdown in Land Mobile Radio sales in North America in the lead up to the U.S election, which should be partially offset by improved performance (and margin expansion) within HF.
- **Mining Technology 1H17: Revenue \$4.1m / EBIT \$0.3m** (vs. Moelis est. Revenue \$4m / EBIT \$0.6m)
  - i. Small profit for the division in FY17 (vs. \$1.2m loss in FY16).
  - ii. Gaining sales traction evidenced by two contracts announced in 1H17 (~\$2.8m revenue).
    - ◆ Successful installation of Mining Tech equipment at underground gold mine in WA (related to contract announced in Aug’16).
  - iii. Recent turnaround in commodities may act tailwind in 2H17.
- **CDA remains net cash and well positioned for further investment & acquisitions**
  - i. Positive operating cash flows generated in 1H17 have been largely used to pay down borrowings, positioning the company to explore growth via accretive acquisitions.

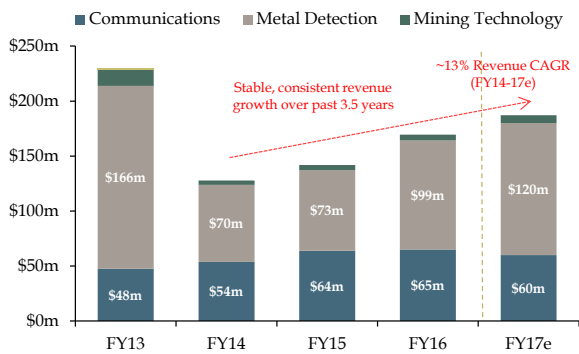
## CDA Investment Thesis

In our view, there are many reasons to believe that CDA's existing earnings are of greater quality than the Group's historical earnings (particularly with reference to the strong performance experiences during periods such as 2013).

Key drivers supporting this thesis have been set out below:

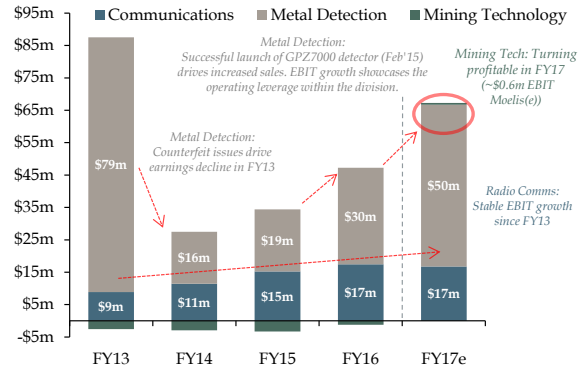
- **Evidence of more consistent and sustainable underlying group earnings:**
  - i. Consistent Group revenue and EBIT growth since FY14 (see figure 1&2 below)
  - ii. Greater contributions now being made from a diversified product base that is continuing to extend into additional regions/markets.

**Figure 1: Revenue (by Division)**



Source: Company Reports, Moelis and Company Research

**Figure 2: EBIT (by Division, excl. unallocated expenses)**



Source: Company Reports, Moelis and Company Research

- **Large investment being made into product and distribution:**
  - i. Four years of significant product investment (~\$16m per year) producing a range of products that have recently (or are soon to be) released.
  - ii. Investment also made into global sales and distribution networks, with sales staff now located in more strategic locations best suited for servicing the end customer.
- **Improved quality of Metal Detection earnings due to:**
  - i. No counterfeit of flagship world-leading GPZ7000 detector after two years on the market, proving the sophistication of the products Military-grade encryption. Investing into Intellectual Property protection has been a core part of CDA's strategy in recent years.
  - ii. Sales expansion into new African regions, reducing reliance on any sole geography and improving the likelihood of capturing gold surge activity on the continent. Notably, no gold surge activity has been documented within Africa over the past 12 months.
  - iii. Replacement cycle likely has further to run as customers upgrade from old GPX Model Detector (~120,000 units sold historically) for newer GPZ7000 detector (~12,000 units sold since launch in Feb'15).
  - iv. Entry into spare parts and entry-level detector markets should further underpin sales.
- **Opportunities for Radio Communications in FY17 & FY18 including:**
  - i. Demand for High Frequency Radio's due to unstable global environment and ongoing conflicts throughout the Middle East & Africa. Innovative HF Radio product releases in 1H17 aimed at new target markets including Military 2 (developing world army).
  - ii. Land Mobile Radio (LMR)'s 'Cascade' product (due for release in 1H18) will expand reach in the North American LMR market. Management believe Trump Administration policies may provide a net tailwind to sales (increased infrastructure spend etc.).
- **Mining Technology division turning profitable in FY17**, with recent turnaround in commodities perhaps acting as a tailwind for product sales in 2H17
- **New Defence Electronics division** may leverage existing IP for defence sector opportunities.
- **Net cash balance sheet that is well positioned for growth via accretive acquisitions** which management are currently evaluating.

## Metal Detection – can the GPZ7000’s impressive run continue?

The largest swing factor for CDA’s FY17 earnings is the sales momentum within its Metal Detection division in 2H17. This will largely be determined by the sales of the division’s flagship detector - the GPZ7000 (released Feb’15).

Figure 3: GPZ7000 Detector



GPZ7000 Metal Detectors sell for ~\$10,000 per unit with very high gross margin.

African demand for the product has been particularly strong during 2H16 & 1H17.

Source: Company Reports

### Our View

While we estimate that 2H17 Metal Detection revenues will ease from the elevated levels experienced in 1H17, we are of the view that sales momentum is likely to continue above management’s estimates of “predictable and sustainable” underlying levels for the Division (i.e. annual run rate of ~\$70m).

### Our Estimates (& Earnings Sensitivities)

Below we set out our estimates for Metal Detection in 2H17 alongside 1H17 actual and management estimates of “predictable and sustainable” underlying revenues for the Division (per 2016 AGM):

Figure 4: Earnings Sensitivities – Moelis Estimates

	Scenario 1 (High Case - 2H17 run-rate @ 1H17 rate)	Scenario 2 (Moelis est.) (Mid Case - 2H17 run rate @ 85% 1H17 rate)	Scenario 3 (2H run-rate @ normalised levels)
2H17 Revenue (Metal Detection, Monthly Run-Rate)	\$11.0m/month	\$9.2m/month	\$7.3m/month
FY17 Total Revenue (Metal Detection)	\$131m	\$120m (Moelis Est.)	\$109m
CDA Group NPAT (Moelis est.)	\$42m	\$37.5m (Moelis Est.)	\$33m

Moelis estimated 2H17 revenue assumes [25] % discount vs. 1H17 levels.

Source: Company, Moelis Analysis

Using our assumptions across the rest of the CDA Group, this scenario analysis suggests:

- **Scenario 1** - Should 2H17 Metal Detection revenues remain at 1H17 levels, Group FY17 NPAT could reach ~\$42m.
- **Scenario 2 (Moelis est.)** - Should 2H17 Metal Detection revenues reduce by ~15% from 1H17 levels, Group FY17 NPAT could arrive at ~\$37.5m.
- **Scenario 3** - Should 2H17 Metal Detection revenues normalise down to levels quoted by management as “predictable and sustainable” for this division, Group FY17 NPAT could be delivered at ~\$33m.

**Key factors influencing Metal Detection’s ongoing performance**

Below we outline the factors that support our assessment that 2H17 sales should remain above “predictable and sustainable levels”.

**1. Replacement cycle may have further to run**

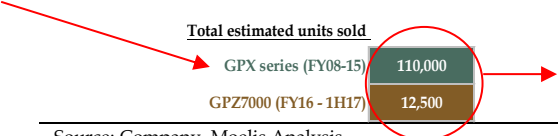
CDA has stated that a high proportion of sales relate to customers replacing/upgrading from the old GPX model to the latest GPZ7000 model.

Figure 5 below estimates the unit sales of the older GPX model detector (during its time as CDA’s flagship detector FY08-15), vs. the GPZ7000 (which began gaining sales traction in FY16).

**Figure 5: Old (GPX) vs. New (GPZ) model sales (during period of flagship detector status, Moelis est.)**

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	1H17
Flagship Detector Model	GPX	GPX	GPX	GPX	GPX	GPX	GPX	GPX	GPZ7000	GPZ7000
Metal Detection Revenue	\$42m	\$107m	\$107m	\$92m	\$99m	\$166m	\$70m	\$73m	\$99m	\$65m
Estimated revenue from flagship device (assuming 60% of division sales attributed to flagship detector series)	\$25m	\$64m	\$64m	\$55m	\$59m	\$100m	\$42m	\$44m	\$60m	\$39m
Estimated GPX5000 units sold (assuming ~\$4,500/unit avg. RRP)	6,000	15,200	15,200	13,200	14,100	23,800	10,000	10,500		
Estimated GPZ7000 units sold (assuming ~\$8-10,000/unit avg. RRP)									7,400	4,900
<b>Total estimated units sold</b>										
GPX series (FY08-15)	110,000									
GPZ7000 (FY16 - 1H17)	12,500									

*We note that in addition to this estimate there may have been many more counterfeit GPX units sold units sold*



*Historical CDA Unit Sales: ~100,000 GPX vs. ~10,000 GPZ Supporting evidence for continuation of the GPZ replacement cycle?*

Source: Company, Moelis Analysis

Based on the approximation above, we estimate historical sales of ~110,000 units for the old GPX model vs. ~12,000 units for the latest GPZ7000 model.

However, we would also point out the following:

- The GPZ model price may rule out many previous GPX customers (~2x higher price)
- Developed-world markets are more mature today than at the inception of the GPX model.

Despite these considerations however, we believe that the analysis above suggests the GPZ7000 machine may still be in the early to mid-phase of the replacement cycle.

**2. Counterfeit protection through military-grade encryption**

After 2yrs on the market, there has been no known counterfeit of the GPZ7000 device, proving the sophistication of the product’s military-grade encryption (we note this was a key factor in the sales decline of the GPX model which was counterfeited in 2013).

**3. Geographic Sales Expansion into more African Regions**

Expansion into ~8 African countries has reduced reliance on any one region, and has increased the chance of capturing gold surge activity on the continent.

Interestingly, there has been no recorded gold surge activity over the past 12 months, boding well for the sustainability of continued sales.

Certain African countries well known for their gold activity, such as Guinea, that over the past few years have purchased very few gold detection products from CDA, have recently started making purchases of GPZ7000 machines.

**4. Lower unit sales required to generate revenues**

Higher price point of the GPZ means much lower units sales are required to generate the same levels of revenues experienced during previous sales peaks (such as 2013).

Revenues that 2013 would have required flagship detector unit sales of ~3,000 month, now only require GPZ sales of ~1000/month.

**5. Establishment of Dubai Sales Office (improved distribution network)**

An important location for African dealers looking to source gold detection products, Dubai has placed CDA closer to its end consumer markets. Improvements across the distribution network have increased divisional margins and access to end-customer feedback.

**6. New product offerings opening up new end-user markets**

New entry-level products are expanding the Division’s target markets, and entry into the spare parts market also provides an opportunity for high-margin sales. The recent launch of the extension coil for the GPZ7000 in Australia has had an ‘excellent customer reaction”, which should see its release to other regions.

**7. Gold price appreciation**

Gold is up ~7% in CY2017 and is now back at the levels of the GPZ7000’s release (Feb’15).

Obviously the metal price supports the economics & viability of gold prospecting:

**Figure 6: Gold Price**



Source: Company, Moelis Analysis

**8. Historical seasonality skew towards 2<sup>nd</sup> half**

Over each of the past 3 years there has been a skew in Metal Detection earnings towards 2<sup>nd</sup> half. Given the exceptional performance in 1H17, we do not anticipated this to occur in 2H17, however, the seasonality factors (such as weather conditions) that historically drive this skew, may continue to help support sales in 2H17.



## Revised Earnings Estimates

### Group Earnings Estimates

Our revised earnings estimates for the Group are set out below:

Figure 7: CDA Group Earnings (Moelis Estimates, \$m's)

	FY17 (Moelis est.)			FY16 (Actual)		
	1H17	2H17	FY17	1H16	2H16	FY16
<i>Metal Detection</i>	65	55	120	34	66	99
<i>Radio Communications</i>	35	25	60	29	36	65
<i>Mining Technology</i>	4	3	7	2	3	5
<b>Revenue</b>	<b>104</b>	<b>83</b>	<b>187</b>	<b>65</b>	<b>105</b>	<b>170</b>
<b>Gross Profit</b>	<b>64</b>	<b>51</b>	<b>115</b>	<b>36</b>	<b>58</b>	<b>94</b>
<b>Operating Costs</b>	<b>(26)</b>	<b>(22)</b>	<b>(48)</b>	<b>(28)</b>	<b>(39)</b>	<b>(67)</b>
<i>Metal Detection</i>	28	22	50	9	20	29
<i>Radio Communications</i>	10	7	17	7	15	21
<i>Mining Technology</i>	0.4	0.2	0.6	(1.3)	0.1	(1.2)
<i>Unallocated Expenses</i>	(8)	(9)	(17)	(6)	(12)	(19)
<b>NPBT</b>	<b>30</b>	<b>21</b>	<b>50</b>	<b>8</b>	<b>23</b>	<b>31</b>
Tax	(7)	(5)	(12)	(6)	(5)	(10)
<b>Underlying NPAT</b>	<b>22.6</b>	<b>15.5</b>	<b>37.5</b>	<b>7.0</b>	<b>15.0</b>	<b>21.1</b>
<b>EPS</b>	<i>12.8 cps</i>	<i>8.7 cps</i>	<b>21.1 cps</b>	<i>4.0 cps</i>	<i>8.4 cps</i>	<b>11.9 cps</b>
<b>DPS</b>	<i>6.0 cps</i>	<i>4.5 cps</i>	<b>10.5 cps</b>	<i>2.0 cps</i>	<i>4.0 cps</i>	<b>6.0 cps</b>

Source: Company, Moelis Analysis

### Key Takeaways

- *Group Underlying NPAT* estimated to increase by ~77% YoY, primarily driven by stronger sales in the Metal Detection division.
- *Metal Detection*: Revenue +20% YoY, NPBT + 70% YoY. A greater weighting of GPZ7000 sales has improved gross margins, which coupled with the divisions significant operating leverage has driven an expansion in EBIT margin.
- *Radio Communications* revenue to decrease in 2H17 (vs. 1H17) due to 1H17 being buoyed by delivery of an ~\$8m contract to a U.S based military customer in 1Q17.
- *Mining Technology* to contribute a small FY17 profit of ~\$0.6m (vs. 1.2m loss in FY16)

## Valuation

We maintain our **BUY** rating with a revised target price of **\$2.40** (Previous: \$2.05).

Our DCF model estimates FY17 NPAT of \$37.5m (+9% vs. previous Moelis estimate of \$34.3m), reflecting YoY earnings growth of ~75%. We have also increased our earnings in FY18 and beyond, largely reflecting a greater level of confidence in the sustainability of underlying metal detection earnings.

Our share price target is derived from our Discounted Cash Flow (DCF) valuation, grown by the cost of equity, less any dividends estimated to be paid in the next 12 months.

*We maintain our **BUY** rating with a revised target price of **\$2.40** (Previous: \$2.05)*

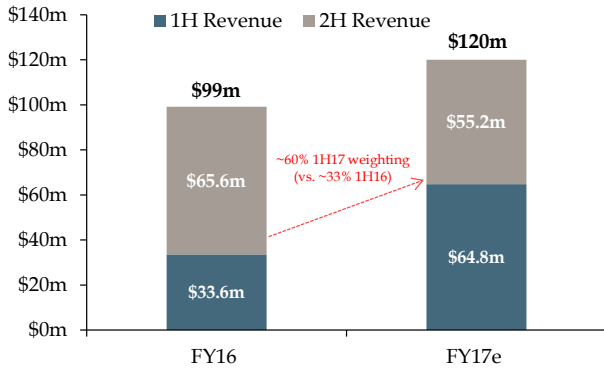


## Divisional Outlook

### (1) Metal Detection (Minelab) ~65% of Moelis estimated FY17 revenue

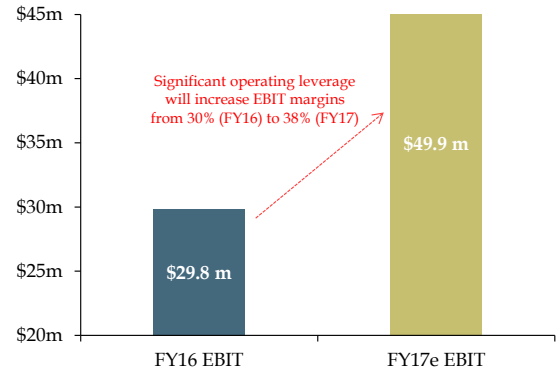
Our key earnings estimates for the metal detection division have been set out below:

**Figure 8: Metal Detection Revenue (Moelis est.)**



Source: Company Report, Moelis Analysis

**Figure 9: Metal Detection EBIT (Moelis est.)**



Source: Company Report, Moelis Analysis

### Key Takeaways

- Our estimates assume 2H17 Metal Detection sales run-rate of ~\$9.2m/month (vs. 1H17: ~\$11m).
- Management have stated they now expect the underlying Metal Detection business (excluding gold surge activity) to achieve “predictable and sustainable annual revenues of at least ~\$70m”, with periods of strong African demand (such as FY17) producing the potential for sales to reach \$100m and beyond.
- FY17 EBIT Margin: 42% (vs. 30% FY16) - margins expansion due to higher weighting of GPZ7000 sales combined with the Division’s largely fixed cost base providing significant operating leverage.
- We believe the quality of Metal Detection earnings has improved over the past few years due to each of the factors listed within the ‘Key factors influencing Metal Detection’s ongoing performance’ section on page 5 of this report.

**(2) Radio Communications ~ 30% of Moelis estimated FY17E revenue**

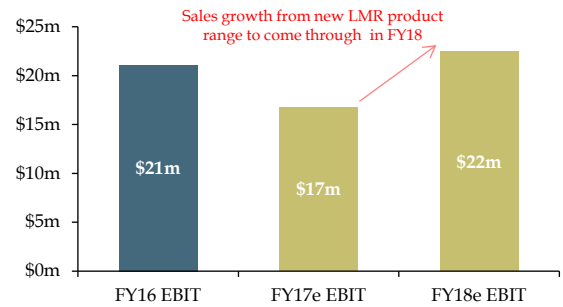
Our earnings estimates for the metal detection division have been set out below:

**Figure 10: Radio Communications Estimates (Moelis est.)**

	FY17 (Moelis est.)			FY16 (Actual)		
	1H17	2H17	FY17	1H16	2H16	FY16
High Frequency	24	15	40	21	19	40
Land Mobile Radio	10	10	20	8	17	25
<b>Revenue (Radio Comms)</b>	<b>35</b>	<b>25</b>	<b>60</b>	<b>29</b>	<b>36</b>	<b>65</b>
High Frequency	8	4	13	6	5	11
Land Mobile Radio	2	1	4	2	4	7
<b>EBIT (Radio Comms)</b>	<b>10</b>	<b>7</b>	<b>17</b>	<b>8</b>	<b>10</b>	<b>17</b>

Source: Name of Source

**Figure 11: Radio Communications EBIT (Moelis est.)**



Source: Name of Source

**Key Takeaways**

- Revenue and EBIT down YoY, however expected to grow in FY18 as sales gain momentum from new product releases in FY17 & FY18.
- FY17 EBIT Margin: 28% (vs. 27% FY16)

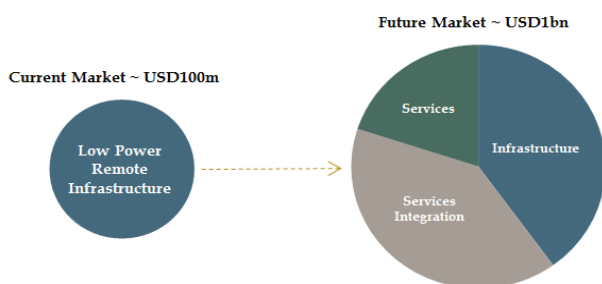
**High Frequency (HF) Radio Division ~ 62% of FY16E radio communication revenue**

- The High Frequency business (HF) made a strong start to FY17, delivering its ~\$8m contract to a U.S based military customer in 1Q17.
- CDA's intent is to become a total communications solutions provider and expand into sectors such as the Military 2 market (developing world military). FY17 events supporting this strategy include:
  - 1H17 launch of the Sentry range of tactical radios for the global Military market.
  - Jan'17 acquisition of a Military Tactical Antenna range from a UAE telecom provider, extending the scope of product & service offerings.

**Land Mobile Radio (LMR) ~ 38% of FY17E radio communication revenue**

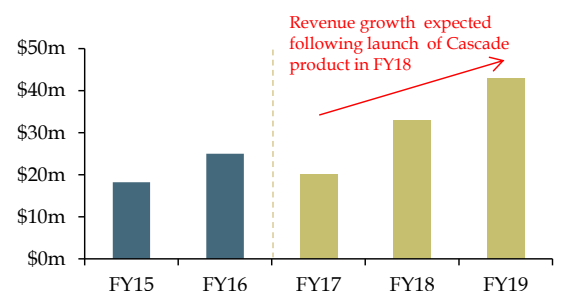
- CDA has identified the LMR division as a key area of growth for the business.
- In FY17, a \$5m investment is being undertaken in order to fast track the development of its 'Cascade' product which is set to expand the business' market share in the North American LMR Market (currently dominated by Motorola).
- CDA will target relatively small opportunities in the market, offering a lower-cost alternative to competing product.
- As its product range expands, CDA intends to offer a more holistic network solution, allowing customers to view CDA as a 'one-stop shop' for LMR network needs. We view this as an astute move, given the attractive margins that can be earned on other products and services not currently offered by CDA.

**Figure 12: Land Mobile Radio (potential market size with offerings new)**



Source: Company Reports

**Figure 13: Land Mobile Radio Sales (Moelis est.)**

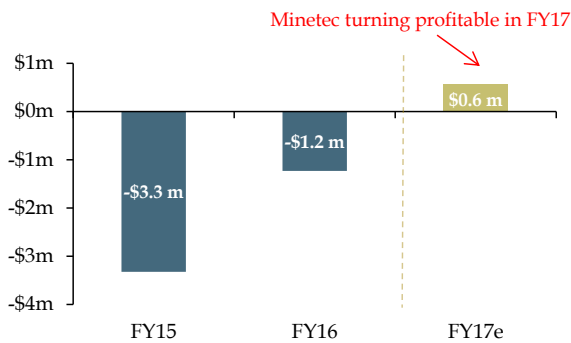


Source: Company reports, Moelis Analysis

**(3) Mining Technology ~ 5% of Moelis estimated FY17E revenue**

Our earnings estimates for the metal detection division have been set out below:

**Figure 14: Mining Technology EBIT (Moelis est.)**



Source: Company, Moelis Analysis

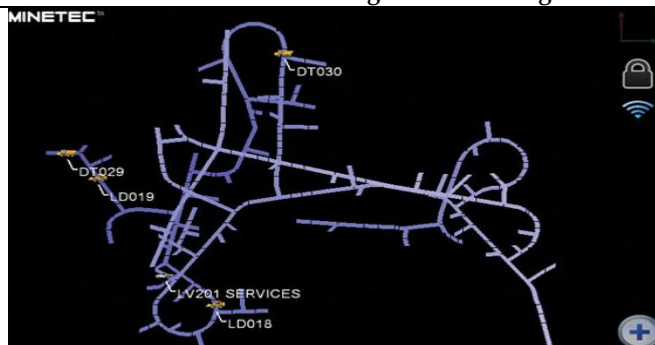
**Key Takeaways**

- As a result of improving sales, as well as cost outs realised during FY16, we note estimate the division will make a small profit in FY17 (vs. \$1.2m loss in FY16).
- The recent turnaround in commodities should act as a tailwind for Minetec in 2H17, supporting an improved outlook for mining capex.
- During the period Minetec’s technology was successfully installed in an underground gold mine in WA, with the customer using the technology extensively throughout the site.

**What is Minetec’s Tracking Solutions Technology?**

- Acts as a live underground map positioning system, providing non-satellite high precision tracking of people and machinery underground.
- The technology provides a substantial improvement on conventional methods such as GPS and Wi-Fi-based tracking, which in underground environments are typically less accurate.
- The Minetec solution is based on the CSIRO developed WASP (Wireless Ad hoc System for Positioning) tracking technology, which CDA previously won the licence to commercialise.
- Minetec has developed its own proprietary mining task management system (named SMARTS) which works in conjunction with WASP, to produce data that can help drive safety and productivity improvements in the mine including sub-metre real time tracking of people and machinery, proximity detection and collision avoidance, and reporting outputs that can help drive decision making.
- Deployed in 9 operating mines, with customers including Rio Tinto, Newcrest, Oz Minerals and Saracen Minerals.
- Distribution strategy includes partnering with mining services companies to expand reach.

**Figure 15: Minetec's 'SMARTs' Underground Tracking Technology**



Source: Company, Moelis Analysis

#### (4) New 'Defence Electronics' Division

While material revenue opportunities may not appear before FY19, Codan's new division will attempt to capitalise on:

- High value, multi-year programs including Land 400, the offshore patrol boats and the air warfare destroyers.
- Recent announcements including the \$50bn submarines contract won by French company DCNS, due to be built in Adelaide.
- Government support for innovation to create domestic jobs, potentially providing CDA with a competitive advantage over incumbent international defence solution providers; and
- Restricted competition due to limited domestic engineering capability, a result of falling defence spend in recent years.

CDA's favourable group earnings outlook, coupled with its strong net cash position, supports any type of investment the Group may wish to make within this division, or any other existing division over the short to medium term.

**Figure 16: DCNS Submarine concept design**



Source: Company, Moelis Analysis

Profit and Loss (\$m)	2015a	2016a	2017e	2018e	2019e
<b>Revenue</b>	<b>143.9</b>	<b>169.5</b>	<b>187.2</b>	<b>178.5</b>	<b>189.8</b>
<i>Growth</i>	8.8%	17.8%	10.4%	(4.6%)	6.3%
<b>EBITDA</b>	<b>29.9</b>	<b>41.9</b>	<b>63.2</b>	<b>54.5</b>	<b>56.1</b>
<i>Growth</i>	35.4%	40.2%	50.8%	(13.8%)	3.0%
Dep'n & Amort	(10.6)	(12.7)	(13.5)	(14.2)	(14.2)
<b>EBIT</b>	<b>19.3</b>	<b>29.2</b>	<b>49.8</b>	<b>40.3</b>	<b>42.0</b>
<i>Growth</i>	48.2%	51.1%	70.3%	(19.1%)	4.2%
Net Interest Expense	(2.5)	(1.7)	(0.5)	(0.1)	(0.3)
<b>Profit Before Tax</b>	<b>16.8</b>	<b>27.5</b>	<b>49.3</b>	<b>40.2</b>	<b>41.7</b>
Tax	(4.1)	(6.4)	(11.8)	(9.3)	(10.5)
<i>Tax Rate (%)</i>	24.4%	23.3%	24.0%	23.0%	25.1%
Minorities	0.0	0.0	0.0	0.0	0.0
<b>NPAT (Underlying)</b>	<b>12.7</b>	<b>21.1</b>	<b>37.5</b>	<b>30.9</b>	<b>31.2</b>
<i>Growth</i>	49.9%	65.7%	77.5%	(17.4%)	1.0%
One-Off Items	(0.3)	(5.6)	0.0	0.0	0.0
<b>NPAT (Reported)</b>	<b>12.4</b>	<b>15.5</b>	<b>37.5</b>	<b>30.9</b>	<b>31.2</b>
<b>EPS (Underlying) (€)</b>	<b>7.2</b>	<b>11.9</b>	<b>21.1</b>	<b>17.5</b>	<b>17.6</b>
<i>Growth</i>	44.4%	65.6%	77.4%	(17.4%)	1.0%

Balance Sheet (\$m)	2015a	2016a	2017e	2018e	2019e
Cash	7.2	14.3	14.3	36.8	47.9
Inventory	31.3	28.5	31.8	30.3	32.3
Current Receivables	20.4	19.1	15.0	19.6	20.9
PPE	16.0	10.8	10.7	10.6	10.6
Intangibles	131.7	133.0	138.3	140.3	143.2
Other	0.0	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>208.7</b>	<b>212.5</b>	<b>216.9</b>	<b>244.4</b>	<b>261.6</b>
Current Payables	25.2	30.4	30.9	30.3	32.3
ST Debt	0.0	0.0	0.0	0.0	0.0
LT Debt	42.5	26.9	10.1	14.0	14.0
Provisions	7.3	7.2	9.0	8.7	9.2
Other	25.2	32.6	33.1	32.5	34.5
<b>Total Liabilities</b>	<b>80.3</b>	<b>73.5</b>	<b>59.0</b>	<b>62.0</b>	<b>64.5</b>
<b>Net Assets</b>	<b>128.4</b>	<b>138.9</b>	<b>157.9</b>	<b>182.4</b>	<b>197.1</b>
Equity & Reserves	103.5	109.2	109.4	119.1	119.7
Retained Profits	24.9	29.7	48.5	63.3	77.5
<b>Shareholders' Equity</b>	<b>128.4</b>	<b>138.9</b>	<b>157.9</b>	<b>182.4</b>	<b>197.1</b>
Minorities	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>128.4</b>	<b>138.9</b>	<b>157.9</b>	<b>182.4</b>	<b>197.1</b>

Cashflow (\$m)	2015a	2016a	2017e	2018e	2019e
EBITDA	29.9	41.9	63.2	54.5	56.1
Net Interest	(2.4)	(2.0)	(0.5)	(0.1)	(0.3)
Tax	(0.6)	(0.1)	(11.8)	(9.3)	(10.5)
Δ in Working Capital	3.5	9.4	1.2	(3.7)	(1.2)
Other	0.3	(1.1)	1.9	(0.4)	0.5
<b>Operating Cash Flow</b>	<b>30.7</b>	<b>48.2</b>	<b>54.0</b>	<b>41.1</b>	<b>44.7</b>
<i>Growth</i>	168.5%	57.2%	12.0%	(23.9%)	8.8%
Capex	(18.8)	(18.4)	(18.7)	(16.1)	(17.1)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestments	5.4	0.0	0.0	0.0	0.0
Other	0.0	0.3	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>(13.4)</b>	<b>(18.1)</b>	<b>(18.7)</b>	<b>(16.1)</b>	<b>(17.1)</b>
Equity Raised	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(5.3)	(7.1)	(17.7)	(16.7)	(16.7)
Net Borrowings	(17.9)	(15.5)	(17.6)	3.9	0.0
Other	0.0	0.0	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>(23.2)</b>	<b>(22.6)</b>	<b>(35.3)</b>	<b>(12.8)</b>	<b>(16.7)</b>
FX / Non Cash Items	0.1	0.0	0.0	0.0	0.0
<b>Change in Cash</b>	<b>(5.9)</b>	<b>7.5</b>	<b>0.0</b>	<b>12.2</b>	<b>10.9</b>
<b>Free Cash Flow</b>	<b>11.9</b>	<b>29.5</b>	<b>35.3</b>	<b>25.1</b>	<b>27.7</b>

Valuation Summary	
Current Mkt Capitalisation	381.0
Shares on Issue	177.2
Last Price	2.15
<b>12 Mth Target Price</b>	<b>2.40</b>
Total Estimated 12 Mth Return	16.5%
12 Mth Fwd Capital Return	11.6%
12 Mth Fwd Dividend Yield	4.9%

Valuation Ratios	2015a	2016a	2017e	2018e	2019e
<b>EPS (Underlying) (€)</b>	<b>7.2</b>	<b>11.9</b>	<b>21.1</b>	<b>17.5</b>	<b>17.6</b>
<i>Growth</i>	44.4%	65.6%	77.4%	(17.4%)	1.0%
<b>P/E (x)</b>	<b>29.9x</b>	<b>18.0x</b>	<b>10.2x</b>	<b>12.3x</b>	<b>12.2x</b>
Small Industrials (ex Fin's)	16.9x	17.0x	15.3x	13.9x	17.0x
Premium / (Discount)	76.4%	6.1%	nm	nm	nm
<b>EV/EBITDA (x)</b>	<b>12.7x</b>	<b>9.1x</b>	<b>6.0x</b>	<b>7.0x</b>	<b>6.8x</b>
Small Industrials (ex Fin's)	17.1x	18.9x	10.8x	9.8x	9.1x
Premium / (Discount)	nm	nm	nm	nm	nm
<b>DPS (€)</b>	<b>3.5</b>	<b>6.0</b>	<b>10.5</b>	<b>9.1</b>	<b>9.7</b>
<i>Growth</i>	16.7%	71.4%	74.9%	(13.8%)	7.6%
Yield (%)	1.6%	2.8%	4.9%	4.2%	4.5%
Payout Ratio (%)	48.7%	50.4%	49.7%	51.9%	55.3%
Franking (%)	100.0%	100.0%	100.0%	100.0%	100.0%
NTA	(3.3)	5.9	19.6	42.2	53.9
NTA/Share (\$)	(0.02)	0.03	0.11	0.24	0.30

Performance Ratios	2015a	2016a	2017e	2018e	2019e
ROA	6.1%	9.9%	17.3%	12.7%	12.0%
ROE	9.9%	15.2%	23.7%	17.0%	15.9%
ROIC	8.9%	14.8%	24.6%	19.5%	19.3%
Net Debt (Cash) (\$m)	35.4	12.6	(4.2)	(22.8)	(33.8)
Net Debt/EBITDA (x)	1.2x	0.3x	(0.1x)	(0.4x)	(0.6x)
ND/(ND + Equity) (%)	21.6%	8.3%	(2.7%)	(14.3%)	(20.7%)
Interest Cover (x)	11.2x	23.1x	81.1x	93.4x	47.6x
Working Capital	21.9	15.2	12.1	16.2	16.9
Working Capital/Sales (%)	15.2%	8.9%	6.5%	9.1%	8.9%

Cash Flow Metrics	2015a	2016a	2017e	2018e	2019e
<b>FCF/Share (\$)</b>	<b>0.07</b>	<b>0.17</b>	<b>0.20</b>	<b>0.14</b>	<b>0.16</b>
Price/FCPS (x)	32.1x	12.9x	10.8x	15.2x	13.7x
Free Cash Flow Yield (%)	3.1%	7.7%	9.3%	6.6%	7.3%
Gross Cash Conversion	112.9%	119.2%	105.1%	92.9%	99.5%
Capex/Sales (%)	(13.1%)	(10.9%)	(10.0%)	(9.0%)	(9.0%)
Capex/Depreciation (x)	1.8x	1.4x	1.4x	1.1x	1.2x

Margins	2015a	2016a	2017e	2018e	2019e
EBITDA	20.8%	24.7%	33.8%	30.5%	29.6%
EBIT	13.4%	17.2%	26.6%	22.6%	22.1%
NPAT	8.9%	12.4%	20.0%	17.3%	16.5%

Valuation Methodology	
WACC (%)	10.3%
Discounted Cash Flow Valuation	2.25
Sum-of-the-Parts Valuation	0.000
Average Valuation	2.25
<b>12 Mth Target Price</b>	<b>2.40</b>

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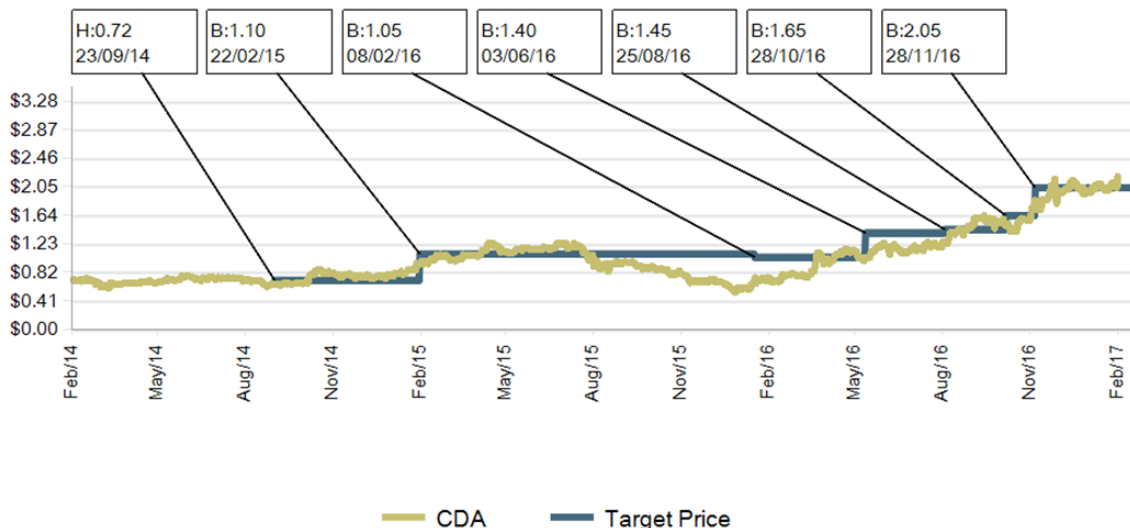
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