

# CODAN LIMITED

**BUY**

Reinvested profits positions FY18 to deliver another year of strong earnings.

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

1 September 2017

## COMPANY UPDATE

Ticker	CDA
Stock Price	\$2.25
Target Price	\$2.60
Forecast Capital Return	15.6%
Forecast Dividend Yield	5.8%
Estimated Total Return - 12 Mth Forward	21.3%

### Company market data

Market Cap.	\$398.9m
Free Float (%)	48.6
Enterprise Value	\$377.5m
52 Week Range	\$1.35 - \$2.52
Shares Out.	177.3m
Avg. Daily Value	\$0.0m

Estimates changes	2017a	2018e	2019e	2020e
Core NPAT - <i>old</i>	46.5	32.0	31.7	36.0
Core NPAT - <i>new</i>	44.7	34.0	33.0	39.0
% Change	(3.9)	6.3	4.1	8.1
Core EPS dil. (€) - <i>old</i>	26.3	18.0	17.9	20.3
Core EPS dil. (€) - <i>new</i>	25.2	19.2	18.6	22.0
% Change	(3.9)	6.2	4.1	8.1
DPS (€) - <i>old</i>	13.1	9.4	9.9	11.2
DPS (€) - <i>new</i>	13.0	10.0	10.3	12.1
% Change	(0.8)	6.5	4.3	8.4

All figures are in AUD unless otherwise specified.

### Share price performance

Codan Limited vs. AS52 (rebased index)



### Analyst

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## EVENT

CDA FY17 Result.

- **Underlying NPAT: \$44.7m** (vs. guidance: \$44m, +112% YoY).
- **Total dividend: 13cps** (7cps annual + 6cps special, +117% YoY).
- **Metal Detection: \$148m sales** (+66% YoY) & **\$62m EBIT** (+110% YoY) led by strong sales of the GPZ7000 gold detector into Africa + growth in coin & treasure sales in developed markets.
- **Radio Communications: \$71m sales** (+66% YoY) & **\$20m EBIT** (+110% YoY) produced its strongest result in 8 years + launched a range of new products which should support growth in FY18 & beyond.
- **Mining Technology: \$7m sales** (+45% YoY) & **\$0.3m EBIT** (vs. \$1.2m loss in FY16) produced its first full year positive contribution and continued to develop and expand its sales pipeline.
- **Unallocated expenses: \$20m** (+ 23% YoY). Reflecting additional costs from new Mawson Lakes facility plus extra staff inventive payments.

## IMPACT

We increase our FY18 NPAT estimate by +\$2m (or 6.4%) to \$34.0m.

This reflects higher than previously estimated contributions from Metal Detection (+\$2m) and Radio Comms (+\$3m), offset by higher corp costs (-\$3m).

## INVESTMENT VIEW

We anticipate that FY18 will be another year that exceeds managements estimates of CDA's 'base business' Group NPAT of \$20-\$25m.

Radio Communications looks well positioned for growth following successful product launches which are benefiting from ongoing global conflict.

In Metal Detection we assume a 20% decrease in sales in FY18, reflecting a slower sales rate from the GPZ. This is partially offset by higher expected sales in coin &amp; treasure, plus new products such as the 'gold monster' (~\$1,000 RRP) which has been recording strong sales since launch in May'17.

We assume a modest contribution from Mining Technology in FY18 (+\$2m), noting significant upside could exist to these estimates should the business execute on some of the larger opportunities in its pipeline.

In our view CDA presents good value, trading on an attractive ~12x FY18 P/E with a strong ~\$21m net cash balance sheet. Catalysts exist for outperformance (vs. our FY18 estimates) in each of its 3 business segments.

 We maintain our **BUY** rating & increase our **Target Price to \$2.60** (prev: \$2.50).

Y/E Jun 30	2017a	2018e	2019e	2020e
EBITDA	75.7	60.8	59.9	69.2
EV/EBITDA	5.0x	6.2x	6.3x	5.5x
Core NPAT	44.7	34.0	33.0	39.0
Core EPS (Diluted) (€)	25.2	19.2	18.6	22.0
P/E	8.9x	11.7x	12.1x	10.2x
EPS growth	111.9%	(24.0%)	(2.8%)	17.9%
DPS (€)	13.0	10.0	10.3	12.1
Yield	5.8%	4.4%	4.6%	5.4%
DPS growth	116.7%	(23.1%)	2.8%	17.8%
Dividend Payout Ratio	51.5%	52.1%	55.2%	55.1%

All figures are in AUD.

## EARNINGS ESTIMATES

Our revised earnings estimates for the Group have been set out below:

**Figure 1: CDA Earnings Estimates (Moelis, \$m's)**

	FY16	FY17	1H18e	2H18e	FY18e	YoY (%)	Moelis Comments
Metal Detection	99	148	61	56	117	-21%	Reflects lower assumed GPZ7000 sales run rate
Radio Communications	65	71	40	40	80	+13%	New products released in HF and LMR driving growth
Mining Technology	5	7	5	6	11	+50%	Ongoing commercialisation of underground tracking.
<b>Revenue</b>	<b>170</b>	<b>226</b>	<b>106</b>	<b>103</b>	<b>208</b>	<b>-8%</b>	Above managements est. for 'base business' sales of \$160-\$180m.
Metal Detection	29	62	22	19	41	-33%	
Radio Communications	21	20	12	12	23	+16%	
Mining Technology	(1.2)	0.3	1	1	2	+392%	
Unallocated Expenses	(19)	(20)	(10)	(10)	(20)	-0%	Flat year on year reflecting inflationary increases less incentives in FY17 paid for outperformance.
Finance Costs	(2)	(1)	(0)	(0)	(0)		
<b>Profit Before Tax</b>	<b>29</b>	<b>61</b>	<b>24</b>	<b>22</b>	<b>46</b>	<b>-25%</b>	
Tax	(6)	(16)	(6)	(5)	(12)	-27%	
<b>Underlying NPAT</b>	<b>21.1</b>	<b>44.7</b>	<b>18</b>	<b>16</b>	<b>34.0</b>	<b>-24%</b>	
<b>EPS</b>	<b>12cps</b>	<b>25cps</b>			<b>19cps</b>	<b>-24%</b>	
<b>DPS</b>	<b>6 cps</b>	<b>13 cps</b>			<b>10 cps</b>	<b>-23%</b>	
<b>Net Cash (Debt)</b>	<b>(13)</b>	<b>21</b>	<b>6</b>		<b>11</b>	<b>-50%</b>	

Source: Company, Moelis Analysis

## METAL DETECTION

We remain confident that the Metal Detection can deliver FY18 sales in excess of managements estimates of ‘baseline revenue’ for the division of \$85-\$95m.

Our estimate of Metal Detection sales in FY18 (\$116m) reflects a 20% decrease vs. FY17 to reflect more conservative assumptions around GPZ sales (due to limited visibility).

We note our assumptions imply a metal detection sales rate of ~\$9.5m sales per month, which compares to the exiting run rate recorded in May & Jun’17 of \$12m/month.

We remain confident in the division’s prospects however given the following factors:

- CDA having a near monopoly on high-end gold detectors.
- No GPZ7000 Counterfeit after 2.5yrs on the market.
- Continued runway in the GPZ7000 replacement cycle.
- New products (gold monster, coin & treasure, countermine) and geographies (Morocco, Asia, Sth America) helping to diversify the sales mix.
- Supportive gold price.

Figure 2: New Gold Monster



Source: Company Presentation

Figure 3: Recreational Detectors



Source: Company Presentation

Figure 4: Spare Parts/Accessories



Source: Company Presentation

We estimate the GPZ7000 till has further to run in its replacement cycle (albeit at a potentially slower sales rate),

Our analysis below estimates the total addressable market for the GPZ7000 market is ~50,000 units, with CDA having sold ~20,000 units since the products launch in Feb’15.

Figure 5: GPZ7000 Sales Replacement Cycle (Moelis estimates)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Flagship Detector Model	GPX	GPX	GPX	GPX	GPX	GPX	GPX	GPX	GPZ	GPZ
Total Metal Detection Revenue	\$42m	\$107m	\$107m	\$92m	\$99m	\$166m	\$70m	\$73m	\$99m	\$148m
Sales from Flagship Detector	\$23m	\$59m	\$59m	\$51m	\$54m	\$91m	\$38m	\$40m	\$55m	\$81m
GPX units sold (cummulative)	5,500	20,000	35,000	45,000	60,000	80,000	90,000	100,000		
GPZ7000 units sold (cummulative)								1,000	8,000	20,000

GPZ7000 Addressable Market (assumes 45% of total GPX unit sales)	45,000
GPZ Units Sold (FY15 - FY17)	20,000
% through replacement cycle	44%

*The >100,000 units sales of the old GPX5000 proves the depth of the gold detecting market.*

Source: Company, Moelis Analysis

## RADIO COMMUNICATIONS

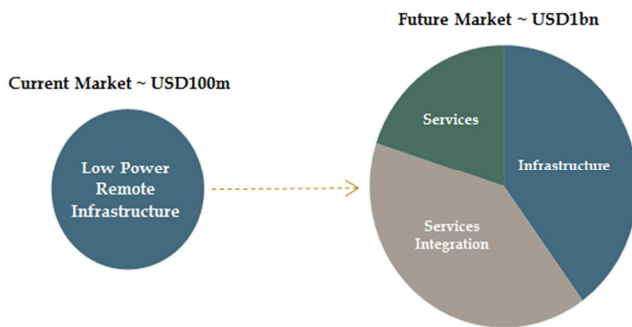
CDA is appears well positioned for growth in Radio Communications following a range of new product releases across both the High Frequency and Land Mobile Radio divisions in FY17 and FY18.

Global instability and the threat of terror is increasing the relevance of emergency and remote communication systems such as Codan's.

### Land Mobile Radio (LMR)

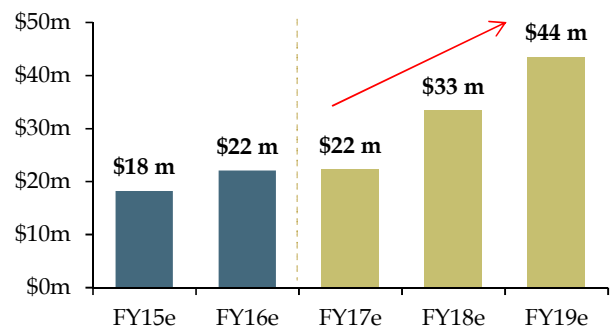
- New 'Cascade' radio was launched Q1 FY18 aimed at expanding CDA's market share in the ~\$1bn North American LMR market.
- CDA will target smaller towns and remote cities in the U.S. offering a lower-cost alternative to the dominant incumbent, Motorola (>80% market share).
- The Cascade product expands CDA's offering beyond just the radio, into systems integration and ongoing maintenance/support services.

**Figure 6: \$1bn Nth American LMR market**



Source: Company Reports

**Figure 7: Land Mobile Radio Sales**

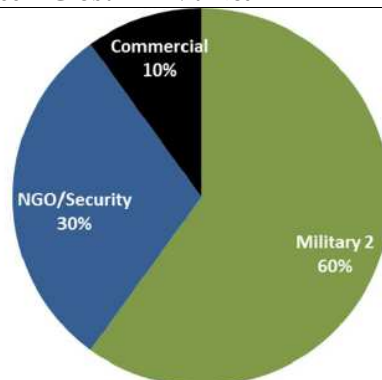


Source: Company reports, Moelis Analysis

### High Frequency (HF) Radio Division

CDA has successfully launched its new range of handheld tactical radios for the global military market. This opens up a large section of the HF market that was previously largely unserved by CDA.

**Figure 8: \$500m Global HF Market**



Source: Company, Moelis Analysis

## MINING TECHNOLOGY

Mining Technology has potential for sales to ramp up in FY18 as the product slowly gains commercial traction.

More publically released results from live case studies in should help generate sales leads and repeat business.

In 2H17, CDA's Minetec Technology was rolled out across an underground gold mine in WA by mining services company RUC Mining.

At a recent Mining Conference CDA co-presented the results of the project with RUC Mining in which RUC's MD shared that mine productivity increased by ~35% using CDA's mining technology.

### What is Minetec's Tracking Solutions Technology?

- Promotional YouTube video → <https://www.youtube.com/watch?v=CjxD2q3q1s8>
- CDA's technology provides a live underground map positioning system, providing high precision tracking of people and machinery within an underground mine.
- Provides tracking accuracy to less than 1 metre - competing products can typically only offer 'zoned' accuracy of ~10-30 metres.
- The solution is based on the CSIRO developed WASP (Wireless Ad hoc System for Positioning) tracking technology. CDA has licenced this WASP technology for the purposes of developing its mining tracking solution software (called "SMARTS").
- This proprietary mining task management system (called SMARTS) which works in conjunction with WASP, to produce data that can help drive safety and productivity improvements in the mine (and improve decision making).
- Deployed in 9 operating mines, with customers including Rio Tinto, Newcrest, Oz Minerals and Saracen Minerals.
- CDA's go-to-market strategy includes partnering with mining services companies to expand its sales reach.

**Figure 9: Minetec's Underground Tracking Technology**



Source: Company Presentations

**Figure 10: Minetec Manifesto Presentation**



Source: Company Presentations

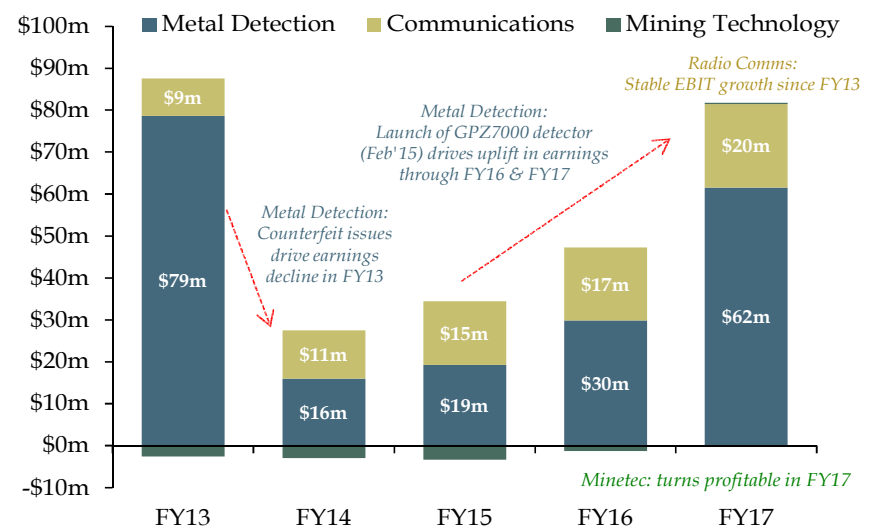
## CDA INVESTMENT THESIS

We maintain a **BUY** rating with a revised Target Price of **\$2.60** (prev: \$2.50).

Key features of our investment thesis include:

- **Strong earnings growth over last 4 years**

**Figure 11: CDA Divisional EBIT (Moelis (e), excluding unallocated expenses)**



Source: Company, Moelis Analysis

- **Multiple new product releases opening up new markets and diversifying Group earnings profile.**  
CDA has invested ~\$18m/year for the past 4 years into product development, launching many new products in FY17 with further releases slated for FY18.
- **Improved quality of Metal Detection earnings** following no counterfeit of GPZ7000 after 2.5ys, middle phases of GPZ replacement cycle, sales expanding into new geographies, supportive gold price.
- **Radio Communications positioned for growth**  
*Land Mobile Radio:* Launch of new 'Cascade' product (Q1 FY18) should increase CDA's market share of the lucrative North American LMR market.  
*High Frequency:* Expansion into Military 2 segment (developed world armies) + unstable global environment in Middle East and Africa.
- **Mining Technology making positive contribution with large scale commercialisation opportunities.**  
RUC Mining (one of CDA's customers) recently presented results from its recent implementation of Minetec's product, citing a 35% increase in productivity.
- **New Defence Electronics division** looking to leverage existing IP and capitalise on revenue opportunities within the defence sector.
- **~\$21m net cash balance sheet (as at Jun'17)** supportive of potential acquisitions or product investment opportunities.

Profit and Loss (\$m)	2016a	2017a	2018e	2019e	2020e
<b>Revenue</b>	<b>169.5</b>	<b>226.1</b>	<b>208.1</b>	<b>216.5</b>	<b>237.7</b>
<i>Growth</i>	17.8%	33.4%	(7.9%)	4.0%	9.8%
<b>EBITDA</b>	<b>41.9</b>	<b>75.7</b>	<b>60.8</b>	<b>59.9</b>	<b>69.2</b>
<i>Growth</i>	40.2%	80.4%	(19.7%)	(1.4%)	15.4%
Dep'n & Amort	(12.7)	(14.1)	(14.7)	(15.3)	(16.2)
<b>EBIT</b>	<b>29.2</b>	<b>61.6</b>	<b>46.0</b>	<b>44.7</b>	<b>52.9</b>
<i>Growth</i>	51.1%	110.7%	(25.3%)	(2.9%)	18.5%
Net Interest Expense	(1.7)	(0.9)	(0.3)	(0.3)	(0.1)
<b>Profit Before Tax</b>	<b>27.5</b>	<b>60.7</b>	<b>45.7</b>	<b>44.4</b>	<b>52.8</b>
Tax	(6.4)	(16.0)	(11.7)	(11.3)	(13.8)
<i>Tax Rate (%)</i>	23.3%	26.3%	25.6%	25.5%	26.2%
Minorities	0.0	0.0	0.0	0.0	0.0
<b>NPAT (Underlying)</b>	<b>21.1</b>	<b>44.7</b>	<b>34.0</b>	<b>33.0</b>	<b>39.0</b>
<i>Growth</i>	65.7%	112.0%	(24.0%)	(2.8%)	17.9%
One-Off Items	(5.6)	0.0	0.0	0.0	0.0
<b>NPAT (Reported)</b>	<b>15.5</b>	<b>44.7</b>	<b>34.0</b>	<b>33.0</b>	<b>39.0</b>
<b>EPS (Underlying) (€)</b>	<b>11.9</b>	<b>25.2</b>	<b>19.2</b>	<b>18.6</b>	<b>22.0</b>
<i>Growth</i>	65.6%	111.9%	(24.0%)	(2.8%)	17.9%

Balance Sheet (\$m)	2016a	2017a	2018e	2019e	2020e
Cash	14.3	21.4	10.8	21.0	33.4
Inventory	28.5	31.0	33.3	34.6	38.0
Current Receivables	19.1	20.6	20.8	21.6	23.8
PPE	10.8	12.0	11.9	11.9	12.1
Intangibles	133.0	140.4	146.5	150.7	155.7
Other	0.0	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>212.5</b>	<b>232.7</b>	<b>230.6</b>	<b>247.3</b>	<b>270.4</b>
Current Payables	30.4	36.6	31.2	32.5	35.7
ST Debt	0.0	0.0	0.0	0.0	0.0
LT Debt	26.9	0.0	0.0	0.0	0.0
Provisions	7.2	7.7	7.1	7.4	8.1
Other	32.6	52.8	47.4	48.6	51.8
<b>Total Liabilities</b>	<b>73.5</b>	<b>67.7</b>	<b>61.7</b>	<b>63.3</b>	<b>67.1</b>
<b>Net Assets</b>	<b>138.9</b>	<b>165.0</b>	<b>168.9</b>	<b>184.0</b>	<b>203.2</b>
Equity & Reserves	109.2	105.9	93.6	93.9	95.6
Retained Profits	29.7	59.1	75.3	90.2	107.6
<b>Shareholders' Equity</b>	<b>138.9</b>	<b>165.0</b>	<b>168.9</b>	<b>184.0</b>	<b>203.2</b>
Minorities	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>138.9</b>	<b>165.0</b>	<b>168.9</b>	<b>184.0</b>	<b>203.2</b>

Cashflow (\$m)	2016a	2017a	2018e	2019e	2020e
EBITDA	41.9	75.7	60.8	59.9	69.2
Net Interest	(2.0)	(0.8)	(0.3)	(0.3)	(0.1)
Tax	(0.1)	(1.5)	(20.1)	(11.3)	(13.8)
Δ in Working Capital	9.4	2.2	(7.9)	(0.9)	(2.3)
Other	(1.1)	14.4	(0.6)	0.3	0.7
<b>Operating Cash Flow</b>	<b>48.2</b>	<b>89.9</b>	<b>31.9</b>	<b>47.7</b>	<b>53.5</b>
<i>Growth</i>	57.2%	86.5%	(64.5%)	49.5%	12.3%
Capex	(18.4)	(23.7)	(20.8)	(19.5)	(21.4)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	0.3	0.0	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>(18.1)</b>	<b>(23.7)</b>	<b>(20.8)</b>	<b>(19.5)</b>	<b>(21.4)</b>
Equity Raised	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(7.1)	(17.7)	(21.7)	(17.9)	(19.7)
Net Borrowings	(15.5)	(26.9)	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>(22.6)</b>	<b>(44.7)</b>	<b>(21.7)</b>	<b>(17.9)</b>	<b>(19.7)</b>
FX / Non Cash Items	0.0	0.0	0.0	0.0	0.0
<b>Change in Cash</b>	<b>7.5</b>	<b>21.6</b>	<b>(10.7)</b>	<b>10.3</b>	<b>12.4</b>
<b>Free Cash Flow</b>	<b>29.5</b>	<b>51.9</b>	<b>11.1</b>	<b>28.2</b>	<b>32.2</b>

Valuation Summary	
Current Mkt Capitalisation	398.9
Shares on Issue	177.3
Last Price	2.25
<b>12 Mth Target Price</b>	<b>2.60</b>
Total Estimated 12 Mth Return	21.3%
12 Mth Fwd Capital Return	15.6%
12 Mth Fwd Dividend Yield	5.8%

Valuation Ratios	2016a	2017a	2018e	2019e	2020e
<b>EPS (Underlying) (€)</b>	<b>11.9</b>	<b>25.2</b>	<b>19.2</b>	<b>18.6</b>	<b>22.0</b>
<i>Growth</i>	65.6%	111.9%	(24.0%)	(2.8%)	17.9%
<b>P/E (x)</b>	<b>18.9x</b>	<b>8.9x</b>	<b>11.7x</b>	<b>12.1x</b>	<b>10.2x</b>
Small Industrials (ex Fin's)	17.7x	18.3x	16.2x	14.9x	18.3x
Premium / (Discount)	6.9%	(51.2%)	(27.6%)	(18.8%)	(43.9%)
<b>EV/EBITDA (x)</b>	<b>9.0x</b>	<b>5.0x</b>	<b>6.2x</b>	<b>6.3x</b>	<b>5.5x</b>
Small Industrials (ex Fin's)	19.5x	14.3x	11.6x	10.4x	9.7x
Premium / (Discount)	(53.8%)	(65.1%)	(46.3%)	(39.4%)	(43.5%)
<b>DPS (€)</b>	<b>6.0</b>	<b>13.0</b>	<b>10.0</b>	<b>10.3</b>	<b>12.1</b>
<i>Growth</i>	71.4%	116.7%	(23.1%)	2.8%	17.8%
Yield (%)	2.7%	5.8%	4.4%	4.6%	5.4%
Payout Ratio (%)	50.4%	51.5%	52.1%	55.2%	55.1%
Franking (%)	100.0%	100.0%	100.0%	100.0%	100.0%
NTA	5.9	24.6	22.4	33.3	47.6
NTA/Share (\$)	0.03	0.14	0.13	0.19	0.27

Performance Ratios	2016a	2017a	2018e	2019e	2020e
ROA	9.9%	19.2%	14.7%	13.4%	14.4%
ROE	15.2%	27.1%	20.1%	18.0%	19.2%
ROIC	14.8%	31.6%	21.6%	20.4%	23.0%
Net Debt (Cash) (\$m)	12.6	(21.4)	(10.8)	(21.0)	(33.4)
Net Debt/EBITDA (x)	0.3x	(0.3x)	(0.2x)	(0.4x)	(0.5x)
ND/(ND + Equity) (%)	8.3%	(14.9%)	(6.8%)	(12.9%)	(19.7%)
Interest Cover (x)	23.1x	84.6x	76.7x	76.0x	72.1x
Working Capital	15.2	(1.0)	7.5	8.1	9.8
Working Capital/Sales (%)	8.9%	(0.5%)	3.6%	3.7%	4.1%

Cash Flow Metrics	2016a	2017a	2018e	2019e	2020e
<b>FCF/Share (\$)</b>	<b>0.17</b>	<b>0.29</b>	<b>0.06</b>	<b>0.16</b>	<b>0.18</b>
Price/FCPS (x)	13.5x	7.7x	36.1x	14.2x	12.4x
Free Cash Flow Yield (%)	7.4%	13.0%	2.8%	7.1%	8.1%
Gross Cash Conversion	119.2%	103.1%	86.4%	99.3%	98.2%
Capex/Sales (%)	(10.9%)	(10.5%)	(10.0%)	(9.0%)	(9.0%)
Capex/Depreciation (x)	1.4x	1.7x	1.4x	1.3x	1.3x

Margins	2016a	2017a	2018e	2019e	2020e
EBITDA	24.7%	33.5%	29.2%	27.7%	29.1%
EBIT	17.2%	27.2%	22.1%	20.6%	22.3%
NPAT	12.4%	19.8%	16.3%	15.3%	16.4%

Valuation Methodology	
WACC (%)	10.3%
Discounted Cash Flow Valuation	2.45
Sum-of-the-Parts Valuation	0.000
Average Valuation	2.45
<b>12 Mth Target Price</b>	<b>2.60</b>

Source: Company data, IRESS, Moelis & Company research estimates

1-Sep-17

## RESEARCH & SALES RESPONSIBILITIES

### Equities

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All companies under coverage are assigned a rating of Buy, Hold or Sell based on the expected 12 month total return estimated by the analyst(s). The total return is a combination of the estimated capital gain or loss, in addition to the estimated 12 month forward dividends or distributions. In relation to all companies that Moelis Australia Securities conducts research coverage on the relevant total return bands that derive the ratings are:

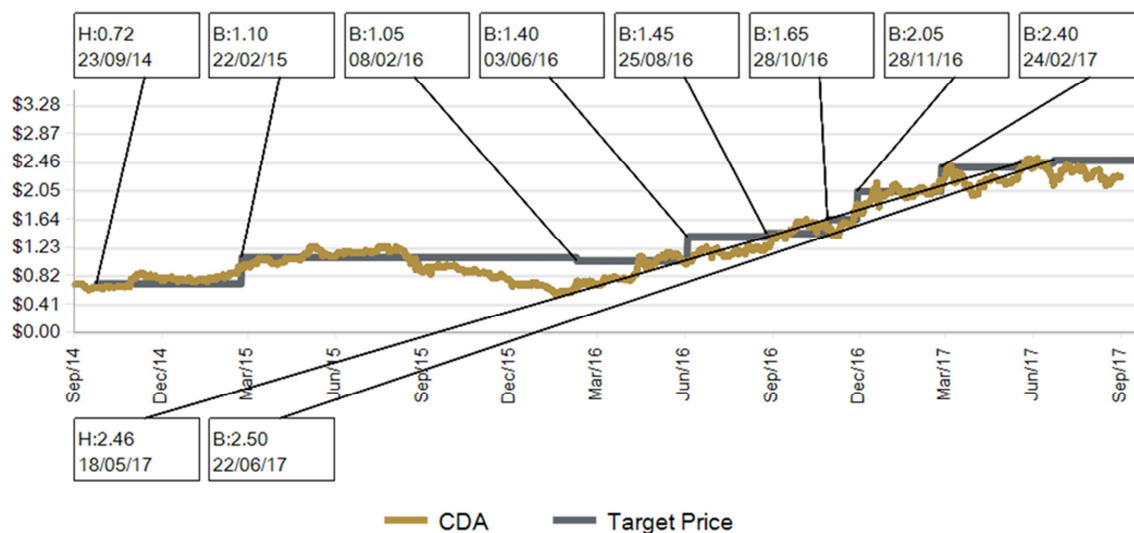
**Buy:** >15% **Hold:** 5% to 15% **Sell:** <5%.

### RATINGS DISTRIBUTION TABLE

#### Distribution of Ratings as at 1 September 2017

SELL	HOLD	BUY
0.0%	38.1%	61.9%

#### Rating and Price Target History: Codan Limited (CDA) as of 31/08/2017





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