

CODAN LIMITED

BUY

More than just gold driving FY18 profit upgrade. BHP deal provides further Minetec validation.

Technology Hardware & Equipment / Electronic Equipment & Instruments

21 May 2018

COMPANY UPDATE

Ticker	CDA
Stock Price	\$2.99
Target Price	\$3.32
Forecast Capital Return	11.0%
Forecast Dividend Yield	4.3%
Estimated Total Return - 12 Mth Forward	15.4%

Company market data

Market Cap.	\$530.1m
Free Float (%)	61.8
Enterprise Value	\$511.2m
52 Week Range	\$2.02 - \$2.99
Shares Out.	177.3m
Avg. Daily Value	\$0.0m

Estimates changes	2017a	2018e	2019e	2020e
Core NPAT - <i>old</i>	44.7	36.0	34.5	35.1
Core NPAT - <i>new</i>	44.7	39.2	40.0	41.4
% Change	0.0	8.7	15.8	17.8
Core EPS dil. (€) - <i>old</i>	25.2	20.1	19.2	19.6
Core EPS dil. (€) - <i>new</i>	25.2	21.8	22.3	23.0
% Change	0.0	8.7	15.8	17.8
DPS (€) - <i>old</i>	13.0	10.3	10.7	10.9
DPS (€) - <i>new</i>	13.0	11.2	12.4	12.8
% Change	0.0	9.5	15.8	17.8

All figures are in AUD unless otherwise specified.

Share price performance

Codan Limited vs. AS52 (rebased index)



Analyst

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EVENT

- FY18 Profit Guidance.
- Minetec awarded \$9.5m revenue contract at BHP's Olympic Dam (to be recognised evenly over FY18 and FY19).

KEY HIGHLIGHTS

- FY18 Underlying NPAT expected to be "in the region of \$38m" (vs. consensus \$34m and Moelis \$36.0m)
- 2H18 performance driven by a mix of pre-existing and recently released products, including the Equinox coin & treasure (C&T) detector.
- \$20m net cash at 30 April 2018 (vs. \$4.4m net debt at Dec'17).
- \$9.5m contract awarded to Minetec to supply BHP's Olympic Dam mine in SA with its underground Fleet Management System solution. The \$9.5m revenue will be split ~50% FY18 and ~50% FY19.

INVESTMENT VIEW

This announcement provides further evidence of CDA's diversifying earnings base, with a growing range of new products and end-markets contributing to earnings throughout 2H FY18, and providing multiple avenues of potential growth for the Group heading into FY19.

We estimate that growth within CDA's new products should dilute the contribution of gold detectors from ~45% of Group revenues in FY17, to ~35% of Group revenue by FY20. We expect this broadening of the earnings base to continue generating a re-rate of the stock over time.

Recently released products/deals include Minelab (Equinox C&T detector), Radio (Sentry HF & Cascade LMR products) and Minetec (BHP/CAT deals).

The Group's balance sheet has strengthened to a \$20m net cash position, providing scope for acquisitions or enlarged dividends. The movement in net cash, plus the interim dividend paid since Dec'17 implies ~\$30m of cash has been generated through the 4 months ending 30 April 2018.

We have upgraded our NPAT estimates for FY18 by 8.7% to \$39.2m (from \$36.0m) and FY19 by 16% to \$40.0m (from \$34.5m), underpinned by the successful launch of the new Equinox C&T machine, and the deal struck by Minetec with BHP at Olympic Dam that provides further validation for its underground mining technology solutions.

We maintain our **BUY** rating. Our revised **target price of \$3.32** implies ~14x FY19 P/E which we deem an appropriate multiple for CDA.

Y/E Jun 30	2017a	2018e	2019e	2020e
EBITDA	75.7	68.5	71.7	74.6
EV/EBITDA	6.8x	7.5x	7.1x	6.9x
Core NPAT	44.7	39.2	40.0	41.4
Core EPS (Diluted) (€)	25.2	21.8	22.3	23.0
P/E	11.8x	13.7x	13.4x	13.0x
EPS growth	111.9%	(13.6%)	2.1%	3.4%
DPS (€)	13.0	11.2	12.4	12.8
Yield	4.3%	3.8%	4.1%	4.3%
DPS growth	116.7%	(13.7%)	10.6%	3.4%
Dividend Payout Ratio	51.5%	51.4%	55.7%	55.7%

All figures are in AUD.

ESTIMATES CHANGES

Changes to our earnings estimates are set out below:

Figure 1: Moelis Estimates

	FY17a	1H18a	2H18e	FY18e	FY19e	FY20e	FY18e (prior)	FY19e (prior)	FY18e ▲	FY19e ▲
Metal	148	63	82	145	130	122	141	120	+3%	+8%
Radio	71	29	39	68	81	88	66	79	+2%	+3%
Mining	7	2	7	9	28	49	9	25	+4%	+13%
Revenue	226	95	127	222	239	260	216	223	+3%	+7%
<i>Metal Detection (% of Group sales)</i>	65%			65%	54%	47%				
Metal	62	23	33	56	47	41	54	41	+4%	+13%
<i>EBIT Margin</i>	42%	36%	41%	39%	36%	33%	38%	35%		
Radio	20	6	11	16	22	23	16	20	+4%	+9%
<i>EBIT Margin</i>	28%	19%	28%	24%	27%	26%	24%	26%		
Mining Technology	0	0	1	0	6	14	-1	5	na	+25%
<i>EBIT Margin</i>	5%	-	10%	5%	22%	28%	-7%	20%		
Unallocated Expense	-20	-7	-12	-19	-20	-21	-19	-20	+0%	+0%
Segment EBIT	62	21	33	54	55	57	50	47	+8%	+18%
<i>Group EBIT Margin</i>	27%	22%	26%	24%	23%	22%	23%	21%	1bps	2bps
NPAT	44.7	16	23	39.2	40.0	41.4	36.0	34.5	+9%	+16%
<i>Group NPAT Margin</i>	20%	17%	18%	18%	17%	16%	17%	15%	1bps	1bps
Net Debt (cash)	(21.4)			(12.4)	(14.1)	(25.4)	12.1	9.0	25	4

Source: Company, Moelis Analysis

Our FY18 and FY19 NPAT have increased by 9% and 16% respectively.

The upgrade to our earnings estimates comprises:

- **Metal Detection** - In total we have increased our FY19 metal detection revenues by \$4m in FY18 and ~\$10m in FY19. This translates into additional EBIT of ~\$2m in FY18 and ~\$6m in FY19. Our upgrade is based on:
 - Strong ongoing sales of gold into Africa and other regions (including some new regions such as Mexico and Somalia which may have scope to further expand sales in FY19)
 - Successful launch of the new Equinox C&T detector which we estimate could increase C&T division sales by at least \$5m / year vs. our prior estimates.
- **Mining Technology (Minetec)** - Our prior 2H FY18 and FY19 estimates already reflected strong sales growth within the Minetec division, however due to the further product validation provided by the deal signed with BHP at Olympic Dam, we have increased FY19 revenue by ~\$3m. This translates into additional EBIT of ~\$1m.
- **Radio Communications** - despite not specifically calling out the radio communications division within the business update, based on the strong level of Group guidance provided we assume that the division can now produce FY18 revenue close to that which it produced in FY17. This produces \$0.6m of incremental EBIT vs. our prior estimates. The growth within our FY19 estimates is based on increased sales of the recently released product in both HF (Sentry - aimed at Military 2 market) and LMR (Cascade - aimed at \$1bn Nth American LMR market).

MINING TECHNOLOGY (MINETEC)

BHP DEAL AT OLYMPIC DAM...MORE VALIDATION

Figure 2: Mining Technology Estimates

	FY17	FY18e	FY19e	FY20e
Metal Detection	148	145	130	122
Radio Communications	71	68	81	88
Mining Technology	7	9	28	49
Group Revenue	226	222	239	260

Source: Company, Moelis Analysis

BHP provides further product validation

- Following on from the deal signed with Caterpillar in Feb'18, BHP has contracted CDA's Minetec division to roll out its Underground Fleet Management System within its Olympic Dam mine in South Australia.
- The contract has an estimated value of \$9.5m with revenue to be recognised ~50% within FY18 and ~50% within FY19.
- This deal provides further strong validation of the capacity and potential of CDA's Mining Technology solution.
- Below we provide an overview of the Minetec's previously announced deal with Caterpillar, as well as an overview of the Minetec product

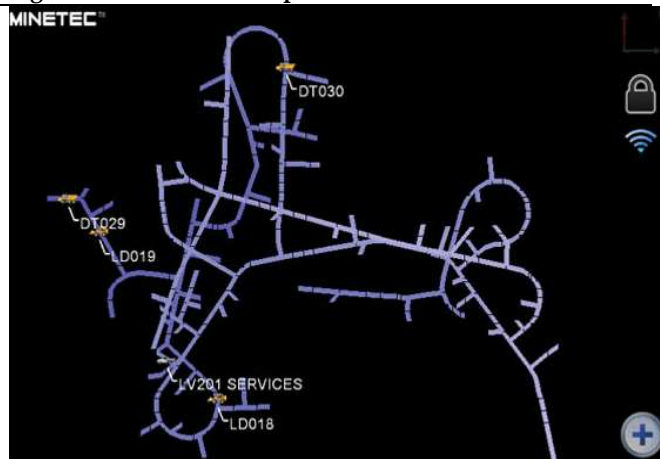
CAT Deal

- In Feb'18 Minetec entered into an exclusive deal with Caterpillar (NYSE: CAT) to integrate its underground mining technology solution with CAT's 'Minestar' product.
- An overview of the Minestar product can be seen in the video link below → <https://www.youtube.com/watch?v=LPROloJzU0Y>
- The partnership with CAT provides an opportunity to accelerate the path-to-market of CDA's UG mining technology, by leveraging CAT's network of 172 dealers across 190 countries.
- UG mining software solutions are strategically important for CAT given it can assist in generating "iron" sales (trucks, machinery) which are more at the core of CAT's business.
- The revenue model for CDA as part of the deal will be structured under a profit-share arrangement, whereby CDA and CAT share in the margin generated by the Minestar product's sale. CDA is entitled to at least 50% of the profit margin on sale of the Minestar product.
- While the deal is exclusive to CAT (i.e. CDA cannot partner with a competitor to integrate its product into theirs), it does not interfere with CDA selling its own Minetec product (i.e. as distinct from the integrated Minestar product) directly to customers, as evidenced by the recently announced BHP deal.
- CDA is currently working with CAT to roll out this process will be to roll out the integrated Minestar product across a live mine setting in WA (scheduled for 2H FY18), in order to eliminate any bugs/issues before taking the product to market ~1H FY19.
- CAT has first right of refusal to acquire Minetec should it be sold.

Minetec - Product Overview

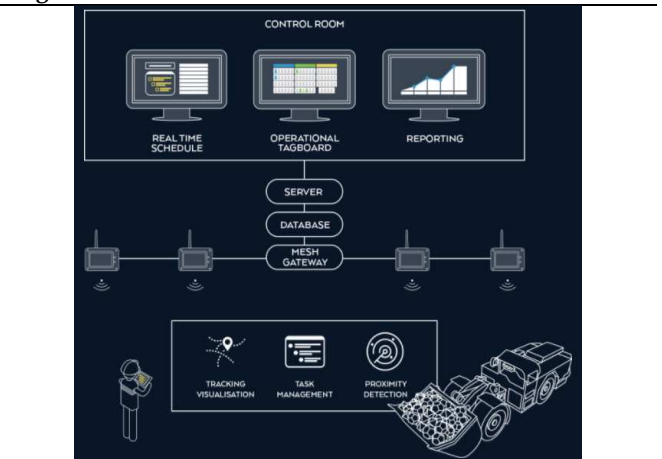
- Minetec promotional video → <https://www.youtube.com/watch?v=Nt0FGB7Y9ec>
- Minetec is an underground mine map positioning system, capable of precisely tracking people and assets within an underground mine site in real-time.
- The Minetec system acts like a high-precision GPS network underground, displaying in real time the precise locations of mobile equipment and personnel against a 3-D map of the mine. This information can be displayed in a remote control room, or on a tablet mounted within a vehicle anywhere in the mine.

Figure 3: Minetec - Example Interface



Source: CDA Presentation

Figure 4: Minetec - Product Overview



Source: CDA Presentation

- The solution uses the CSIRO-developed “WASP” technology of which CDA has exclusive licence for mining purposes. The WASP algorithm provides highly accurate distance measurements using the ‘Time of Arrival’ (to a fraction of a nanosecond) of beacon signals that are periodically transmitted by nodes placed around the mine.
- Management claim the product has market leading accuracy (accurate to ~3cm, vs. next closest competitor at ~3 metres) and has superior data streaming capability (~100mb/second) which allows for higher quality video and connection into the mine sites existing comms network.
- The technology is currently deployed in ~10 operating mines, with customers including Rio Tinto, Newcrest, Oz Minerals and Saracen Minerals.
- Feedback from existing deployments has included a +35% increase in month-on-month mine productivity post installation at WA underground gold mine.

Figure 5: Minetec Operating mines (as at FY16)



Source: CDA FY16 Presentation

METAL DETECTION

Figure 6: Metal Detection vs. Group Revenue

	FY17a	FY18e	FY19e	FY20e
Metal Detection	148	145	130	122
Radio Communications	71	68	81	88
Mining Technology	7	9	28	49
Group Revenue	226	222	239	260

Source: Company, Moelis Analysis

- We have increased our estimates of Metal Detection sales within FY18 & FY19 based on continued strong sales of Gold Detectors in FY18 as well as the successful launch of the new Coin and Treasure machine, the Equinox.
- The Equinox coin & treasure detector retails for ~\$US650-\$900 per unit. Management believe this product has the potential to significantly disrupt much of the competing product within the price range.

Figure 7: Equinox Detector

- **NEW Multi-IQ** technology
 - Simultaneous multi-frequency
 - Adaptable for all target types and ground conditions
 - Obsoletes all single frequency VLF detectors
- Mid-range coin & treasure detector
 - Waterproof
 - Wireless audio
 - Lightweight
 - Easy set-up
 - RRP \$649 - \$899 USD
- Strong order book
- First shipments February 2018



Source: Company, Moelis Analysis

- We estimate that the GPZ7000 gold detector is approximately half-way through its replacement cycle:

Figure 8: GPZ7000 Replacement Cycle

	FY12	FY13	FY14	FY15	FY16	FY17	1H18e
Flagship Detector Model	GPX	GPX	GPX	GPX	GPZ	GPZ	GPZ
Total Metal Detection Sales	\$99m	\$166m	\$70m	\$73m	\$99m	\$148m	\$63m
Flagship detector sales	\$54m	\$91m	\$38m	\$40m	\$55m	\$81m	\$29m
Cummulative flagship units sold	13,000	22,000	9,000	9,500			
Total GPX units sold	60,000	80,000	90,000	100,000			
Cummulative GPZ7000 units sold					7,500	11,000	4,000
Total GPZ7000 units sold				1,000	9,000	20,000	24,000

Estimated addressable market for GPZ (50% of GPX Sales):	50,000
GPZ units sold to date (FY15 - 1H18):	24,000
% through replacement cycle:	48%

Source: Company, Moelis Analysis

We remain confident in the medium-long term outlook for Metal Detection due to its:

- No. 1 market share in handheld Metal Detection (>\$400m p.a. market)
- High technological barriers to entry (world leading IP protected by patents)
- High barriers to distribution/global sales reach (danger factor/ political instability)
- Sophisticated counterfeit protection (military-grade software encryption)
- Broadening product mix (gold, coin/treasure, countermine)
- Growing geographical sales mix (reducing concentration risk)
- World's best gold detector (GPZ7000) only mid-way through replacement cycle, with next flagship detector already in product development.
- Supportive gold price (>\$1,300/ounce)

Profit and Loss (\$m)	2016a	2017a	2018e	2019e	2020e
Revenue	169.5	226.1	222.1	239.3	259.7
<i>Growth</i>	17.8%	33.4%	(1.8%)	7.7%	8.5%
EBITDA	41.9	75.7	68.5	71.7	74.6
<i>Growth</i>	40.2%	80.4%	(9.5%)	4.7%	4.1%
Dep'n & Amort	(12.7)	(14.1)	(14.2)	(16.7)	(18.0)
EBIT	29.2	61.6	54.2	55.0	56.6
<i>Growth</i>	51.1%	110.7%	(11.9%)	1.4%	2.9%
Net Interest Expense	(1.7)	(0.9)	(0.9)	(0.5)	(0.1)
Profit Before Tax	27.5	60.7	53.4	54.6	56.5
Tax	(6.4)	(16.0)	(14.2)	(14.6)	(15.2)
<i>Tax Rate (%)</i>	23.3%	26.3%	26.6%	26.7%	26.8%
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT (Underlying)	21.1	44.7	39.2	40.0	41.4
<i>Growth</i>	65.7%	112.0%	(12.4%)	2.1%	3.4%
One-Off Items	(5.6)	0.0	0.0	0.0	0.0
NPAT (Reported)	15.5	44.7	39.2	40.0	41.4
EPS (Underlying) (€)	11.9	25.2	21.8	22.3	23.0
<i>Growth</i>	65.6%	111.9%	(13.6%)	2.1%	3.4%

Balance Sheet (\$m)	2016a	2017a	2018e	2019e	2020e
Cash	14.3	21.4	11.4	12.9	24.1
Inventory	28.5	31.0	31.8	37.0	40.4
Current Receivables	19.1	20.6	22.9	23.2	25.4
PPE	10.8	12.0	13.3	14.4	15.6
Intangibles	133.0	140.4	148.5	153.4	158.9
Other	0.0	0.0	0.0	0.0	0.0
Total Assets	212.5	232.7	235.2	248.2	271.7
Current Payables	30.4	36.6	35.7	36.1	39.4
ST Debt	0.0	0.0	0.0	0.0	0.0
LT Debt	26.9	0.0	0.2	0.0	0.0
Provisions	7.2	7.7	10.7	10.9	11.8
Other	32.6	52.8	40.5	41.0	44.3
Total Liabilities	73.5	67.7	58.7	59.1	63.4
Net Assets	138.9	165.0	176.5	189.1	208.3
Equity & Reserves	109.2	105.9	99.7	94.3	94.9
Retained Profits	29.7	59.1	76.8	94.8	113.4
Shareholders' Equity	138.9	165.0	176.5	189.1	208.3
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	138.9	165.0	176.5	189.1	208.3

Cashflow (\$m)	2016a	2017a	2018e	2019e	2020e
EBITDA	41.9	75.7	68.5	71.7	74.6
Net Interest	(2.0)	(0.8)	(0.9)	(0.5)	(0.1)
Tax	(0.1)	(1.5)	(20.8)	(19.2)	(15.2)
Δ in Working Capital	9.4	2.2	(4.1)	(5.0)	(2.2)
Other	(1.1)	14.4	(8.2)	0.1	1.0
Operating Cash Flow	48.2	89.9	34.4	47.1	58.1
<i>Growth</i>	57.2%	86.5%	(61.7%)	37.0%	23.2%
Capex	(18.4)	(23.7)	(23.6)	(22.7)	(24.7)
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
Investing Cash Flow	(18.1)	(23.7)	(23.6)	(22.7)	(24.7)
Equity Raised	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(7.1)	(17.7)	(21.0)	(22.7)	(22.2)
Net Borrowings	(15.5)	(26.9)	0.2	(0.2)	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	(22.6)	(44.7)	(20.8)	(22.9)	(22.2)
FX / Non Cash Items	0.0	0.0	0.0	0.0	0.0
Change in Cash	7.5	21.6	(10.0)	1.5	11.2
Free Cash Flow	29.5	51.9	10.8	24.4	33.4

Valuation Summary	
Current Mkt Capitalisation	530.1
Shares on Issue	177.3
Last Price	2.99
12 Mth Target Price	3.32
Total Estimated 12 Mth Return	15.4%
12 Mth Fwd Capital Return	11.0%
12 Mth Fwd Dividend Yield	4.3%

Valuation Ratios	2016a	2017a	2018e	2019e	2020e
EPS (Underlying) (€)	11.9	25.2	21.8	22.3	23.0
<i>Growth</i>	65.6%	111.9%	(13.6%)	2.1%	3.4%
P/E (x)	25.1x	11.8x	13.7x	13.4x	13.0x
Small Industrials (ex Fin's)	0.0x	16.5x	16.5x	15.1x	12.3x
Premium / (Discount)	nm	(28.2%)	(17.1%)	(11.1%)	5.7%
EV/EBITDA (x)	12.2x	6.8x	7.5x	7.1x	6.9x
Small Industrials (ex Fin's)	0.0x	11.0x	11.0x	10.7x	9.8x
Premium / (Discount)	nm	(38.6%)	(32.1%)	(33.3%)	(30.4%)
DPS (€)	6.0	13.0	11.2	12.4	12.8
<i>Growth</i>	71.4%	116.7%	(13.7%)	10.6%	3.4%
Yield (%)	2.0%	4.3%	3.8%	4.1%	4.3%
Payout Ratio (%)	50.4%	51.5%	51.4%	55.7%	55.7%
Franking (%)	100.0%	100.0%	100.0%	100.0%	100.0%
NTA	5.9	24.6	28.1	35.7	49.4
NTA/Share (\$)	0.03	0.14	0.16	0.20	0.28

Performance Ratios	2016a	2017a	2018e	2019e	2020e
ROA	9.9%	19.2%	16.7%	16.1%	15.2%
ROE	15.2%	27.1%	22.2%	21.1%	19.9%
ROIC	14.8%	31.6%	24.1%	22.9%	22.5%
Net Debt (Cash) (\$m)	12.6	(21.4)	(11.1)	(12.9)	(24.1)
Net Debt/EBITDA (x)	0.3x	(0.3x)	(0.2x)	(0.2x)	(0.3x)
ND/(ND + Equity) (%)	8.3%	(14.9%)	(6.7%)	(7.3%)	(13.1%)
Interest Cover (x)	23.1x	84.6x	63.6x	69.2x	91.4x
Working Capital	15.2	(1.0)	11.3	16.2	17.5
Working Capital/Sales (%)	8.9%	(0.5%)	5.1%	6.8%	6.7%

Cash Flow Metrics	2016a	2017a	2018e	2019e	2020e
FCF/Share (\$)	0.17	0.29	0.06	0.14	0.19
Price/FCPS (x)	18.0x	10.2x	49.3x	21.7x	15.9x
Free Cash Flow Yield (%)	5.6%	9.8%	2.0%	4.6%	6.3%
Gross Cash Conversion	119.2%	103.1%	82.1%	93.6%	98.8%
Capex/Sales (%)	(10.9%)	(10.5%)	(10.6%)	(9.5%)	(9.5%)
Capex/Depreciation (x)	1.4x	1.7x	1.7x	1.4x	1.4x

Margins	2016a	2017a	2018e	2019e	2020e
EBITDA	24.7%	33.5%	30.8%	30.0%	28.7%
EBIT	17.2%	27.2%	24.4%	23.0%	21.8%
NPAT	12.4%	19.8%	17.6%	16.7%	15.9%

Valuation Methodology	
WACC (%)	10.0%
Discounted Cash Flow Valuation	3.11
Sum-of-the-Parts Valuation	0.000
Average Valuation	3.11
12 Mth Target Price	3.32

RESEARCH & SALES RESPONSIBILITIES
Equities

Simon Scott	Head of Equities	+612 8288 5418
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DISCLOSURE APPENDIX
ANALYST CERTIFICATION

The Analyst, Ronan Barratt, responsible for the content of this research report, in whole or in part, certifies that with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report accurately reflect his or her personal views on the subject companies and securities, and (2) no part of his or her compensation was, is, or will be directly or indirectly linked to the specific recommendations or views expressed in this research report.

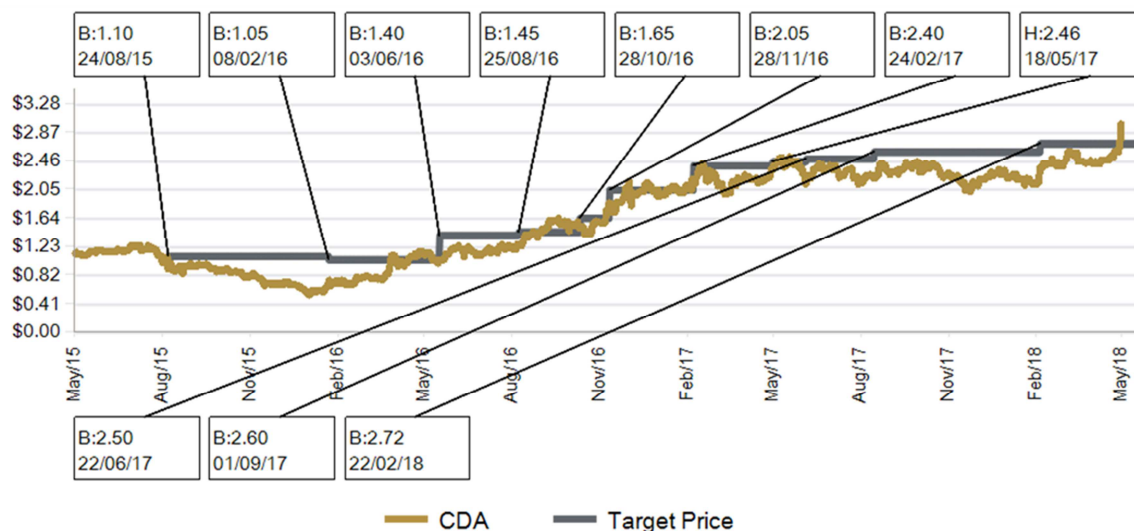
RATING DEFINITIONS

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 21 May 2018

SELL	HOLD	BUY
1.7%	33.3%	63.3%

Rating and Price Target History: Codan Limited (CDA) as of 18/05/2018


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