



Codan Ltd (CDA)

Metal Detectors Stand Out

Event:

- FY18a result; revised earnings and PT.

Investment Highlights:

- CDA has announced its FY18a results with highlights including underlying NPAT of \$39.8M, beating twice upgraded guidance (\$38M) and FSBe of \$38.2M.
- Metal Detection was the standout segment with a strong second half showing to finish the year. Geographic diversification and market traction for new products drove higher sales, while margins remained robust.
- Tracking Solutions continues to scale, with the Olympic Dam contributing to growth in both FY18a and FY19e.
- Radio Communications will look for a stronger FY19e, with contract timings the main driver of a pullback in the segment's revenue and result contribution. The business had expected a recovery for Radio Communications in 2H18a, though management has noted an encouraging pipeline and order book as well as the capture of FY18 contracts in early FY19e.
- Special dividend of 4cps accompanies final dividend of 4.5cps: and taken with the interim dividend of 4cps, takes the dividend to 12.5cps, yielding 3.9%.
- The company remains well funded: \$27.7M cash at balance date, with nil debt.
- Improved outlook for FY19e: the company has rebased base business revenue to \$180-200M, which is expected to deliver \$25-30M NPAT; previous base earnings expectation was \$20-25M NPAT. The Metal Detection segment was rebased to \$110M base revenue (previously \$85-95M), while Minetec is expected to generate \$15M revenue in FY19e, and Radio Communications segment revenue will recover to \$65-75M revenue (unchanged). The company will provide a trading update at its AGM in October 2018.

Earnings and Valuation:

- We have an increased valuation of \$3.55 per CDA share (previously \$3.40) due to increased earnings. We have revised our FY19e-FY21e earnings forecasts to \$40.2M, \$41.0M, and \$42.3M (previously \$35.5M, \$39.9M, and \$44.5M).
- We have increased our revenue assumption for Metal Detection, and decreased revenue assumptions for both Radio Communications and Tracking Solutions broadly in line with company guidance. We have an increased Metal Detection margin assumption and a decreased Radio Communications margin assumption.

Recommendation:

- We maintain coverage of CDA with an unchanged BUY recommendation and a price target of \$3.55 per share (prior \$3.40), in line with increased valuation.
- Catalysts for the share price include: 1) updates on trading conditions, particularly Metal Detection and Caterpillar progress; the company expects to provide a trading update at its AGM in October 2018; 2) further contract wins in Radio Communications and Tracking Solutions.

Recommendation	BUY			
Previous	Buy			
Risk	High			
Price Target	\$3.55			
Previous	\$3.40			
Share Price (A\$)	\$3.19			
ASX Code	CDA			
52 week low - high (A\$)	2.02-3.28			
Capital structure				
Shares on Issue (M)	178.2			
Market Cap (A\$M)	568			
Net Cash/(Debt) (A\$M)	28			
EV (A\$M)	540			
12mth Av Daily Volume ('000)	213			
Y/e Jun US\$	FY18a	FY19e	FY20e	FY21e
Sales \$M	229.9	233.0	221.2	231.3
EBITDA \$M	70.4	70.3	72.0	75.2
NPAT Adj. \$M	39.8	40.2	41.0	42.3
EPS adj c	22.1	22.1	22.3	22.8
PER (x)	14.4	14.4	14.3	14.0
Dividend c	12.5	11.1	11.2	11.4
Div Payout Ratio %	57%	50%	50%	50%
Dividend yield %	3.9%	3.5%	3.5%	3.6%

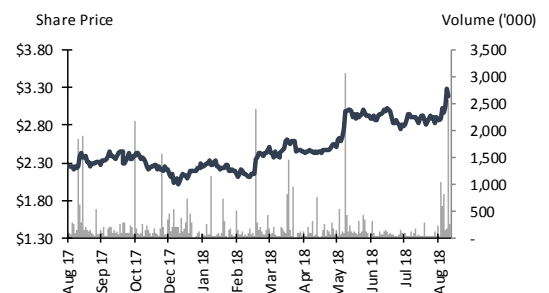
Board

David Simmons	Chairman
Donald McGurk	CEO
Lt-Gen Peter Leahy	Non-Executive Director
Jim McDowell	Non-Executive Director
Graeme Barclay	Non-Executive Director
Kathy Gramp	Non-Executive Director

Major Shareholders

I M Wall and P M Wall	19.5%
Pinara Group Pty Ltd	14.5%
IOOF Holdings	5.8%

Share Price Graph



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The analyst does not own CDA securities.

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Refer to end of report for details.



Codan Ltd (CDA)

Full Year Ended, 30 June

Profit and Loss A\$M	2018a	2019e	2020e	2021e	Financial Metrics	2018a	2019e	2020e	2021e
Sales revenue	229.9	233.0	221.2	231.3	Sales growth %	33%	1%	-5%	5%
Operating Costs	159.6	162.6	149.2	156.1	EPS growth %	-5%	0%	0%	1%
EBITDA	70.4	70.3	72.0	75.2	EBITDA margin	31%	30%	33%	33%
D&A	16.7	17.1	17.9	19.7	EBIT margin	23%	23%	24%	24%
EBIT	53.7	53.2	54.1	55.5	Gearing (ND/ND+E)	n/a	n/a	n/a	n/a
Net Interest exp / (income)	0.5	-0.4	-0.6	-0.8	Interest Cover (EBIT/net int)	>10	>10	>10	>10
Profit before tax	53.2	53.6	54.7	56.3	Average ROE %	22%	19%	18%	17%
Tax exp / (benefit)	13.4	13.4	13.7	14.1	Average ROA %	16%	14%	14%	13%
Underlying NPAT	39.8	40.2	41.0	42.3	Payout, %	57%	50%	50%	50%
Significant items	1.7	0.0	0.0	0.0	Wtd ave shares diluted (M)	180	182	184	185
NPAT attributable reported	41.5	40.2	41.0	42.3					
EPS diluted, cps	22.1	22.1	22.3	22.8					
DPS, cps	12.5	11.1	11.2	11.4					
Cashflow A\$M	2018a	2019e	2020e	2021e	Valuation multiples	2018a	2019e	2020e	2021e
EBITDA	70.4	70.3	72.0	75.2	P/E x	14.4	14.4	14.3	14.0
Change in WC / Other	1.0	-1.4	2.6	-4.9	EV/EBITDA x	7.8	7.7	7.4	7.0
Tax paid	-22.6	-13.4	-13.6	-13.9	EV/EBIT x	9.4	9.7	9.6	9.4
Share-based expense	0.0	0.0	0.0	0.0	EV/sales x	2.4	2.4	2.6	2.5
Net interest	-0.5	0.4	0.6	0.8	Dividend yield %	3.9%	3.5%	3.5%	3.6%
Operating Cashflow	48.2	55.9	61.7	57.2					
Purchase of PP&E	-3.4	-4.0	-4.0	-4.0	Valuation				
Payments Intangibles	-19.0	-20.3	-20.8	-21.3	FCF Valuation				
Payments For Acquisitions	0.0	0.0	0.0	0.0	Total NPV of FCF				618
Investing Cashflow	-22.5	-24.3	-24.8	-25.3	Less Net Debt/(Cash)				-28
Dividends Paid	-19.6	-23.5	-21.1	-21.5	Equity Value - A\$				646
Proceeds from borrowings	0.0	0.0	0.0	0.0	FCF Valuation, WACC 10.7%				3.59
Repayment of borrowings	0.0	0.0	0.0	0.0	Sum of Parts Valuation	1yr fwd EBIT	EBIT, x	EV	
Financing Cashflow	-19.6	-23.5	-21.1	-21.5	Radio Comms	11	12	129	
Net Cashflow	6.2	8.1	15.8	10.4	Metal Detection	60	9	559	
					Tracking Solutions	1	25	27	
					Corporate Costs	-19	6	-113	
					Total			602	
					Sum of Parts Valuation, A\$/sh			3.50	
					Valuation, FCF 50%, EV/EBIT 50%			3.55	
Balance Sheet A\$M	2018a	2019e	2020e	2021e	Shares on issue	M			
Cash / (Debt)	27.7	35.8	51.6	62.0	Ordinary shares	178.2			
Current Assets (Excl Cash)	67.7	64.7	64.4	67.2	Performance Rights /Options	2.3			
PPE	12.5	13.9	15.2	15.5	Fully Diluted	180.5			
Intangibles / Other	146.4	168.0	169.6	179.7	Substantial shareholders				
Total Assets	254.3	282.4	300.8	324.4	I M Wall and P M Wall	19.5%			
Accounts payable	46.3	47.0	44.6	46.6	Pinara Group Pty Ltd	14.5%			
Other Liabilities	19.9	27.2	27.5	27.9	IOOF Holdings	5.8%			
Total Liabilities	66.2	74.2	72.1	74.5					
Reserves and capital	107.0	107.0	107.0	107.0					
Retained earnings	81.0	101.1	121.6	142.8					
Total Equity	188.1	208.2	228.7	249.8					
Total Equity & Liabilities	254.3	282.4	300.8	324.4					

Source: Foster Stockbroking estimates



FY18a RESULT HIGHLIGHTS

- CDA has announced FY18a results with highlights including underlying NPAT of \$39.8M NPAT from \$229.9M revenue; the Metal Detection and Tracking Solutions segments in particular demonstrated strong 2H performances. Underlying NPAT was ahead of twice-upgraded company guidance (\$38M), and FSBe (\$38.2M).
- Revenue from Metal Detection products and Tracking Solutions showed strong YoY growth of 11% and 30%, respectively, while Communications declined 20% due to contracts timing and a slowdown in US government spending.
- The company remains well funded. CDA had a cash balance of \$27.7M at balance date, with nil debt.
- The company declared a fully franked final dividend of 4.5cps, and taken with the interim dividend of 4cps, takes the full year dividend to 8.5cps. Moreover, the Board also declared a special dividend of 4cps. We had previously flagged the increased likelihood of a special dividend (FSBe 1.6cps) due to the company's strong cash position and nil debt, and the announcement of the special dividend exceeded our expectation for the quantum.

Figure 1: CDA FY18a Result Comparison

A\$M	FY17a	FY18a	%, YoY	FY18 FSBe	% vs FSBe
Sales	226.1	229.9	2%	217.4	6%
Operating costs	150.3	159.6	6%	151.2	5%
Underlying EBITDA	75.8	70.4	-7%	66.2	6%
D&A	14.1	16.7	18%	14.7	13%
Underlying EBIT	61.7	53.7	-13%	51.4	4%
Net interest exp/(inc)	0.9	0.5	-44%	0.5	0%
Profit before tax	60.8	53.2	-13%	50.9	4%
Tax expense / (benefit)	16.0	13.4	-16%	12.7	5%
Underlying NPAT	44.9	39.8	-11%	38.2	4%
EPS, cps	24.2	22.1	-9%	21.2	4%
DPS, cps	13.0	12.5	-4%	10.6	18%

Source: Company; Foster Stockbroking estimates.

Radio Communications

- Radio communications revenue pulled back 20% to \$56.5M in FY18a, with the business noting a slowdown in US government spending and timing of contracts as the main causes. The segment result deteriorated over the year, reporting a \$1.2M segment result in 2H18a, down from \$5.6M in 1H18a, while the segment margin also compressed to 4% from 19% over the same periods.
- In spite of FY18a issues, management has noted that the pipeline and order book are strong, while the contracts which did not make it into FY18a have been captured in a strong start to FY19e.
- Management expects a return to base business sales from Radio Communications to be in the range of \$65-75M in FY19e.

Metal Detection

- The Metal Detection segment was the standout in the result, and compensated for the temporary decline in Radio Communications. Even though the second half of the financial year is typically the stronger of the two halves for the business, the segment revenue and result for Metal Detection products exceeded our expectations.



- Metal Detection revenue was up 11% to \$164M for FY18a; while the segment delivered a \$64M result for the year, including \$41M in 2H18a, up from \$23M in 1H18a, and which was already cycling off a strong 2H17a.
- The company has made progress in geographic diversification of its product sales, which has helped deliver strong sales over the year. Additionally, strong traction in new product releases, including Gold Monster and SDC 230, have also helped deliver strong sales.
- The Metal Detection segment delivered much better than expected margin in 2H18a of 41%, up from 36% in 1H18a, and which was a return to the form of FY17a; this suggests sales for the higher margin flagship product still remains robust in spite of the introduction of lower priced (and margin) products into the market.
- Management now expects base level sales from Metal Detection to be around \$110M per year, up from a range of \$85-95M.

Tracking Solutions

- The Tracking Solutions segment continues to scale, generating \$9.4M for FY18a, +31% YoY. Encouragingly, the segment generated a segment result of \$1M in 2H18a.
- The contract win at Olympic Dam during the 2H18a was a highlight for the segment. The company has booked approximately half of the \$9.5M contract revenue in FY18a already, with the balance to be earned in FY19e. The company notes the Caterpillar Minetec agreement is also expected to make a contribution to FY19e revenue.
- The company expects to continue scaling the Tracking Solutions business and expects \$15M in sales from this segment in FY19e, with the objective of doubling the size of this business in the course of the next few years.

FY19e OUTLOOK

- The company now expects base business sales of \$180-200M, and for this to generate \$25-30M of NPAT. This is an increase on the previous base earnings expectation of \$20-25M.
- The company has also updated its base business sales from each of its segments. CDA has an unchanged base business sales range from Radio Communications of \$65-75M, while Metal Detection has increased to \$110M from \$85-95M.
- The Tracking Solutions business continues to grow and the company expects \$15M in sales from Minetec in FY19, and has the objective of doubling the size of this business in the course of the next few years. The company has not provided an explicit base business sales expectation for this segment at this stage.
- A further trading update will be provided at the AGM in October 2018. .

EARNINGS FORECASTS AND VALUATION

- We have revised our earnings forecasts to reflect recent performance and company guidance. We now forecast NPAT of \$40.2M, \$41.0M, and \$42.3M in FY19e-FY21e (previously \$35.5M, \$39.9M, and \$44.5M).
- We have increased our revenue assumption for Metal Detection and decreased revenue assumptions for both Radio Communications near the lower end of the base business revenue range (\$68M), and Tracking Solutions, in line with company guidance of \$15M. We have also



revised margin assumptions for these segments, having increased margin assumptions for the Metal Detection segment and decreased for Radio Communications.

- We have an increased valuation of \$3.55 from \$3.40, based on an increase in earnings, using a blended valuation methodology, DCF (50%) and EV/EBIT (50%).

Figure 2: CDA Earnings Changes

	FY19e	Old	Δ	FY20e	Old	Δ	FY21e	Old	Δ
Sales	233.0	220.7	6%	221.2	242.6	-9%	231.3	269.5	-14%
Operating costs	162.6	157.7	3%	149.2	173.2	-14%	156.1	192.4	-19%
Underlying EBITDA	70.3	63.0	12%	72.0	69.4	4%	75.2	77.2	-3%
D&A	17.1	15.4	11%	17.9	16.2	11%	19.7	17.9	10%
Underlying EBIT	53.2	47.6	12%	54.1	53.2	2%	55.5	59.3	-6%
Net interest exp / (inc)	-0.4	0.3	-260%	-0.6	0.0	nm	-0.8	0.0	nm
Profit before tax	53.6	47.4	13%	54.7	53.2	3%	56.3	59.3	-5%
Tax expense	13.4	11.8	13%	13.7	13.3	3%	14.1	14.8	-5%
Underlying NPAT	40.2	35.5	13%	41.0	39.9	3%	42.3	44.5	-5%
EPS underlying, c	22.1	19.5	13%	22.3	21.7	3%	22.8	24.0	-5%
DPS, c	11.1	9.8	13%	11.2	10.9	3%	11.4	12.0	-5%

Source: Foster Stockbroking estimates.

RECOMMENDATION – MAINTAIN BUY, PT INCREASED TO \$3.55

- We maintain a Buy recommendation on CDA and have increased our price target to \$3.55 from \$3.40, based on our blended valuation (50% DCF, 50% EV/EBIT).
- Catalysts for the share price include: 1) updates on trading conditions, particularly Metal Detection and Caterpillar progress; CDA expects to provide a trading update at the AGM in October 2018; 2) further contract wins in Radio Communications and Tracking Solutions.



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Review of disclosure: All the disclosures in the report have been reviewed and checked by Keith Quinn, Compliance Committee Member.