

CODAN LIMITED

BUY
Strong FY18 result with momentum carrying into 1H19

Technology Hardware & Equipment / Electronic Equipment & Instruments

24 August 2018

COMPANY UPDATE

Ticker	CDA
Stock Price	\$3.28
Target Price	\$3.62
Forecast Capital Return	10.4%
Forecast Dividend Yield	4.6%
Estimated Total Return - 12 Mth Forward	15.0%

Company market data

Market Cap.	\$584.5m
Free Float (%)	61.8
Enterprise Value	\$556.8m
52 Week Range	\$2.02 - \$3.04
Shares Out.	178.2m
Avg. Daily Value	\$0.0m

Estimates changes	2018a	2019e	2020e	2021e
Core NPAT - <i>old</i>	39.2	40.0	41.4	46.0
Core NPAT - <i>new</i>	39.8	43.0	41.6	46.6
% Change	1.7	7.4	0.6	1.5
Core EPS dil. (€) - <i>old</i>	21.8	22.3	23.0	25.6
Core EPS dil. (€) - <i>new</i>	22.1	23.8	23.1	25.9
% Change	1.5	7.1	0.3	1.1
DPS (€) - <i>old</i>	11.2	12.4	12.8	14.3
DPS (€) - <i>new</i>	15.5	13.5	13.1	14.7
% Change	38.1	8.5	1.9	3.3

All figures are in AUD unless otherwise specified.

Share price performance

Codan Limited vs. AS52 (rebased index)



Analyst

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EVENT

FY18 Result.

- **NPAT +\$38.2m** vs. guidance: "around \$38m" and MOE(e) \$39.2.
- **'Base business' NPAT guidance increased +20% to \$25-30m.**
- **Metal Detection:** ~\$100m 2H18 sales (+21% vs. pcp.) including contribution from new 'Equinox' coin & treasure device, expanded gold detector range, and sales into new markets.
- **Mining Technology:** Works with Caterpillar and BHP progressing to plan, new contract awarded in Finland. Sales expected to grow from ~\$9m in FY18 to \$15m in FY19.
- **Radio Communications:** 2H sales down vs. pcp in part due to timing of ~\$10m projects dropping in 1Q FY19 rather than 4Q FY18.

IMPACT

Maintain BUY rating, target price increased to \$3.62 (from \$3.32).

We increase FY19e NPAT by 7% to \$43.0m, reflecting sales momentum carried into 1H19 from Metal Detection, as well as large Radio projects in 1Q19.

INVESTMENT VIEW

The FY18 result highlights the benefits of CDA's strong product investments (~\$20m p.a.) undertaken in recent years, with contributions made from a growing range of new products & markets.

\$28m of net cash on the balance sheet provides scope for acquisitions (not included within our estimates) or enlarged dividends.

We estimate ~8% NPAT growth across FY19 with incremental contributions expected from:

- Minelab: 12mth sales of new Equinox C&T detector (launched Feb'18) plus strong start to 1H19 (no slowing of sales in 6 months to Aug'18)
- Radio: ~\$10m projects in 1Q FY19 plus sales of new Sentry (HF) & Cascade (LMR) products. We expect a year similar to FY17 for Radio Comms (~\$17m EBIT vs. ~\$6m in FY18).
- Minetec: Revenue from work being competed with BHP and Caterpillar, as well as more direct sales outside of these two deals.

We expect the ongoing broadening of CDA's earnings base across new products & markets to continue re-rating the stock over time.

CDA trades on 13.8x FY19 P/E with \$28m of net cash that could support acquisitions (not included in our estimates). **BUY. \$3.62 TP.**

Y/E Jun 30	2018a	2019e	2020e	2021e
EBITDA	70.6	79.4	77.7	85.3
EV/EBITDA	7.9x	7.0x	7.2x	6.5x
Core NPAT	39.8	43.0	41.6	46.6
Core EPS (Diluted) (€)	22.1	23.8	23.1	25.9
P/E	14.8x	13.8x	14.2x	12.7x
EPS growth	(12.3%)	7.7%	(3.2%)	12.1%
DPS (€)	15.5	13.5	13.1	14.7
Yield	4.7%	4.1%	4.0%	4.5%
DPS growth	19.2%	(13.1%)	(2.9%)	12.6%
Dividend Payout Ratio	70.0%	56.5%	56.6%	56.9%

All figures are in AUD.

RESULT & REVISED ESTIMATES

FY18 Result

The largest beat vs. MOE estimates came from Metal Detection which recorded strong sales across 2H FY18 supported by GPZ & SDC gold detectors as well as the new equinox coin & treasure device.

Radio Communications EBIT was much lower than expected, in part due to timing of ~\$10m of projects which were expected in 1Q FY19.

Figure 1: FY18 Result

	FY18a	MOE(e)	Diff	vs. pcp
Metal	64	56	14%	4%
<i>EBIT Margin</i>	39%	39%	0%	-3%
Radio	7	16	-59%	-66%
<i>EBIT Margin</i>	12%	24%	-12%	-16%
Mining Technology	1	0	57%	114%
<i>EBIT Margin</i>	8%	5%	3%	3%
Corporate	-18	-19	-7%	-13%
<i>% Group Sales</i>	-8%	-9%	-207%	-760%
EBIT	54	54	-1%	-12%
<i>Group EBIT Margin</i>	23%	24%	-1%	-4%
NPAT	39.8	39.2	2%	-11%
<i>Group NPAT Margin</i>	17%	18%		
EPS	22.1	21.8	2%	-12%
DPS	15.5	11.2	38%	19%

Source: Company, Moelis Research

Figure 2: MOE Revised Estimates

	FY17a	FY18a	FY19e	FY20e
Metal	148	164	153	146
Radio	71	57	72	78
Mining	7	9	17	30
Revenue	226	230	241	254
<i>Metal Detection (% of Group s</i>	65%	71%	63%	57%
Metal	62	64	59	53
<i>EBIT Margin</i>	42%	39%	38%	36%
Radio	20	7	17	18
<i>EBIT Margin</i>	28%	12%	24%	23%
Mining Technology	0	1	2	5
<i>EBIT Margin</i>	5%	8%	10%	16%
Corporate	-20	-18	-18	-19
<i>% Group Sales</i>	-9%	-8%	-8%	-8%
EBIT	62	54	59	56
<i>Group EBIT Margin</i>	27%	23%	24%	22%
NPAT	44.7	39.8	43.5	41.8
<i>Group NPAT Margin</i>	20%	17%	17%	16%
EPS	25.2	22.1	24.2	23.2

Source: Company, Moelis Research

MOE Revised Estimates

- **Metal Detection:** We increased FY19e EBIT by \$12m based on:
 - Sales momentum from 2H18 continuing thus far in 1Q FY19 (historically the 1H usually experiences a seasonal downturn.
 - Successful launch of the new Equinox C&T detector which should generate ~\$5m incremental sales in FY19.
- **Radio Communications:** We expect Radio to have a similar year in FY19 to that which is produced in FY17 (base level sales of ~\$70m and EBIT of ~\$17m. We expect incremental sales growth vs. FY18 from recent product releases including HF (Sentry Radio) and LMR (Cascade Solution)
- **Mining Technology (Minetec):** We estimate sales of ~\$17m (vs. FY18: \$9m) based on ~\$8m BHP, \$2m Caterpillar, ~\$7m other projects.

METAL DETECTION

Figure 3: Segment EBIT estimates

	FY18a	FY19e	FY20e
Metal Detection	64	59	53
Radio Communications	7	17	18
Mining Technology	1	2	5
Segment EBIT (pre Corporate)	72	77	76

Source: Company, Moelis Analysis

The Equinox coin & treasure detector retails for ~\$US650-\$900 per unit, with Management of the view the product can significantly disrupt competing product.

Figure 4: 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 ~60% through its replacement cycle and note that new markets have recently come online for the product.

Figure 5: GPZ7000 Replacement Cycle

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
Flagship Detector Model	GPX	GPX	GPX	GPX	GPX	GPX	GPX	GPX	GPZ	GPZ	GPZ
Total Metal Detection Sales	\$42m	\$107m	\$107m	\$92m	\$99m	\$166m	\$70m	\$73m	\$99m	\$148m	\$164m
Flagship detector sales	\$23m	\$59m	\$59m	\$51m	\$54m	\$91m	\$38m	\$40m	\$55m	\$81m	\$74m
Cumulative GPX units sold	5,500	20,000	35,000	45,000	60,000	80,000	90,000	100,000			
Cumulative GPZ7000 units sold								1,000	9,000	20,000	30,000
Estimated GPZ addressable market (50% of GPX Sales)	50,000										
GPZ units sold to date (FY15-18)	30,000										
% through replacement cycle	60%										

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)
- Supportive gold price (~\$1,200/ounce).

MINING TECHNOLOGY

Figure 6: Segment EBIT estimates

	FY18a	FY19e	FY20e
Metal Detection	64	59	53
Radio Communications	7	17	18
Mining Technology	1	2	5
Segment EBIT (pre Corporate)	72	77	76

Source: Company, Moelis Analysis

BHP deal provides strong product validation

BHP Deal

- BHP has contracted CDA's Minetec division to roll out its Underground Fleet Management System within its Olympic Dam mine in South Australia. CDA expects ~\$5-\$8m in sales from works with BHP in FY19.

CAT Deal

- Caterpillar and Minetec have begun integrating Minetec's product into an expanded Caterpillar Minestar underground solution for hard-rock mines. The integrated Minestar product will be taken to market under the CAT brand through the CAT global dealer network with first commercial sales expected in 2H FY19.
- UG mining software solutions are strategically important for CAT given it can assist in generating "iron" sales (trucks, machinery) which are 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 & CAT share in the margin generated by the Minestar product's sale (CDA entitled to at least 50% of the profit margin on sale).

First commercial sales with CAT expected 2H FY19

RADIO COMMUNICATIONS

Figure 7: Segment EBIT estimates

	FY18a	FY19e	FY20e
Metal Detection	64	59	53
Radio Communications	7	17	18
Mining Technology	1	2	5
Segment EBIT (pre Corporate)	72	77	76

Source: Company, Moelis Analysis

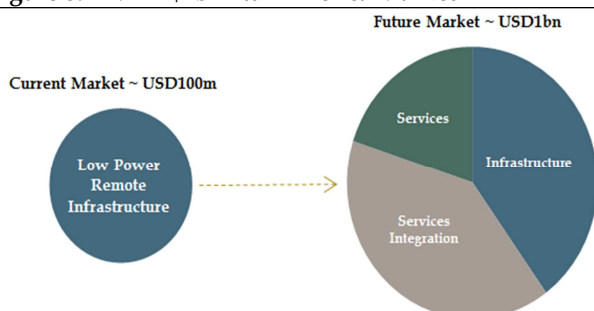
Global instability / terror threats are increasing the relevance of emergency communication systems

We expect growth in Radio Communications in FY19 following the launch of new products across both the High Frequency and Land Mobile Radio divisions in FY18.

New HF division products will target the global military market (CDA has already had success in this market with Afghanistan) utilising the US government-funded Foreign Military Sales vehicle.

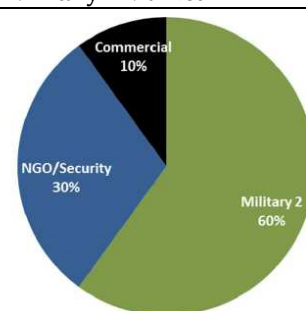
LMR's new product 'Cascade', will target the ~\$1bn North American LMR market. Cascade will offer a lower-cost alternative to the dominant incumbent, Motorola (>80% market share). The Cascade product expands CDA offering beyond just the radio, into systems integration and ongoing maintenance/support services, providing the opportunity to generate for recurring revenue.

Figure 8: LMR - \$1bn Nth America Market



Source: Company Reports

Figure 9: HF - Military 2 Market



Source: Company reports, Moelis Analysis

Profit and Loss (\$m)	2017a	2018a	2019e	2020e	2021e
Revenue	226.1	229.9	241.4	256.1	279.9
<i>Growth</i>	33.4%	1.7%	5.0%	6.1%	9.3%
EBITDA	75.7	70.6	79.4	77.7	85.3
<i>Growth</i>	80.4%	(6.7%)	12.5%	(2.1%)	9.7%
Dep'n & Amort	(14.1)	(16.7)	(21.4)	(21.7)	(22.4)
EBIT	61.6	53.9	58.1	56.0	62.8
<i>Growth</i>	110.7%	(12.5%)	7.7%	(3.6%)	12.2%
Net Interest Expense	(0.9)	(0.7)	0.7	0.9	1.2
Profit Before Tax	60.7	53.2	58.8	56.9	64.1
Tax	(16.0)	(13.3)	(15.8)	(15.3)	(17.4)
<i>Tax Rate (%)</i>	26.3%	25.1%	26.9%	26.8%	27.2%
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT (Underlying)	44.7	39.8	43.0	41.6	46.6
<i>Growth</i>	112.0%	(10.9%)	7.8%	(3.2%)	12.1%
One-Off Items	0.0	0.0	0.0	0.0	0.0
NPAT (Reported)	44.7	39.8	43.0	41.6	46.6
EPS (Underlying) (€)	25.2	22.1	23.8	23.1	25.9
<i>Growth</i>	111.9%	(12.3%)	7.7%	(3.2%)	12.1%

Balance Sheet (\$m)	2017a	2018a	2019e	2020e	2021e
Cash	21.4	27.7	29.8	44.3	60.5
Inventory	31.0	31.6	37.2	39.8	43.6
Current Receivables	20.6	29.8	32.1	34.3	37.7
PPE	12.0	12.5	13.8	15.1	16.4
Intangibles	140.4	146.4	146.7	148.0	150.7
Other	0.0	0.0	0.0	0.0	0.0
Total Assets	232.7	254.3	265.8	287.7	315.3
Current Payables	36.6	46.3	44.6	47.7	52.4
ST Debt	0.0	0.0	0.0	0.0	0.0
LT Debt	0.0	0.0	0.0	0.0	0.0
Provisions	7.7	7.8	9.9	10.6	11.5
Other	52.8	52.4	50.7	53.8	58.4
Total Liabilities	67.7	66.2	66.5	70.3	75.9
Net Assets	165.0	188.1	199.3	217.4	239.3
Equity & Reserves	105.9	107.0	99.3	99.1	100.6
Retained Profits	59.1	81.0	100.0	118.3	138.7
Shareholders' Equity	165.0	188.1	199.3	217.4	239.3
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	165.0	188.1	199.3	217.4	239.3

Cashflow (\$m)	2017a	2018a	2019e	2020e	2021e
EBITDA	75.7	70.6	79.4	77.7	85.3
Net Interest	(0.8)	(0.5)	0.7	0.9	1.2
Tax	(1.5)	(22.6)	(20.5)	(15.3)	(17.4)
Δ in Working Capital	2.2	(0.1)	(9.6)	(1.7)	(2.6)
Other	14.4	0.8	2.1	0.7	1.0
Operating Cash Flow	89.9	48.2	52.1	62.3	67.5
<i>Growth</i>	86.5%	(46.4%)	8.1%	19.5%	8.3%
Capex	(23.7)	(22.0)	(22.9)	(24.3)	(26.6)
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestments	0.0	0.0	0.0	0.0	0.0
Other	0.0	(0.5)	0.0	0.0	0.0
Investing Cash Flow	(23.7)	(22.5)	(22.9)	(24.3)	(26.6)
Equity Raised	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(17.7)	(19.6)	(27.1)	(23.5)	(24.7)
Net Borrowings	(26.9)	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	(44.7)	(19.6)	(27.1)	(23.5)	(24.7)
FX / Non Cash Items	0.0	0.1	0.0	0.0	0.0
Change in Cash	21.6	6.3	2.1	14.5	16.2
Free Cash Flow	51.9	26.2	29.2	38.0	40.9

Valuation Summary	
Current Mkt Capitalisation	584.5
Shares on Issue	178.2
Last Price	3.28
12 Mth Target Price	3.62
Total Estimated 12 Mth Return	15.0%
12 Mth Fwd Capital Return	10.4%
12 Mth Fwd Dividend Yield	4.6%

Valuation Ratios	2017a	2018a	2019e	2020e	2021e
EPS (Underlying) (€)	25.2	22.1	23.8	23.1	25.9
<i>Growth</i>	111.9%	(12.3%)	7.7%	(3.2%)	12.1%
P/E (x)	13.0x	14.8x	13.8x	14.2x	12.7x
Small Industrials (ex Fin's)	16.5x	16.5x	15.1x	12.3x	16.5x
Premium / (Discount)	(21.2%)	(10.5%)	(9.0%)	15.6%	(23.4%)
EV/EBITDA (x)	7.4x	7.9x	7.0x	7.2x	6.5x
Small Industrials (ex Fin's)	11.0x	11.0x	10.7x	9.8x	9.1x
Premium / (Discount)	(33.1%)	(28.3%)	(34.5%)	(27.3%)	(28.4%)
DPS (€)	13.0	15.5	13.5	13.1	14.7
<i>Growth</i>	116.7%	19.2%	(13.1%)	(2.9%)	12.6%
Yield (%)	4.0%	4.7%	4.1%	4.0%	4.5%
Payout Ratio (%)	51.5%	70.0%	56.5%	56.6%	56.9%
Franking (%)	100.0%	100.0%	100.0%	100.0%	100.0%
NTA	24.6	41.7	52.6	69.4	88.6
NTA/Share (\$)	0.14	0.23	0.29	0.39	0.49

Performance Ratios	2017a	2018a	2019e	2020e	2021e
ROA	19.2%	15.7%	16.2%	14.5%	14.8%
ROE	27.1%	21.2%	21.6%	19.1%	19.5%
ROIC	31.6%	25.2%	25.0%	23.7%	25.6%
Net Debt (Cash) (\$m)	(21.4)	(27.7)	(29.8)	(44.3)	(60.5)
Net Debt/EBITDA (x)	(0.3x)	(0.4x)	(0.4x)	(0.6x)	(0.7x)
ND/(ND + Equity) (%)	(14.9%)	(17.3%)	(17.6%)	(25.6%)	(33.8%)
Interest Cover (x)	84.6x	76.9x	178.9x	87.8x	70.5x
Working Capital	(1.0)	8.0	15.6	16.7	18.2
Working Capital/Sales (%)	(0.5%)	3.5%	6.5%	6.5%	6.5%

Cash Flow Metrics	2017a	2018a	2019e	2020e	2021e
FCF/Share (\$)	0.29	0.15	0.16	0.21	0.23
Price/FCPS (x)	11.2x	22.3x	20.0x	15.4x	14.3x
Free Cash Flow Yield (%)	8.9%	4.5%	5.0%	6.5%	7.0%
Gross Cash Conversion	103.1%	101.2%	91.2%	99.8%	99.6%
Capex/Sales (%)	(10.5%)	(9.6%)	(9.5%)	(9.5%)	(9.5%)
Capex/Depreciation (x)	1.7x	1.3x	1.1x	1.1x	1.2x

Margins	2017a	2018a	2019e	2020e	2021e
EBITDA	33.5%	30.7%	32.9%	30.4%	30.5%
EBIT	27.2%	23.5%	24.1%	21.9%	22.5%
NPAT	19.8%	17.3%	17.8%	16.2%	16.7%

Valuation Methodology	
WACC (%)	10.0%
Discounted Cash Flow Valuation	3.40
Sum-of-the-Parts Valuation	0.000
Average Valuation	3.40
12 Mth Target Price	3.62

RESEARCH & SALES RESPONSIBILITIES
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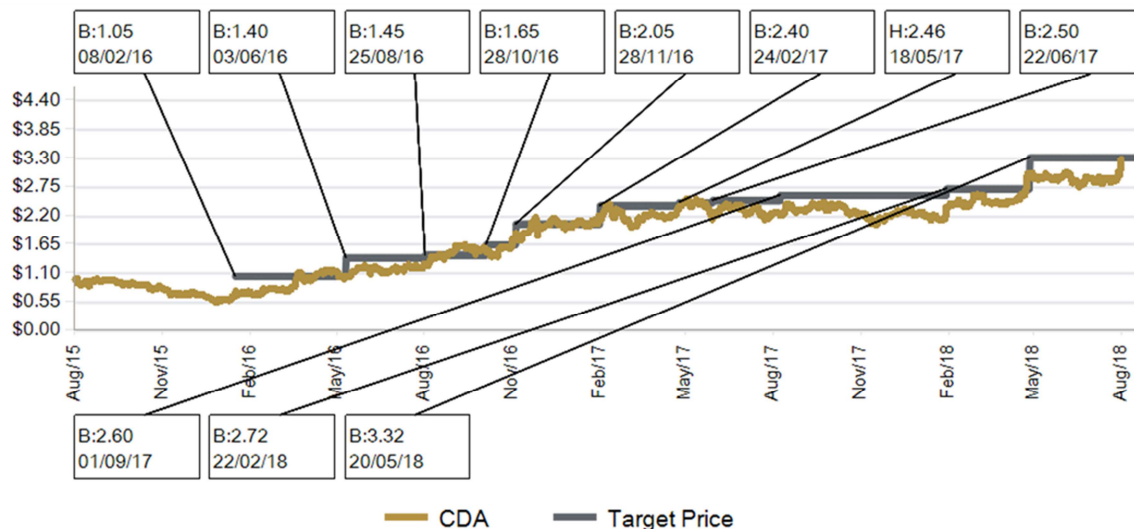
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Buy: >15% **Hold:** 5% to 15% **Sell:** <5%.

RATINGS DISTRIBUTION TABLE
Distribution of Ratings as at 24 August 2018

SELL	HOLD	BUY
3.3%	39.3%	54.1%

Rating and Price Target History: Codan Limited (CDA) as of 24/08/2018


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