

CODAN LIMITED

BUY

Earnings broadening across new products and markets

Technology Hardware & Equipment / Electronic Equipment & Instruments

27 May 2019

COMPANY UPDATE

Ticker	CDA
Stock Price	\$3.30
Target Price	\$3.90
Forecast Capital Return	18.2%
Forecast Dividend Yield	4.5%
Estimated Total Return - 12 Mth Forward	22.7%

Company market data

Market Cap.	\$588.0m
Free Float (%)	61.8
Enterprise Value	\$575.0m
52 Week Range	\$2.75 - \$3.37
Shares Out.	178.2m
Avg. Daily Value	\$0.5m

Estimates changes	2018a	2019e	2020e	2021e
Core NPAT - <i>old</i>	39.8	44.1	43.2	47.2
Core NPAT - <i>new</i>	39.8	44.6	45.5	49.6
% Change	0.0	1.2	5.4	5.1
Core EPS dil. (€) - <i>old</i>	22.1	24.5	24.0	26.2
Core EPS dil. (€) - <i>new</i>	22.1	24.8	25.3	27.5
% Change	0.0	1.2	5.4	5.1
DPS (€) - <i>old</i>	12.5	13.9	14.8	16.2
DPS (€) - <i>new</i>	12.5	14.1	15.5	16.9
% Change	0.0	1.3	4.8	4.6

All figures are in AUD unless otherwise specified.

Share price performance

Codan Limited vs. AS52 (rebased index)



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EVENT

FY19 Business Update and Investor Day

IMPACT

After a strong sales performance in 2H to date, CDA have provided FY19 NPAT guidance of between \$42m-\$45m (vs. consensus \$43m). The swing factor in guidance relates to whether a radio communications order will ship by 30 June, or slip in to 1Q FY20.

We modestly increase our FY19e NPAT by 1.2% to \$44.5m, reflecting the outlook for a slightly stronger 2H vs. 1H (1H NPAT: \$22.2m).

We have raised our FY20e NPAT by 5.4% to \$45.5m, reflecting our increased confidence in the Group's ability to generate incremental earnings from a suite of new product releases in Metal and Radio, as well as positive contribution from the Tracking Solutions division.

INVESTMENT VIEW

We continue to be encouraged by the broadening of CDA's sales mix, with successful new product launches highlighting the ability for CDA to leverage its existing IP in order to access new addressable markets.

At ~13x P/E, this IP remains undervalued in our view, especially when factoring the Minetec division is yet to be monetised and the Group's balance sheet capacity (~\$30m net cash) remains undepleted.

Our CDA investment thesis comprises:

Growth across all business divisions as a strong pipeline of new product releases supports the sales outlook and broadens the earnings base.

Minetec division on the cusp of commercialising product with CAT.

World-leading hand-held Metal Detection with strong comp advantages: Market leading IP, well-established global distribution network in hard to reach locations, proven depth of product replacement cycle.

High & growing returns on invested capital (~22% ROIC).

Proven track record of re-investing capital at high rates of return: ~60% Return on Incremental Capital across FY16-FY19e.

~\$30m net cash balance sheet supporting acquisitions or enlarged dividends.

Maintain BUY. \$3.90 TP (prev: \$3.68).

Y/E Jun 30	2018a	2019e	2020e	2021e
EBITDA	70.6	79.5	84.9	90.9
EV/EBITDA	8.1x	7.2x	6.8x	6.3x
Core NPAT	39.8	44.6	45.5	49.6
Core EPS (Diluted) (€)	22.1	24.8	25.3	27.5
P/E	14.9x	13.3x	13.1x	12.0x
EPS growth	(12.3%)	11.8%	2.0%	8.8%
DPS (€)	12.5	14.1	15.5	16.9
Yield	3.8%	4.3%	4.7%	5.1%
DPS growth	(3.8%)	12.5%	10.0%	9.5%
Dividend Payout Ratio	56.4%	56.8%	61.2%	61.6%

All figures are in AUD.

GROUP ESTIMATES

Moelis earnings estimates and key investor day takeaways are set out below:

Figure 1: Moelis Estimates

Profit and Loss	Actual	Estimates			
	1H19a	2H19e	FY19e	FY20e	FY21e
EBIT					
Metal Detection	30	33	63	62	63
<i>Margin</i>	<i>36%</i>	<i>38%</i>	<i>37%</i>	<i>37%</i>	<i>36%</i>
Radio	10	8	19	19	22
<i>Margin</i>	<i>25%</i>	<i>24%</i>	<i>25%</i>	<i>24%</i>	<i>26%</i>
Mining Technology	0	0	0	2	6
<i>Margin</i>	<i>0%</i>	<i>-7%</i>	<i>-4%</i>	<i>12%</i>	<i>21%</i>
Corporate	-9	-11	-20	-22	-24
Group EBIT	30	30	61	62	67
Group EBIT Margin		23%	24%	23%	23%
Net Finance Expense	0	1	1	1	1
PBT	30	31	61	62	68
Tax	-8	-8	-17	-17	-19
NPAT	22.2	22.5	44.6	45.5	49.6
EPS	12.3	12.5	24.8	25.3	27.5
DPS	6.5	7.6	14.1	15.5	16.9

Source: Company, Moelis Analysis

Metal Detection

- 5 new products currently under developments (usually 2-3).
- Consumer division previously did ~\$2-\$3m sales/month, now \$5-6m post Equinox launch in 2017. A new entry-level machine (~\$300/unit) to launch in Sep'19.
- 5 year outlook - consumer business could be bigger than gold.
- Scope to roll out multi-frequency technology from equinox to gold machines
- CDA have established a sales office in Brazil which is now profitable (South America is a large addressable market, CDA competitors have limited footprint).
- New countermeasure device launched at \$25k RRP / unit. Addressable market ~\$20m.
- Scope for strong price increases across select products in 1H FY20.

Radio Communications

- High Frequency
 - Swing factor in Group guidance relates to one HF order to Mali.
 - HF entering FY20 with a strong pipeline, military 2 products gaining traction.
 - Major incumbent, Harris (~75% share), gains support from U.S government including use of unique type 1 encryption.
 - However CDA feedback suggests there is demand for simple, easy to use, interoperable and rugged radios that are more competitively priced than Harris. Harris are unlikely to compete on price in these smaller orders/locations so as to retain their premium pricing model.

Figure 2: \$1.9b HF addressable market



Source: Company, Moelis Analysis

- Land Mobile Radio
 - New Cascade product (\$20m investment) to launch FY21.
 - Will expand addressable from \$100m (current market targeting repeaters) to \$900m (full LMR infrastructure solutions including systems integration, ongoing maintenance/support).
 - CDA expect to double sales from ~\$25m to ~\$50m over the next few years.
 - Will target smaller regional locations outside the core markets of the large incumbent, Motorola (>80% market share).

Mining Technology

- Will not meet previous FY19 revenue target for \$15m and will produce a small loss for the year, as commercialisation of the CAT JV has taken longer than expected.
- CAT: Working through product integration and product validation at Newmont Tanami trial.
- CAT: Expect Minestar to be placed on CAT dealer catalogue in near-term which will assist in pushing product out through CAT network.
- CAT: CDA role at each new site to become lower touch over time as CAT dealers are trained up.
- CAT: Scoping the Minestar products application at Freeport mine in Indonesia (worlds largest gold and second largest copper mine).
- BHP: Progressing well. Rolling out underground tracking across ~55km worth of tunnels at Olympic Dam (total mine has ~250km of tunnels).
- Addressable market of ~2,500 underground mines globally.

Codan Limited (CDA)						Market Cap: \$588m	Last Price: \$3.30	Target Price: \$3.90	Buy	
Y/E Jun 30										
Profit and Loss (\$m)						2017a	2018a	2019e	2020e	2021e
Revenue	226.1	229.9	256.8	265.9	289.2					
<i>Growth</i>	33.4%	1.7%	11.7%	3.5%	8.8%					
EBITDA	75.7	70.6	79.5	84.9	90.9					
<i>Growth</i>	80.4%	(6.7%)	12.6%	6.8%	7.1%					
Dep'n & Amort	(14.1)	(16.7)	(18.9)	(23.4)	(24.0)					
EBIT	61.6	53.9	60.6	61.5	67.0					
<i>Growth</i>	110.7%	(12.5%)	12.4%	1.6%	8.8%					
Net Interest Expense	(0.9)	(0.7)	0.6	1.0	1.3					
Profit Before Tax	60.7	53.2	61.2	62.5	68.2					
Tax	(16.0)	(13.3)	(16.6)	(16.9)	(18.7)					
<i>Tax Rate (%)</i>	26.3%	25.1%	27.1%	27.1%	27.4%					
Minorities	0.0	0.0	0.0	0.0	0.0					
NPAT (Underlying)	44.7	39.8	44.6	45.5	49.6					
<i>Growth</i>	112.0%	(10.9%)	12.0%	2.0%	8.8%					
One-Off Items	0.0	0.0	0.0	0.0	0.0					
NPAT (Reported)	44.7	39.8	44.6	45.5	49.6					
EPS (Underlying) (¢)	25.2	22.1	24.8	25.3	27.5					
<i>Growth</i>	111.9%	(12.3%)	11.8%	2.0%	8.8%					
Balance Sheet (\$m)						2017a	2018a	2019e	2020e	2021e
Cash	21.4	27.7	31.4	47.8	63.4					
Inventory	31.0	31.6	41.1	43.6	47.5					
Current Receivables	20.6	29.8	30.8	32.7	35.6					
PPE	12.0	12.5	14.1	14.7	15.6					
Intangibles	140.4	146.4	150.7	151.9	154.5					
Other	0.0	0.0	0.0	0.0	0.0					
Total Assets	232.7	254.3	274.5	297.1	323.0					
Current Payables	36.6	46.3	51.4	54.5	59.4					
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	9.5	10.1	11.0					
Other	52.8	52.4	57.4	60.6	65.5					
Total Liabilities	67.7	66.2	73.0	76.7	82.4					
Net Assets	165.0	188.1	201.5	220.4	240.6					
Equity & Reserves	105.9	107.0	100.9	101.9	102.7					
Retained Profits	59.1	81.0	100.6	118.5	137.9					
Shareholders' Equity	165.0	188.1	201.5	220.4	240.6					
Minorities	0.0	0.0	0.0	0.0	0.0					
Total Equity	165.0	188.1	201.5	220.4	240.6					
Cashflow (\$m)						2017a	2018a	2019e	2020e	2021e
EBITDA	75.7	70.6	79.5	84.9	90.9					
Net Interest	(0.8)	(0.5)	0.6	1.0	1.3					
Tax	(1.5)	(22.6)	(21.0)	(16.9)	(18.7)					
Δ in Working Capital	2.2	(0.1)	(5.5)	(1.3)	(2.0)					
Other	14.4	0.8	1.7	0.6	0.9					
Operating Cash Flow	89.9	48.2	55.3	68.2	72.5					
<i>Growth</i>	86.5%	(46.4%)	14.6%	23.4%	6.2%					
Capex	(23.7)	(22.0)	(24.8)	(25.2)	(27.4)					
Acquisitions	0.0	0.0	0.0	0.0	0.0					
Divestments	0.0	0.0	0.0	0.0	0.0					
Other	0.0	(0.5)	0.0	0.0	0.0					
Investing Cash Flow	(23.7)	(22.5)	(24.8)	(25.2)	(27.4)					
Equity Raised	0.0	0.0	0.0	0.0	0.0					
Dividends Paid	(17.7)	(19.6)	(26.7)	(26.6)	(29.4)					
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)	(26.7)	(26.6)	(29.4)					
FX / Non Cash Items	0.0	0.1	0.0	0.0	0.0					
Change in Cash	21.6	6.3	3.7	16.4	15.6					
Free Cash Flow	51.9	26.2	42.9	55.6	58.7					
Valuation Summary										
Current Mkt Capitalisation						588.0				
Shares on Issue						178.2				
Last Price						3.30				
12 Mth Target Price						3.90				
Total Estimated 12 Mth Return						22.7%				
12 Mth Fwd Capital Return						18.2%				
12 Mth Fwd Dividend Yield						4.5%				
Valuation Ratios						2017a	2018a	2019e	2020e	2021e
EPS (Underlying) (¢)						25.2	22.1	24.8	25.3	27.5
<i>Growth</i>						111.9%	(12.3%)	11.8%	2.0%	8.8%
P/E (x)						13.1x	14.9x	13.3x	13.1x	12.0x
Small Industrials (ex Fin's)						16.5x	19.3x	17.2x	15.6x	19.3x
Premium / (Discount)						(20.8%)	(22.7%)	(22.8%)	(16.3%)	(37.8%)
EV/EBITDA (x)						7.6x	8.1x	7.2x	6.8x	6.3x
Small Industrials (ex Fin's)						11.0x	11.0x	11.8x	10.7x	9.9x
Premium / (Discount)						(30.9%)	(25.9%)	(38.7%)	(36.5%)	(36.3%)
DPS (¢)						13.0	12.5	14.1	15.5	16.9
<i>Growth</i>						116.7%	(3.8%)	12.5%	10.0%	9.5%
Yield (%)						3.9%	3.8%	4.3%	4.7%	5.1%
Payout Ratio (%)						51.5%	56.4%	56.8%	61.2%	61.6%
Franking (%)						100.0%	100.0%	100.0%	100.0%	100.0%
NTA						24.6	41.7	50.8	68.5	86.1
NTA/Share (\$)						0.14	0.23	0.28	0.38	0.48
Performance Ratios						2017a	2018a	2019e	2020e	2021e
ROA						19.2%	15.7%	16.3%	15.3%	15.3%
ROE						27.1%	21.2%	22.1%	20.7%	20.6%
ROIC						31.6%	25.2%	21.9%	26.0%	27.5%
Net Debt (Cash) (\$m)						(21.4)	(27.7)	(31.4)	(47.8)	(63.4)
Net Debt/EBITDA (x)						(0.3x)	(0.4x)	(0.4x)	(0.6x)	(0.7x)
ND / (ND + Equity) (%)						(14.9%)	(17.3%)	(18.5%)	(27.7%)	(35.8%)
Interest Cover (x)						84.6x	76.9x	120.7x	88.8x	71.7x
Working Capital						(1.0)	8.0	11.8	12.5	13.6
Working Capital/Sales (%)						(0.5%)	3.5%	4.6%	4.7%	4.7%
Cash Flow Metrics						2017a	2018a	2019e	2020e	2021e
FCF/Share (\$)						0.29	0.15	0.24	0.31	0.33
Price/FCPS (x)						11.3x	22.4x	13.7x	10.6x	10.0x
Free Cash Flow Yield (%)						8.9%	4.5%	7.3%	9.5%	10.0%
Gross Cash Conversion						103.1%	101.2%	96.0%	100.3%	100.2%
Capex/Sales (%)						(10.5%)	(9.6%)	(9.7%)	(9.5%)	(9.5%)
Capex/Depreciation (x)						1.7x	1.3x	1.3x	1.1x	1.1x
Margins						2017a	2018a	2019e	2020e	2021e
EBITDA						33.5%	30.7%	31.0%	31.9%	31.4%
EBIT						27.2%	23.5%	23.6%	23.1%	23.2%
NPAT						19.8%	17.3%	17.4%	17.1%	17.1%
Valuation Methodology										
WACC (%)						10.0%				
Discounted Cash Flow Valuation						3.65				
Sum-of-the-Parts Valuation						0.000				
Average Valuation						3.65				
12 Mth Target Price						3.90				

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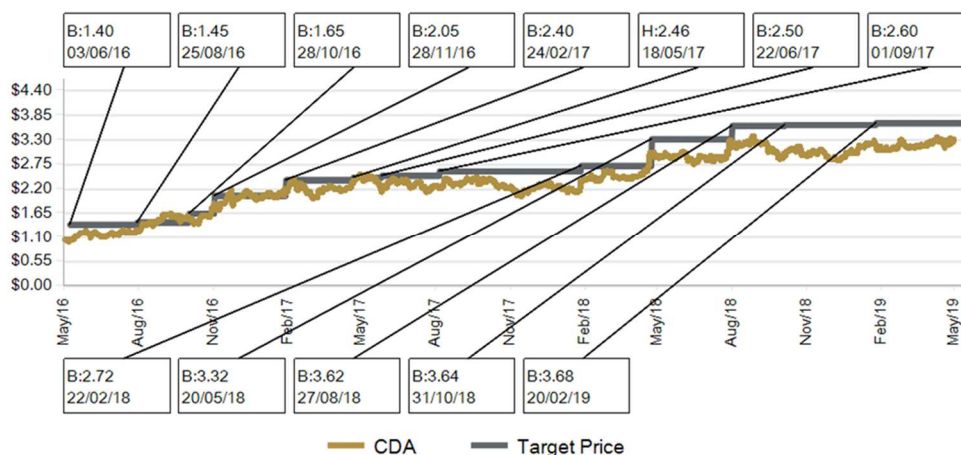
Buy: >15% **Hold:** 5% to 15% **Sell:** <5%.

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Distribution of Ratings as at 27 May 2019

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10.0%	35.0%	55.0%

Rating and Price Target History: Codan Limited (CDA) as of 27/05/2019



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