

CODAN LIMITED

BUY

Material win for Tactical Communications

Technology Hardware & Equipment / Electronic Equipment & Instruments

15 July 2019

COMPANY UPDATE

Ticker	CDA
Stock Price	\$3.63
Target Price	\$3.96
Forecast Capital Return	9.1%
Forecast Dividend Yield	4.1%
Estimated Total Return - 12 Mth Forward	13.2%

Company market data

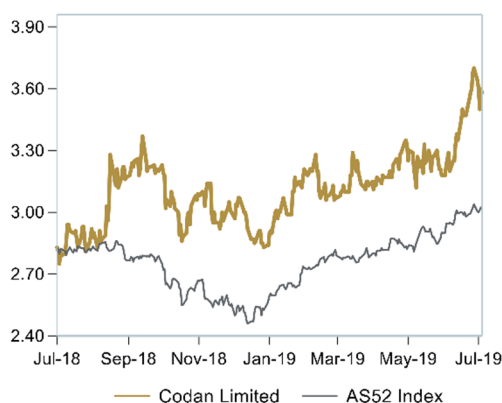
Market Cap.	\$646.8m
Free Float (%)	61.8
Enterprise Value	\$633.8m
52 Week Range	\$2.79 - \$3.70
Shares Out.	178.2m
Avg. Daily Value	\$0.5m

Estimates changes	2018a	2019e	2020e	2021e
Core NPAT - <i>old</i>	39.8	44.6	45.5	49.6
Core NPAT - <i>new</i>	39.8	44.6	47.0	51.1
% Change	0.0	0.0	3.3	3.2
Core EPS dil. (€) - <i>old</i>	22.1	24.8	25.3	27.5
Core EPS dil. (€) - <i>new</i>	22.1	24.8	26.1	28.4
% Change	0.0	0.0	3.3	3.2
DPS (€) - <i>old</i>	12.5	14.1	15.5	16.9
DPS (€) - <i>new</i>	12.5	14.1	16.0	17.5
% Change	0.0	0.0	3.2	3.1

All figures are in AUD unless otherwise specified.

Share price performance

Codan Limited vs. AS52 (rebased index)



Analyst

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EVENT

\$15m contact win within the Tactical Communications division.

Customer is the Government of Republic of Kenya, delivery 1H FY20.

IMPACT

Our FY20e NPAT increases by 3.3% to \$47.0m, reflecting an incremental \$2m of EBIT vs. our previous estimates within the Tactical Communications division from this contract win.

Our FY21e & FY22e NPAT also increase by ~3%, reflecting increased confidence in future sales execution from the Military 2 pipeline.

INVESTMENT VIEW

We see this contract as good validation of CDA's longer-term strategy for Tactical Communications – to target the developing world army (or 'Military 2') market with a full communications platform.

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 ~14x NTM 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 undeployed.

Our CDA investment thesis comprises:

Growth potential 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 competitive 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. \$3.96 TP (prev: \$3.90).

Y/E Jun 30	2018a	2019e	2020e	2021e
EBITDA	70.6	79.5	87.1	93.3
EV/EBITDA	9.0x	8.0x	7.3x	6.8x
Core NPAT	39.8	44.6	47.0	51.1
Core EPS (Diluted) (€)	22.1	24.8	26.1	28.4
P/E	16.4x	14.7x	13.9x	12.8x
EPS growth	(12.3%)	11.8%	5.4%	8.7%
DPS (€)	12.5	14.1	16.0	17.5
Yield	3.4%	3.9%	4.4%	4.8%
DPS growth	(3.8%)	12.5%	13.6%	9.3%
Dividend Payout Ratio	56.4%	56.8%	61.2%	61.6%

All figures are in AUD.

EARNINGS ESTIMATES

Our earnings estimates by division are set out below:

Figure 1: Earnings Estimates

Profit and Loss	Actual	Estimates			
	1H19a	2H19e	FY19e	FY20e	FY21e
EBIT					
Metal Detection	30	33	63	62	63
Radio	10	8	19	21	24
Mining Technology	0	(0)	(0)	2	6
Corporate	(9)	(11)	(20)	(22)	(24)
Group EBIT	30	30	61	64	69
Group EBIT Margin		23%	24%	24%	24%
NPAT	22.2	22.5	44.6	47.0	51.1
EPS	12.3	12.5	24.8	26.1	28.4
DPS	6.5	7.6	14.1	16.0	17.5

Source: Company, Moelis Analysis

Codan Limited (CDA)

Market Cap: \$647m

Last Price: \$3.63

Target Price: \$3.96

Buy

Y/E Jun 30

Profit and Loss (\$m)	2017a	2018a	2019e	2020e	2021e
Revenue	226.1	229.9	256.8	270.1	293.1
<i>Growth</i>	33.4%	1.7%	11.7%	5.2%	8.5%
EBITDA	75.7	70.6	79.5	87.1	93.3
<i>Growth</i>	80.4%	(6.7%)	12.6%	9.5%	7.1%
Dep'n & Amort	(14.1)	(16.7)	(18.9)	(23.4)	(24.1)
EBIT	61.6	53.9	60.6	63.6	69.2
<i>Growth</i>	110.7%	(12.5%)	12.4%	5.0%	8.7%
Net Interest Expense	(0.9)	(0.7)	0.6	1.0	1.3
Profit Before Tax	60.7	53.2	61.2	64.6	70.5
Tax	(16.0)	(13.3)	(16.6)	(17.6)	(19.3)
<i>Tax Rate (%)</i>	26.3%	25.1%	27.1%	27.2%	27.4%
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT (Underlying)	44.7	39.8	44.6	47.0	51.1
<i>Growth</i>	112.0%	(10.9%)	12.0%	5.4%	8.7%
One-Off Items	0.0	0.0	0.0	0.0	0.0
NPAT (Reported)	44.7	39.8	44.6	47.0	51.1
EPS (Underlying) (¢)	25.2	22.1	24.8	26.1	28.4
<i>Growth</i>	111.9%	(12.3%)	11.8%	5.4%	8.7%

Balance Sheet (\$m)	2017a	2018a	2019e	2020e	2021e
Cash	21.4	27.7	31.4	48.3	64.3
Inventory	31.0	31.6	41.1	44.3	48.1
Current Receivables	20.6	29.8	30.8	33.2	36.1
PPE	12.0	12.5	14.1	14.8	15.7
Intangibles	140.4	146.4	150.7	152.2	155.0
Other	0.0	0.0	0.0	0.0	0.0
Total Assets	232.7	254.3	274.5	299.1	325.6
Current Payables	36.6	46.3	51.4	55.4	60.2
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	10.2	11.1
Other	52.8	52.4	57.4	61.4	66.2
Total Liabilities	67.7	66.2	73.0	77.7	83.3
Net Assets	165.0	188.1	201.5	221.5	242.3
Equity & Reserves	105.9	107.0	100.9	102.3	103.2
Retained Profits	59.1	81.0	100.6	119.1	139.1
Shareholders' Equity	165.0	188.1	201.5	221.5	242.3
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	165.0	188.1	201.5	221.5	242.3

Cashflow (\$m)	2017a	2018a	2019e	2020e	2021e
EBITDA	75.7	70.6	79.5	87.1	93.3
Net Interest	(0.8)	(0.5)	0.6	1.0	1.3
Tax	(1.5)	(22.6)	(21.0)	(17.6)	(19.3)
Δ in Working Capital	2.2	(0.1)	(5.5)	(1.6)	(1.9)
Other	14.4	0.8	1.7	0.7	0.9
Operating Cash Flow	89.9	48.2	55.3	69.6	74.1
<i>Growth</i>	86.5%	(46.4%)	14.6%	25.8%	6.6%
Capex	(23.7)	(22.0)	(24.8)	(25.6)	(27.8)
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)	(25.6)	(27.8)
Equity Raised	0.0	0.0	0.0	0.0	0.0
Dividends Paid	(17.7)	(19.6)	(26.7)	(27.1)	(30.3)
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)	(27.1)	(30.3)
FX / Non Cash Items	0.0	0.1	0.0	0.0	0.0
Change in Cash	21.6	6.3	3.7	16.9	16.0
Free Cash Flow	51.9	26.2	42.9	56.7	60.2

Valuation Summary	
Current Mkt Capitalisation	646.8
Shares on Issue	178.2
Last Price	3.63
12 Mth Target Price	3.96
Total Estimated 12 Mth Return	13.2%
12 Mth Fwd Capital Return	9.1%
12 Mth Fwd Dividend Yield	4.1%

Valuation Ratios	2017a	2018a	2019e	2020e	2021e
EPS (Underlying) (¢)	25.2	22.1	24.8	26.1	28.4
<i>Growth</i>	111.9%	(12.3%)	11.8%	5.4%	8.7%
P/E (x)	14.4x	16.4x	14.7x	13.9x	12.8x
Small Industrials (ex Fin's)	16.5x	19.3x	17.2x	15.6x	19.3x
Premium / (Discount)	(12.8%)	(15.0%)	(15.0%)	(10.9%)	(33.7%)
EV/EBITDA (x)	8.4x	9.0x	8.0x	7.3x	6.8x
Small Industrials (ex Fin's)	11.0x	11.0x	11.8x	10.7x	9.9x
Premium / (Discount)	(23.8%)	(18.4%)	(32.4%)	(31.8%)	(31.6%)
DPS (¢)	13.0	12.5	14.1	16.0	17.5
<i>Growth</i>	116.7%	(3.8%)	12.5%	13.6%	9.3%
Yield (%)	3.6%	3.4%	3.9%	4.4%	4.8%
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	69.3	87.3
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%	15.7%	15.7%
ROE	27.1%	21.2%	22.1%	21.2%	21.1%
ROIC	31.6%	25.2%	21.9%	26.7%	28.2%
Net Debt (Cash) (\$m)	(21.4)	(27.7)	(31.4)	(48.3)	(64.3)
Net Debt/EBITDA (x)	(0.3x)	(0.4x)	(0.4x)	(0.6x)	(0.7x)
ND / (ND + Equity) (%)	(14.9%)	(17.3%)	(18.5%)	(27.9%)	(36.1%)
Interest Cover (x)	84.6x	76.9x	120.7x	90.1x	72.5x
Working Capital	(1.0)	8.0	11.8	12.7	13.8
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	0.32	0.34
Price/FCPS (x)	12.4x	24.7x	15.1x	11.4x	10.7x
Free Cash Flow Yield (%)	8.1%	4.1%	6.6%	8.8%	9.3%
Gross Cash Conversion	103.1%	101.2%	96.0%	100.1%	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	1.2x

Margins	2017a	2018a	2019e	2020e	2021e
EBITDA	33.5%	30.7%	31.0%	32.2%	31.8%
EBIT	27.2%	23.5%	23.6%	23.6%	23.6%
NPAT	19.8%	17.3%	17.4%	17.4%	17.4%

Valuation Methodology	2017a	2018a	2019e	2020e	2021e
WACC (%)					10.0%
Discounted Cash Flow Valuation					3.70
Sum-of-the-Parts Valuation					0.000
Average Valuation					3.70
12 Mth Target Price					3.96

RESEARCH & SALES RESPONSIBILITIES

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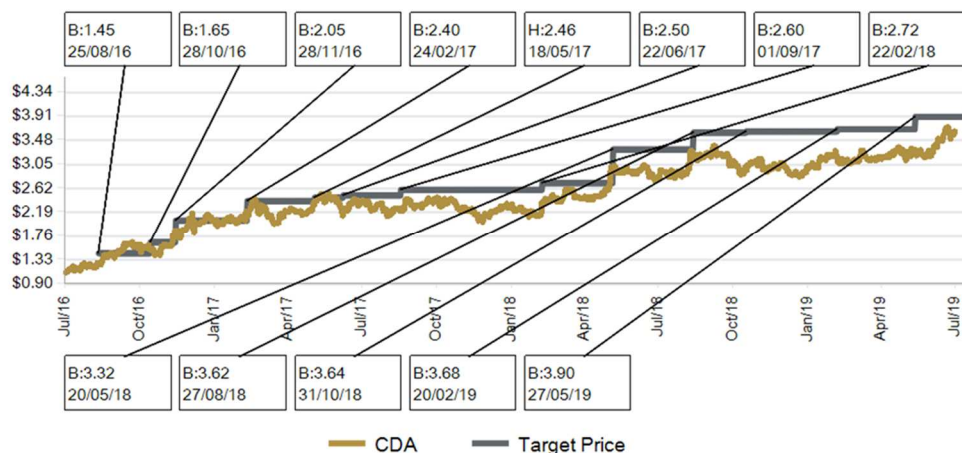
Buy: >15% **Hold:** 5% to 15% **Sell:** <5%.

RATINGS DISTRIBUTION TABLE

Distribution of Ratings as at 15 July 2019

SELL	HOLD	BUY
10.9%	39.1%	50.0%

Rating and Price Target History: Codan Limited (CDA) as of 15/07/2019



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