

Australian Equity Research
19 August 2019

BUY

unchanged

PRICE TARGET A\$4.00

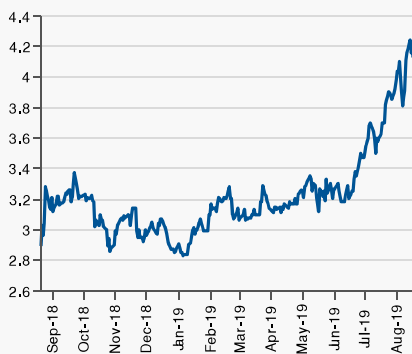
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Price (20-Aug) A\$4.30

Ticker CDA-ASX

52-Week Range (A\$):	2.68 - 3.47
Avg Daily Vol (000s) :	200.0
Market Cap (A\$M):	762
Shares Out. (M) :	177.1
Dividend /Shr (AUc):	12.0
Dividend Yield (%) :	286.4
Net Debt (Cash) (A\$M):	(29)
Enterprise Value (A\$M):	718
Cash (A\$M):	29.0
Long-Term Debt (A\$M):	0.0

FYE Jun	2017A	2018A	2019E	2020E
Sales (A\$M)	226.1	229.9	258.0	279.7
EBITDA (A\$M)	75.6	70.4	74.7	81.1
Net Income Adj (A\$M)	44.7	39.8	43.6	47.3
EPS Adj&Dil (AUc)	25.2	22.3	24.5	26.6
P/E (x)	16.6	18.8	17.1	15.8
EV/EBITDA (x)	9.6	10.2	9.5	8.6
DPS (AUc)	13.00	12.50	13.00	13.00
Div. Yield (%)	3.1	3.0	3.1	3.1



Priced as of close of business 20 August 2019

CDA designs and manufactures a range of electronic products including radio communication products, metal detection products and mining technology

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Results Preview

Detecting earnings momentum

CDA's result next week shouldn't contain any surprises with guidance provided in May for NPAT to be in the range of \$42m-\$45m. Management said at the time that 2H19 was expected to be as strong as the \$22.2m posted in 1H19, which points to the higher end of the range. We expect the result to continue demonstrating the broadening of the product base and addressable markets and therefore a more robust business and growth outlook. We have a BUY rating and \$4.00 Target Price. While the stock is trading about this level, we will reassess our view post results. We do anticipate however that the strong gold price is having a positive impact on demand for metal detectors and this is likely to underpin a positive outlook statement.

FY19 result expectations

Result out Monday 26th August, looking for revenue of \$258m, EBITDA of \$74.7m and NPAT of \$43.6m. Our NPAT estimate is around the mid-point of the guidance range of \$42m-\$45m. Therefore we don't expect any surprises, certainly not to the downside. The makeup of the result will be interesting. We're expecting a solid 2H19 result from **Communications** albeit not to the 1H19 levels where revenue was a record result for the division. That said, management flagged a particular contract that was expected to drop into June 2019. If this occurs then a result above the top end of the range could be possible. We're forecasting **Metal Detection** to post an improved revenue result (vs 1H19) despite penetration into new markets during the previous half. Seasonality combined with a strong gold price are expected to be the main drivers. We're estimating a slightly lower segment result due to a product mix change, with lesser reliance on the high margin GPZ7000.

Cash expected to be up and currency should help in FY20 – CDA flagged being in a net cash position of \$29m as at 30 April. It's likely they'll finish the year with ~\$30m-\$40m. In the absence of a suitable acquisition, we'd expect the company to announce a special dividend, which is consistent with previous years. It's also worth noting that CDA is a net beneficiary of the weaker AUD/USD. We estimate a 1c movement has a 1% impact on EBITDA and an average rate in FY19 of \$0.73/\$0.74.

Outlook commentary – CDA usually don't give much away in terms of guidance at this time of year with management preferring to wait until the AGM in October. We do expect, however, to get a read on the impact of the gold price strength on metal detector sales. Our channel checks suggests demand in very strong across the product range, which is impacting product availability. We'll also be looking for an update on Tracking Solutions and the integration of Minetec's technology suite into Caterpillar's Minestar™ system. We remain of the view that this division could be a meaningful driver of CDA's valuation of the next two years.

Valuation and recommendation

We have a BUY rating and a \$4.00 Target Price. While CDA is trading above this level, we will reassess our view post results. With momentum across Communications and Metal Detection, some hidden value within Tracking Solutions, a balance sheet primed to pursue growth and some currency tailwinds, there remains a lot to like in our view.

Figure 1: Codan Limited (CDA); Canaccord Genuity forecasts

Profit & Loss (\$m)	2017A	2018A	2019F	2020F	Valuation ratios	2017A	2018A	2019F	2020F
Sales Revenue	226.1	229.9	258.0	279.7	EPS (cps)	25.2	22.3	24.5	26.6
EBITDA	75.6	70.4	74.7	81.1	P/E (x)	16.6	18.8	17.1	15.8
Depreciation	-2.4	-2.8	-2.2	-2.4	PER Rel - All Ind.	-19%	-10%	-17%	-14%
EBITA	73.1	67.5	72.5	78.7	PER Rel - Small Ind.	-13%	-1%	-10%	-7%
Amortisation	-11.6	-13.8	-13.2	-14.3	Enterprise Value (\$m)	725.2	718.9	710.1	693.7
EBIT	61.5	53.7	59.3	64.4	EV / EBITDA (x)	9.6	10.2	9.5	8.6
Net Interest Expense	-0.8	-0.5	0.0	0.0	EV / EBIT (x)	11.8	13.4	12.0	10.8
NPBT	60.7	53.2	59.3	64.4	DPS (cps)	13.0	12.5	13.0	13.0
Tax expense	-16.0	-13.4	-15.7	-17.1	Dividend Yield (%)	3.1%	3.0%	3.1%	3.1%
NPAT - underlying	44.7	39.8	43.6	47.3	Franking (%)	100%	100%	100%	100%
Significant items	-1.2	1.7	0.0	0.0	CFPS (cps)	42.6	27.1	30.9	36.0
Reported NPAT	43.5	41.5	43.6	47.3	P / CFPS (x)	9.8	15.5	13.5	11.6
Cash Flow (\$m)	2017A	2018A	2019F	2020F	Profitability ratios	2017A	2018A	2019F	2020F
Operating EBITDA	75.6	70.4	74.7	81.1	EBITDA Margin (%)	33.4	30.6	28.9	29.0
- Interest & Tax Paid	-7.2	-16.5	-13.4	-15.7	EBIT Margin (%)	27.2	23.4	23.0	23.0
+/- change in Work. Cap.	2.2	-0.1	9.9	2.4	ROE (%)	27.1	21.2	21.8	21.6
- other	5.0	-5.6	-16.0	-3.7	ROA (%)	29.1	23.7	24.2	25.4
Operating Cashflow	75.6	48.3	55.1	64.1	ROIC (%)	31.8	25.8	27.4	29.1
- Capex	-16.4	-16.5	-18.0	-18.0	Balance Sheet ratios	2017A	2018A	2019F	2020F
- Aquisitions/divestments	-7.0	-5.4	-7.0	-7.0	Net Debt (cash)	-21.4	-27.7	-36.6	-52.9
- other	-0.3	-0.5	0.0	0.0	Net Gearing (%)	-13.0	-14.7	-18.3	-24.2
Free Cashflow	51.9	25.8	30.1	39.1	Interest Cover (x)	76.9	107.4	nm	nm
- Ord Dividends	-17.7	-20.0	-21.7	-23.2	NTA per share (\$)	0.44	0.57	0.66	0.76
- Equity /other	0.0	0.4	0.4	0.4	Price / NTA (x)	9.4	7.4	6.4	5.5
Net Cashflow	34.2	6.2	8.9	16.3	EFPOWA (m)	177.3	178.2	178.2	178.2
Cash at beginning of period	14.3	21.4	27.7	36.6	Growth ratios	2017A	2018A	2019F	2020F
+/- borrowings / other	-27.1	0.1	0.0	0.0	Sales revenue (\$m)	33%	2%	12%	8%
Cash at end of period	21.4	27.7	36.6	52.9	EBITDA (\$m)	80%	-7%	6%	9%
Balance Sheet	2017A	2018A	2019F	2020F	EBIT (\$m)	111%	-13%	10%	9%
Cash	21.4	27.7	36.6	52.9	NPAT (\$m)	112%	-11%	9%	9%
Inventories	31.0	31.6	41.3	41.9	EPS (cps)	112%	-11%	9%	9%
Debtors	20.6	29.8	25.8	28.0	DPS (cps)	117%	-4%	4%	0%
PPE	12.0	12.5	13.0	14.4	Interim Analysis	1H18A	2H18A	1H19A	2H19E
Intangibles	86.2	86.6	97.3	95.8	Communications	29.0	27.6	40.7	34.3
Other assets	61.5	66.1	67.8	73.0	Metal Detection	63.5	100.3	82.0	90.5
Total Assets	232.7	254.3	281.8	306.0	Tracking Solutions	2.3	5.9	5.7	4.9
Borrowings	0.0	0.0	0.0	0.0	Total revenue	94.7	133.9	128.4	129.6
Trade Creditors	36.6	46.3	61.9	67.1	EBITDA	27.4	43.0	38.0	36.7
Other Liabilities	31.1	19.9	19.9	19.9	EBITDA margin (%)	28.9%	32.1%	30%	28%
Total Liabilities	67.7	66.2	81.8	87.0	NPAT (\$m)	15.8	24.0	21.0	22.6
NET ASSETS	165.0	188.1	200.0	219.0	EPS	8.8	13.5	11.8	12.7
Board of Directors / Substantial Shareholders					DPS	4.0	8.5	6.5	6.5
Board of Directors	Shareholding				Valuation				
David Simmonds - Chairman	0.0				EBITDA multiple (x)				
Donald McGurk - MD	0.8				EBITDA (\$m)	81.1			
Lt Gen Peter Leahy - N-E Director	0.4				Target multiple (x)	8.3			
Graeme Barclay - N-E Director	0.0				Net Debt (cash) (\$m)	-36.6			
Kathy Gramp - N-E Director	0.0				Implied Valuation	712.3			
Substantial Shareholders	Shareholding				Per Share				
IB Wall and PM Wall	34.8				Target PE Multiple				
Starform Pty Ltd	11.4				EPS (c)	26.6			
Griffina Pty Ltd	10.6				PE Target (x)	15.0			
Otterpaw Pty Ltd	10.6				Per Share	4.00			
A.J Wood	10.6								
JP Morgan Trus Co	10.6								
Top 20 Shareholders	109.6				66.8%				

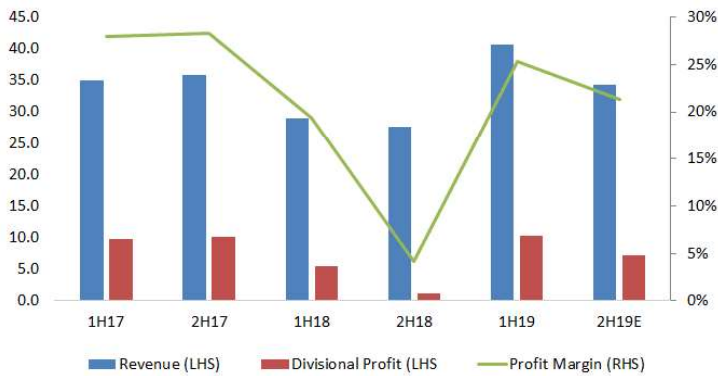
Source: Company Reports, Canaccord Genuity estimates

Figure 2: We expect the FY19 result to demonstrate a continued improvement in baseline earnings for the group

\$M	1H18	2H18	FY18	1H19	2H19E	FY19E	% Change on pcp
Revenue							
Communications	29.0	27.6	56.5	40.7	34.3	75.0	32.6%
Metal Detection	63.5	100.3	163.8	82.0	90.5	172.5	5.3%
Tracking solutions	2.3	5.9	8.3	5.7	4.9	10.6	28.3%
Total	94.7	133.9	228.6	128.4	129.6	258.0	12.9%
Segment result							
Communications	5.6	1.2	6.8	10.3	7.3	17.6	160.5%
Metal Detection	23.0	41.1	64.1	29.6	31.3	60.9	-5.0%
Tracking solutions	-0.3	1.0	0.7	0.0	-0.5	-0.5	nm
Total	28.3	43.2	71.5	39.9	38.1	78.0	9.0%
Segment margin							
Communications	19.3%	4.2%	12.0%	25.4%	21.3%	23.5%	
Metal Detection	36.2%	40.9%	39.1%	36.1%	34.6%	35.3%	
Tracking solutions	-12.9%	17.0%	8.5%	0.1%	-10.9%	-5.0%	

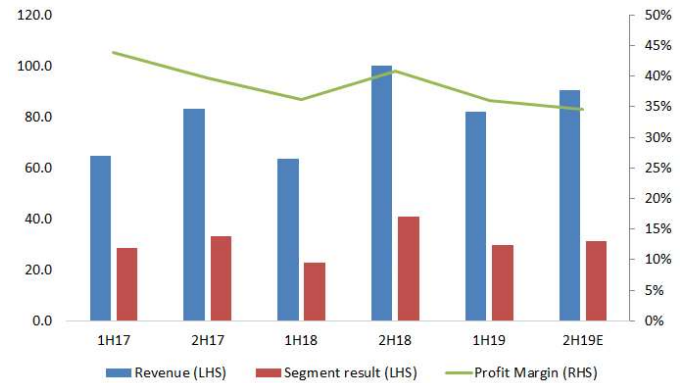
Source: Company reports, Canaccord Genuity estimates

Figure 3: Communications revenue is expected to come in at the top end of the baseline revenue range of \$65-75m. If a large contract flagged by management drops into June, then there's upside to that



Source: Company reports and Canaccord Genuity estimates

Figure 4: Metal Detection's revenue and earnings profile appears to be changing with a broader product spread leading to less volatility. We are expecting a solid 2H18 buoyed by a strong gold price



Source: Company reports and Canaccord Genuity estimates

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Investment Recommendation

Date and time of first dissemination: August 19, 2019, 22:50 ET

Date and time of production: August 19, 2019, 22:50 ET

Target Price / Valuation Methodology:

Codan Limited - CDA

Our target price is based on applying a 8.3x multiple (20% discount to Small Industrials average) to FY20E EV/EBITDA estimate.

Risks to achieving Target Price / Valuation:

Codan Limited - CDA

CDA is exposed to a number of risks including: Counterfeit product: CDA's metal detection products have been subject to counterfeit product. CDA has been countering this by applying a number of security initiatives unique to CDA's products. If CDA is not successful minimising counterfeit product is could impact on demand and margins. Gold price: Increases or decreases in the gold price could impact demand for CDA's gold detection products, a key driver of group profitability. Our view is that the gold price would need to move significantly lower for demand to be impacted. Competition: CDA's success is based around having market leading products in HF Radio Communications and Metal Detection. A superior product on the market by a competitor would have an impact on the demand for CDA's products. Acquisition risk: CDA acquired 2 small businesses in FY12 and further acquisitions are part of the company's strategy. If acquisitions are poorly integrated or the company overpays, then this would impact on the company's earnings.

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Global Stock Ratings (as of 08/19/19)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	512	58.65%	51.37%
Hold	203	23.25%	34.98%
Sell	28	3.21%	17.86%
Speculative Buy	130	14.89%	74.62%
	873*	100.0%	

*Total includes stocks that are Under Review

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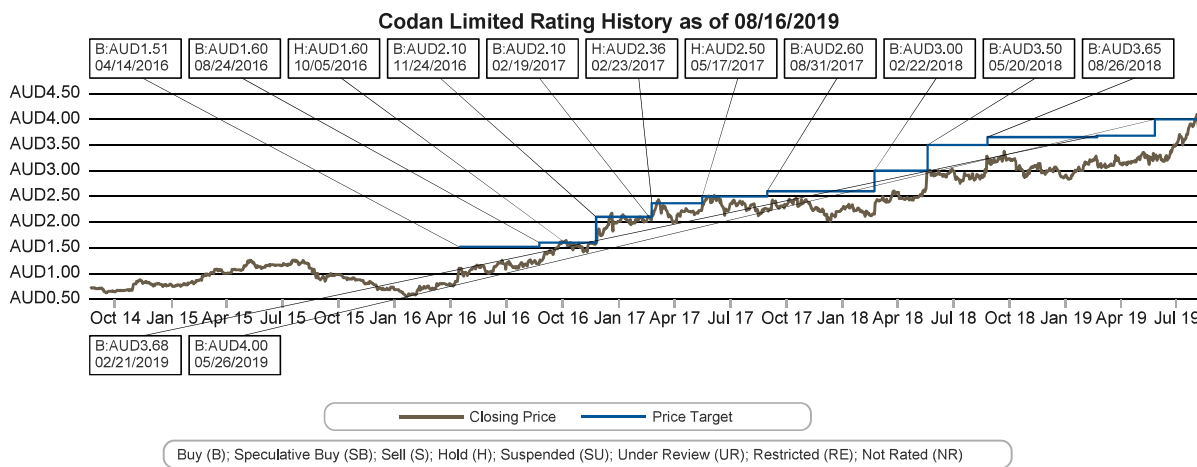
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