

CODAN LIMITED

BUY
More earnings growth and product diversification driving re-rate

Technology Hardware & Equipment / Electronic Equipment & Instruments

26 August 2019

COMPANY UPDATE

| | |
|---|--------|
| Ticker | CDA |
| Stock Price | \$4.50 |
| Target Price | \$5.00 |
| Forecast Capital Return | 11.1% |
| Forecast Dividend Yield | 3.3% |
| Estimated Total Return - 12 Mth Forward | 14.4% |

Company market data

| | |
|------------------|-----------------|
| Market Cap. | \$806.5m |
| Free Float (%) | 61.8 |
| Enterprise Value | \$769.0m |
| 52 Week Range | \$2.83 - \$4.36 |
| Shares Out. | 179.2m |
| Avg. Daily Value | \$0.5m |

| Estimates changes | 2019a | 2020e | 2021e | 2022e |
|--------------------------------|-------|-------|-------|-------|
| Core NPAT - <i>old</i> | 44.6 | 47.0 | 51.1 | 53.6 |
| Core NPAT - <i>new</i> | 45.7 | 51.1 | 56.4 | 60.6 |
| % Change | 2.3 | 8.8 | 10.2 | 13.1 |
| Core EPS dil. (€) - <i>old</i> | 24.8 | 26.1 | 28.4 | 29.7 |
| Core EPS dil. (€) - <i>new</i> | 25.4 | 28.2 | 31.1 | 33.4 |
| % Change | 2.4 | 8.1 | 9.6 | 12.4 |
| DPS (€) - <i>old</i> | 14.1 | 16.0 | 17.5 | 18.4 |
| DPS (€) - <i>new</i> | 14.0 | 17.3 | 19.1 | 20.5 |
| % Change | (0.5) | 8.1 | 9.2 | 11.7 |

All figures are in AUD unless otherwise specified.

Share price performance

Codan Limited vs. AS52 (rebased index)



Analyst

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EVENT

FY19 Result

IMPACT

FY19 NPAT of \$45.7m (vs. Moelis \$44.6m), net cash of \$37.5m at 30 Jun'19.

Metal Detection strong 2H FY19 with product sales mix continuing to diversify (nearly 50% of sales now generated from consumer, i.e. ex gold).

Radio Communications' new products gain traction in the Military 2 space and commence FY20 with a very strong pipeline, including 'double digit' sales sized opportunities.

Minetec records \$1.2 loss but cites two commercial opportunities for FY19 as part of the CAT joint venture (Tanami and Freeport).

INVESTMENT VIEW

With all three divisions well-positioned for growth, we increase our FY20e NPAT by 10% to \$51.1m.

Our target price of \$5.00 reflects 17x FY20 P/E + 21c of net cash.

We believe CDA deserves a re-rating to 17x FY20 P/E (a small discount to the small ordinaries at ~18x) due to the following factors:

Growth inherent within our revised estimates: FY19-21e EPS CAGR of 11% supported by sales from new product releases following ~\$100m of product development spend during FY17-20, all funded via strong FCF.

Diversifying sales mix. Metal detection now spread across a wide range of detectors and geographies. Radio Comms entering new, larger markets. Minetec on the cusp of commercialisation.

26% ROIC and >50% return on incremental capital re-invested since FY16.

\$38m net cash balance sheet provides optionality over future acquisitions.

Increased size & liquidity: >\$800m market cap, improved liquidity turnover.

We estimate growth in FY20 to be underpinned by the strong pipeline in Radio Comms (including \$15m Kenyan Govt contract win for delivery 1H FY20), metal sales from new products (e.g. Vanquish) and markets (e.g. Sth America), and a positive contribution from Minetec.

We **maintain a BUY rating** and increase our **target price to \$5.00** (prev:\$3.96). Short-term catalysts include: launch of Vanquish treasure detector, news flow regarding Minetec/Caterpillar deals, acquisitions, potential ASX300 inclusion.

| Y/E Jun 30 | 2019a | 2020e | 2021e | 2022e |
|------------------------|-------|-------|-------|-------|
| EBITDA | 78.8 | 87.3 | 96.5 | 104.4 |
| EV/EBITDA | 9.8x | 8.8x | 8.0x | 7.4x |
| Core NPAT | 45.7 | 51.1 | 56.4 | 60.6 |
| Core EPS (Diluted) (€) | 25.4 | 28.2 | 31.1 | 33.4 |
| P/E | 17.7x | 15.9x | 14.5x | 13.5x |
| EPS growth | 14.6% | 11.2% | 10.2% | 7.4% |
| DPS (€) | 14.0 | 17.3 | 19.1 | 20.5 |
| Yield | 3.1% | 3.8% | 4.2% | 4.6% |
| DPS growth | 12.0% | 23.3% | 10.4% | 7.7% |
| Dividend Payout Ratio | 55.2% | 61.2% | 61.3% | 61.4% |

All figures are in AUD.

EARNINGS ESTIMATES

Our revised earnings estimates are set out below:

Figure 1: Moelis Estimates

| Profit and Loss | FY19a | FY20e | FY21e | FY22e |
|---------------------------------|--------------|--------------|--------------|--------------|
| Metal Detection | 182 | 187 | 192 | 196 |
| Radio Communications | 78 | 85 | 94 | 103 |
| Mining Technology | 11 | 17 | 27 | 36 |
| Revenue | 271 | 289 | 313 | 335 |
| Metal Detection (% Group sales) | 67% | 65% | 61% | 59% |
| EBIT | | | | |
| Metal Detection | 67 | 70 | 72 | 72 |
| Margin | 37% | 38% | 37% | 37% |
| Radio Communications | 17 | 21 | 24 | 27 |
| Margin | 22% | 24% | 26% | 27% |
| Mining Technology | (1) | 0 | 4 | 7 |
| Margin | -11% | 1% | 13% | 19% |
| Corporate | (19) | (21) | (22) | (23) |
| Group EBIT | 64 | 70 | 78 | 83 |
| Group EBIT Margin | 23.4% | 24.3% | 24.8% | 24.9% |
| NPAT | 45.7 | 51.1 | 56.3 | 60.6 |
| EPS | 25.3 | 28.2 | 31.1 | 33.4 |
| DPS | 14.0 | 17.3 | 19.1 | 20.5 |
| Payout | 55% | 61% | 61% | 61% |

Source: Company, Moelis Analysis

Codan Limited (CDA)

Market Cap: \$807m

Last Price: \$4.50

Target Price: \$5.00

Buy

Y/E Jun 30

| Profit and Loss (\$m) | 2018a | 2019a | 2020e | 2021e | 2022e |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 229.9 | 270.8 | 288.8 | 313.3 | 334.9 |
| <i>Growth</i> | 1.7% | 17.8% | 6.7% | 8.5% | 6.9% |
| EBITDA | 70.6 | 78.8 | 87.3 | 96.5 | 104.4 |
| <i>Growth</i> | (6.7%) | 11.6% | 10.8% | 10.6% | 8.1% |
| Dep'n & Amort | (16.7) | (15.2) | (17.0) | (18.9) | (20.9) |
| EBIT | 53.9 | 63.5 | 70.3 | 77.6 | 83.4 |
| <i>Growth</i> | (12.5%) | 17.8% | 10.7% | 10.4% | 7.5% |
| Net Interest Expense | (0.7) | (0.2) | 0.2 | 0.3 | 0.5 |
| Profit Before Tax | 53.2 | 63.3 | 70.5 | 78.0 | 83.9 |
| Tax | (13.3) | (17.6) | (19.3) | (21.6) | (23.4) |
| <i>Tax Rate (%)</i> | 25.1% | 27.9% | 27.4% | 27.7% | 27.9% |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| NPAT (Underlying) | 39.8 | 45.7 | 51.1 | 56.4 | 60.6 |
| <i>Growth</i> | (10.9%) | 14.6% | 12.0% | 10.2% | 7.4% |
| One-Off Items | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| NPAT (Reported) | 39.8 | 45.7 | 51.1 | 56.4 | 60.6 |
| EPS (Underlying) (¢) | 22.1 | 25.4 | 28.2 | 31.1 | 33.4 |
| <i>Growth</i> | (12.3%) | 14.6% | 11.2% | 10.2% | 7.4% |

| Balance Sheet (\$m) | 2018a | 2019a | 2020e | 2021e | 2022e |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Cash | 27.7 | 37.5 | 37.9 | 49.0 | 60.1 |
| Inventory | 31.6 | 36.7 | 45.9 | 50.1 | 53.5 |
| Current Receivables | 29.8 | 19.0 | 29.1 | 31.8 | 36.2 |
| PPE | 12.5 | 14.1 | 16.8 | 19.5 | 22.0 |
| Intangibles | 146.4 | 157.7 | 165.5 | 173.7 | 182.0 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Assets | 254.3 | 274.3 | 304.5 | 333.3 | 363.1 |
| Current Payables | 46.3 | 44.2 | 49.0 | 53.5 | 57.1 |
| 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 | 7.8 | 9.2 | 10.4 | 11.3 | 12.0 |
| Other | 52.4 | 45.8 | 50.6 | 55.1 | 58.7 |
| Total Liabilities | 66.2 | 63.1 | 69.1 | 74.5 | 78.8 |
| Net Assets | 188.1 | 211.2 | 235.4 | 258.9 | 284.3 |
| Equity & Reserves | 107.0 | 111.4 | 115.4 | 116.7 | 118.4 |
| Retained Profits | 81.0 | 99.8 | 120.0 | 142.2 | 165.9 |
| Shareholders' Equity | 188.1 | 211.2 | 235.4 | 258.9 | 284.3 |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Equity | 188.1 | 211.2 | 235.4 | 258.9 | 284.3 |

| Cashflow (\$m) | 2018a | 2019a | 2020e | 2021e | 2022e |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| EBITDA | 70.6 | 78.8 | 87.3 | 96.5 | 104.4 |
| Net Interest | (0.5) | (0.1) | 0.2 | 0.3 | 0.5 |
| Tax | (22.6) | (20.3) | (19.3) | (21.6) | (23.4) |
| Δ in Working Capital | (0.1) | 3.5 | (14.5) | (2.4) | (4.2) |
| Other | 0.8 | 0.2 | 1.2 | 0.9 | 0.7 |
| Operating Cash Flow | 48.2 | 62.1 | 54.8 | 73.7 | 78.0 |
| <i>Growth</i> | (46.4%) | 28.8% | (11.7%) | 34.6% | 5.8% |
| Capex | (22.0) | (25.7) | (27.4) | (29.8) | (31.8) |
| Acquisitions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Divestments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | (0.5) | 0.0 | 0.0 | 0.0 | 0.0 |
| Investing Cash Flow | (22.5) | (25.7) | (27.4) | (29.8) | (31.8) |
| Equity Raised | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividends Paid | (19.6) | (26.9) | (26.9) | (32.9) | (35.1) |
| Net Borrowings | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Financing Cash Flow | (19.6) | (26.9) | (26.9) | (32.9) | (35.1) |
| FX / Non Cash Items | 0.1 | 0.3 | 0.0 | 0.0 | 0.0 |
| Change in Cash | 6.3 | 9.8 | 0.4 | 11.1 | 11.1 |
| Free Cash Flow | 26.2 | 49.7 | 41.1 | 58.9 | 62.1 |

| Valuation Summary | |
|-------------------------------|-------------|
| Current Mkt Capitalisation | 806.5 |
| Shares on Issue | 179.2 |
| Last Price | 4.50 |
| 12 Mth Target Price | 5.00 |
| Total Estimated 12 Mth Return | 14.4% |
| 12 Mth Fwd Capital Return | 11.1% |
| 12 Mth Fwd Dividend Yield | 3.3% |

| Valuation Ratios | 2018a | 2019a | 2020e | 2021e | 2022e |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| EPS (Underlying) (¢) | 22.1 | 25.4 | 28.2 | 31.1 | 33.4 |
| <i>Growth</i> | (12.3%) | 14.6% | 11.2% | 10.2% | 7.4% |
| P/E (x) | 20.3x | 17.7x | 15.9x | 14.5x | 13.5x |
| Small Industrials (ex Fin's) | 19.3x | 17.2x | 15.6x | 19.3x | 0.0x |
| Premium / (Discount) | 5.3% | 2.8% | 2.2% | (25.0%) | nm |
| EV/EBITDA (x) | 10.9x | 9.8x | 8.8x | 8.0x | 7.4x |
| Small Industrials (ex Fin's) | 11.0x | 11.8x | 10.7x | 9.9x | 0.0x |
| Premium / (Discount) | (1.0%) | (17.2%) | (17.4%) | (19.8%) | nm |
| DPS (¢) | 12.5 | 14.0 | 17.3 | 19.1 | 20.5 |
| <i>Growth</i> | (3.8%) | 12.0% | 23.3% | 10.4% | 7.7% |
| Yield (%) | 2.8% | 3.1% | 3.8% | 4.2% | 4.6% |
| Payout Ratio (%) | 56.4% | 55.2% | 61.2% | 61.3% | 61.4% |
| Franking (%) | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| NTA | 41.7 | 53.5 | 69.9 | 85.2 | 102.3 |
| NTA/Share (\$) | 0.23 | 0.30 | 0.39 | 0.47 | 0.56 |

| Performance Ratios | 2018a | 2019a | 2020e | 2021e | 2022e |
|---------------------------|---------|---------|---------|---------|---------|
| ROA | 15.7% | 16.6% | 16.8% | 16.9% | 16.7% |
| ROE | 21.2% | 21.6% | 21.7% | 21.8% | 21.3% |
| ROIC | 25.2% | 26.4% | 25.8% | 26.7% | 26.8% |
| Net Debt (Cash) (\$m) | (27.7) | (37.5) | (37.9) | (49.0) | (60.1) |
| Net Debt/EBITDA (x) | (0.4x) | (0.5x) | (0.4x) | (0.5x) | (0.6x) |
| ND/(ND + Equity) (%) | (17.3%) | (21.6%) | (19.2%) | (23.4%) | (26.8%) |
| Interest Cover (x) | 76.9x | 141.9x | 90.0x | 85.0x | 80.2x |
| Working Capital | 8.0 | 11.2 | 24.5 | 26.0 | 29.5 |
| Working Capital/Sales (%) | 3.5% | 4.1% | 8.5% | 8.3% | 8.8% |

| Cash Flow Metrics | 2018a | 2019a | 2020e | 2021e | 2022e |
|--------------------------|-------------|-------------|-------------|-------------|-------------|
| FCF/Share (\$) | 0.15 | 0.28 | 0.23 | 0.33 | 0.35 |
| Price/FCPS (x) | 30.6x | 16.2x | 19.6x | 13.7x | 13.0x |
| Free Cash Flow Yield (%) | 3.3% | 6.2% | 5.1% | 7.3% | 7.7% |
| Gross Cash Conversion | 101.2% | 104.9% | 85.4% | 99.2% | 97.5% |
| Capex/Sales (%) | (9.6%) | (9.5%) | (9.5%) | (9.5%) | (9.5%) |
| Capex/Depreciation (x) | 1.3x | 1.7x | 1.6x | 1.6x | 1.5x |

| Margins | 2018a | 2019a | 2020e | 2021e | 2022e |
|---------|-------|-------|-------|-------|-------|
| EBITDA | 30.7% | 29.1% | 30.2% | 30.8% | 31.2% |
| EBIT | 23.5% | 23.4% | 24.3% | 24.8% | 24.9% |
| NPAT | 17.3% | 16.9% | 17.7% | 18.0% | 18.1% |

| Valuation Methodology | |
|--------------------------------|-------------|
| WACC (%) | 9.3% |
| Discounted Cash Flow Valuation | 4.68 |
| Sum-of-the-Parts Valuation | 0.000 |
| Average Valuation | 4.68 |
| 12 Mth Target Price | 5.00 |

RESEARCH & SALES RESPONSIBILITIES

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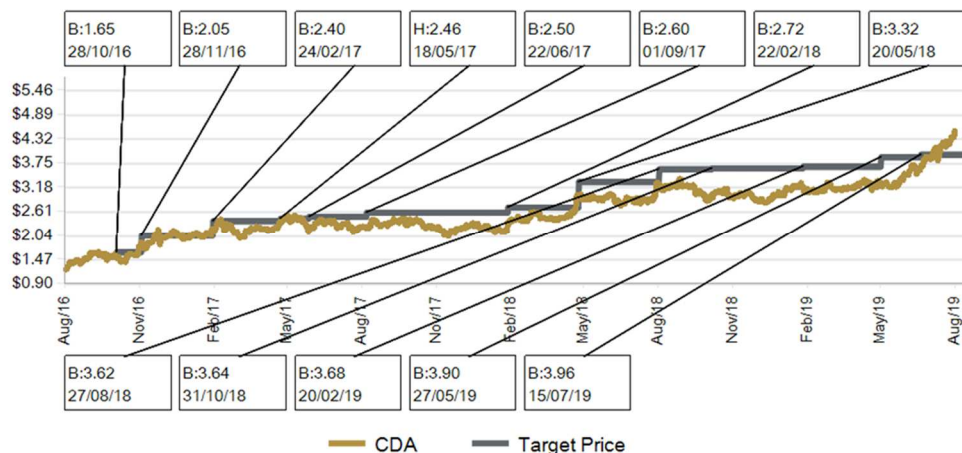
Buy: >15% **Hold:** 5% to 15% **Sell:** <5%.

RATINGS DISTRIBUTION TABLE

Distribution of Ratings as at 26 August 2019

| SELL | HOLD | BUY |
|------|-------|-------|
| 9.2% | 47.7% | 43.1% |

Rating and Price Target History: Codan Limited (CDA) as of 26/08/2019



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