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Codan Limited (CDA)

Hold

FY19 – Fully priced with strong growth outlook

\$4.70

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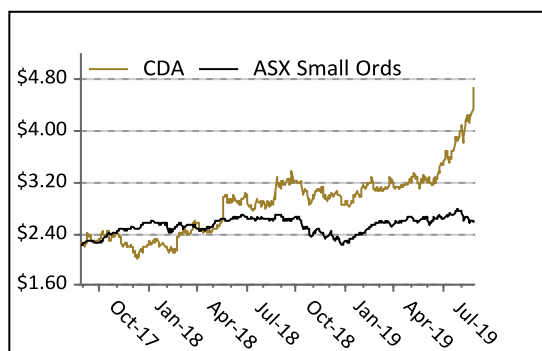
Summary (AUD)

Market Capitalisation	\$842.4
Share Price	\$4.70
52 week low	\$2.78
52 week high	\$4.97
Ave Monthly Vol (year rolling)	4.062M

Key Financials (AUD)

Year End (\$m)	FY19 Act.	FY20 Est.	FY21 Est.
Revenue	270.8	284.0	328.6
EBIT	63.4	60.7	67.9
NPAT Adj.	45.7	44.3	49.5
EPS (c)	25.3	24.5	27.4
PE Ratio (x)	18.5	19.0	17.0
DPS (c)	14.0	13.0	13.5
Div Yield	3.0%	2.8%	2.9%
Franking	100.0%	100.0%	100.0%
EV	799.5	784.3	764.8
EV/EBITDA (x)	10.2	9.8	8.4
EV/EBIT (x)	12.6	12.9	11.3
ROE	31.7%	27.3%	27.6%
EBIT Margin	23.4%	21.4%	20.7%
Payout Ratio.	55.4%	53.0%	49.3%

Share Price Graph (AUD)



Unpacking the FY19 result

CDA delivered 15% Underlying NPAT growth. Driven by: (1) Strengthening of HF Radio (“HF”) product suite; and (2) diversifications of earnings away from GPZ 7000. On the latter, we est. that the GPZ 7000 contributed 45% of metal detection’s gross profit, down from 65% in FY17. By FY21 we expect this to be closer to 25%. Other highlights incl. (1) net cash of \$37m at balance date, likely to build to +\$50m in 12-mths time; and (2) fast-tracking the commercialisation of the substantial R&D pipeline, with a ~20% increase to yearly spend from FY20.

Tactical order book better than ever. Expansion of product offerings to service the Military 2 market is largely complete. In the past 12-mths we est. that HF rev. grew from \$40m to \$60m. We are expecting further growth during FY20 given the strong start to the year, combined with an order book now incl. double digit sized opportunities. Higher margin customers than the traditional humanitarian customer, combined with a significantly larger addressable market provides CDA’s with the opportunity to double HF earnings over the medium term.

Pipeline of NPD in metal detection remains promising. A multi-frequency version of the X-Terra (“Vanquish”) metal detector will be available for release 1Q20. Priced at ~\$300/unit, the addressable market is 300k units p.a. Currently, CDA supplies 12-15k units p.a. using ~10yr technology. As a basis of comparison, the recently launched Equinox product utilising the same multi-frequency technology already holds ~60-80% market share and achieved \$20m of sales in the first year of release (at a slightly higher price point). CDA’s competitors in the entry level recreational market are private operators with significantly smaller R&D budgets, and therefore, we believe it is likely that CDA will win and retain market share in this segment. We forecast that within 12-mths Vanquish could hold ~15% market share, building to 30% market share within 2 years. Outside of this, CDA has a hybrid GPX/SDC2300 Gold Detector (\$5k/unit) for release 3Q20 (offering US\$300/unit COGS savings), revamped CTX-3030 (CTX-4040) high-end recreational detector likely for release mid FY21, MDS-10 Countermine Product expected to be released 2Q20 (niche volumes at very high margins) and lighter weight and easier to operate GPZ-2 expected for commercialisation by FY22/23.

Managing the markets’ expectations regarding Caterpillar Inc. (“CAT”). Delays towards inclusion in the CAT global catalogue remain a bottleneck to scaling Minetec through the CAT network. Tanami proof of concept was completed in March 2019, yet the agreed sales order will now not come through until 1Q20. Freeport Grasberg CAT originated contract now also has a similar timeframe – again being allocated a part number from CAT remains the constraint to progress. The sales cycle remains long (>12-mths) while the implementation and support cycle can stretch even longer. For the next 2-3 years, CAT dealers will probably be reliant on Minetec Engineers for pre and post-sales support. Recent delays are a reminder that success of the venture is largely outside CDA’s control. Therefore, we have tempered our already conservative expectations from this partnership by a further 12-mths.

Valuation & Recommendation

CDA now trades at 19x our FY20e EPS (on a reported basis) or 25x FY20e upper end base level EPS. We observe a difficult comparative period of one-off very high margin GPZ 7000 sales during 1H20 that could nullify or even result in earnings declines during FY20. The business holds net cash of ~\$37m, has significant growth opportunities for the next 3-4 years, and maintains little exposure to the Australian macro. These businesses are hard to find in this environment at a market multiple. **On this basis, we are still happy to own, but downgrade our recommendation from Outperform to Hold.**

Codan Ltd - Summary of Forecasts

\$ 4.700

PROFIT & LOSS SUMMARY (A\$m)				
Period	FY18A	FY19A	FY20E	FY21E
Revenue	229.9	270.8	284.0	328.6
EBITDA Adj.	70.3	78.6	80.2	90.7
Dep'n	(2.8)	(2.6)	(2.6)	(2.6)
Amort'n	(13.8)	(12.6)	(16.9)	(20.2)
EBIT Adj.	53.7	63.4	60.7	67.9
Net Interest	(0.5)	(0.1)	0.5	0.6
Pre-Tax Profit Adj.	53.1	63.3	61.1	68.5
Tax Expense	(13.4)	(17.6)	(16.8)	(19.1)
NPAT Adj.	39.7	45.7	44.3	49.5
Abnormals (net of tax)	1.7	0.0	0.0	0.0
Reported Profit	41.5	45.7	44.3	49.5
Change on pcp				
Total Revenue	1.7%	17.8%	4.9%	15.7%
EBITDA Adj.	-6.9%	11.8%	2.0%	13.1%
EBIT Adj.	-12.8%	18.1%	-4.2%	12.0%
NPAT Adj.	-11.1%	14.9%	-3.0%	11.7%

OPERATING SEGMENTS (A\$m)				
Period	FY18A	FY19A	FY20E	FY21E
Revenue				
Communications	56.5	77.6	97.9	121.2
Metal Detection	164.0	182.1	174.1	187.5
Tracking Solutions	9.4	11.1	12.0	20.0
Other	0.0	0.0	0.0	0.0
TOTAL	229.9	270.8	284.0	328.6
Segment Result				
Communications	6.8	16.7	21.5	26.8
Metal Detection	64.1	67.3	62.2	62.1
Tracking Solutions	0.7	(1.2)	(2.3)	0.7
Other	0.0	0.0	0.0	0.0
D&A	16.7	15.2	19.5	22.8
Unallocated Corporate	(17.6)	(19.4)	(20.3)	(21.3)
Unallocated Other	(0.2)	(0.1)	(0.4)	(0.4)
EBITDA	70.4	78.6	80.2	90.7

PER SHARE DATA				
Period	FY18A	FY19A	FY20E	FY21E
EPS Adj. (c)	22.34	25.29	24.54	27.41
<i>Growth (pcp)</i>	-11.4%	13.2%	-3.0%	11.7%
Ordinary Dividend (c)	8.5	9.0	11.0	13.5
Special Dividend (c)	4.0	5.0	2.0	0.0
Franking	100%	100%	100%	100%
Book NTA per share (c)	23	29	38	50

VALUATION MULTIPLES				
Period	FY18A	FY19A	FY20E	FY21E
PER Adj. (x)	21.0	18.6	19.2	17.1
Dividend Yield (%)	1.8%	1.9%	2.3%	2.9%
Free CF Yield	3.1%	4.3%	4.3%	5.2%
EV/EBITDA (x)	11.6	10.2	9.8	8.5
EV/EBIT (x)	15.2	12.7	13.0	11.3

BALANCE SHEET SUMMARY				
Period	FY18A	FY19A	FY20E	FY21E
Cash	27.7	37.5	52.7	72.2
Receivables	29.8	19.0	19.9	23.1
Inventory	31.6	36.7	38.5	44.5
Current Tax Asset	0.1	0.3	0.3	0.3
Assets Held for Sale	3.8	3.8	3.8	3.8
Other	2.5	5.2	5.2	5.2
Total Current Assets	95.4	102.5	120.4	149.1
Property Plant & Equipment	12.5	14.1	14.0	13.9
Product Development	59.8	69.9	75.7	78.2
Intangibles	86.6	87.8	89.1	90.4
Total Non-Current Assets	158.9	171.8	178.8	182.5
TOTAL ASSETS	254.3	274.3	299.2	331.6
Payables	46.3	44.2	46.3	53.6
Borrowings	0.0	0.0	0.0	0.0
Current Tax Payable	6.1	1.6	1.6	1.6
Provisions	7.3	8.0	8.0	8.0
Total Current Liab	59.7	53.8	56.0	63.3
Other Payables	0.0	0.0	0.0	0.0
Borrowings	0.0	0.0	0.0	0.0
Deferred Tax Liabilities	6.0	8.1	8.1	8.1
Provisions	0.5	1.2	1.2	1.2
Total Non-Current Liab	6.5	9.3	9.3	9.3
TOTAL LIABILITIES	66.2	63.1	65.3	72.5
TOTAL EQUITY	188.1	211.2	233.9	259.1

CASH FLOW SUMMARY				
Period	FY18A	FY19A	FY20E	FY21E
NPAT Adj.	41.5	45.7	44.3	49.5
Add: Depreciation	2.8	2.6	2.6	2.6
Add: Amortisation	13.8	12.6	16.9	20.2
Abnormals, non cash, reclass, work cap	(10.0)	1.2	(0.6)	(1.9)
Gross Cashflows	48.2	62.1	63.3	70.4
Net Capex	(3.4)	(4.1)	(2.5)	(2.5)
Investments in Intangibles	(2.5)	(1.1)	(1.5)	(1.5)
Capitalised product development	(16.5)	(20.5)	(22.5)	(22.5)
(Acquisitions)/Divestments	0.0	0.0	0.0	0.0
Free Cashflows	25.8	36.4	36.8	43.9
Dividends Paid	(19.6)	(26.7)	(21.6)	(24.4)
Debt Issued / (Repaid)	0.0	0.0	0.0	0.0
Equity issued / (Buyback)	0.0	0.0	0.0	0.0
Net Cash Flow	6.2	9.7	15.2	19.5

KEY RATIOS				
Period	FY18A	FY19A	FY20E	FY21E
Net Debt / EBITDA Adj. (x)	(0.4)	(0.5)	(0.7)	(0.8)
Net Debt : Equity (%)	-14.7%	-17.8%	-22.5%	-27.9%
EBIT Interest cover (x)	89.1	n/a	n/a	n/a
Current ratio (x)	1.6	1.9	2.2	2.4
ROE Adj. (%)	30.4%	31.7%	27.3%	27.6%
ROIC Adj. (%)	30.4%	31.7%	27.3%	27.6%
Dividend Payout Ratio (%)	56.0%	55.4%	53.0%	49.3%

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