Cohort

FY17 results

Marching on

Aerospace & defence

Cohort's earnings performance in FY17 once again exceeded our expectations. Stronger performances from EID and MCL more than outweighed the sharp contraction at SCS, where a swift response from management has already improved profitability. The cash performance was also better than expected and the dividend increase to 7.1p was also ahead of our forecast. We expect further solid progress in the current year, and our fair value estimate currently stands at 471p.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
04/16	112.6	12.0	25.0	6.0	17.2	1.4
04/17	112.7	14.5	26.6	7.1	16.2	1.7
04/18e	123.8	15.4	29.1	8.2	14.8	1.9
04/19e	128.2	16.1	31.3	9.0	13.7	2.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and tax credits of 2.20p in FY16 and 1.30p in FY17.

Progress in a year of change

The strength of performance at MCL and the initial 10-month contribution from EID more than offset a sharper than we expected decline in activity at SCS, and lower than anticipated contributions from MASS and SEA. Proactive management action to reduce costs by integrating SCS into MASS and SEA in early November ensured that the ongoing activities returned a modest profit for the rest of FY17. Overall, Cohort delivered lower revenues than we expected, but an adjusted operating profit 1.4% ahead of our forecast. Adjusted EPS of 27.9p was 3% higher than FY16 (or 7% excluding the tax credits in each year) and 10.5% better than we forecast, due partly to the buy-in of the MCL minority, which should enhance FY18 EPS. Net cash at the year end was £8.5m (FY16: £19.8m) after spending £9.1m on EID and MCL net of cash acquired. The dividend rose 18% to 7.1p (FY16: 6.0p), 3.9x covered.

Balance sheet remains strong

Cohort is expected to make further progress in FY18, as the company enjoyed healthy order intake during FY17, with a closing order book up 18% at £136.5m (FY16: £116.0m). MCL has notably continued to pick up new work in the current year. The continued conflict between increasing security and defence requirements and budgetary realities continues, but Cohort remains agile in this environment. The balance sheet also continues to enable pursuit of further investment opportunities. The purchase of a further 23% of EID for €4.4m is expected to close soon, which should also enhance earnings.

Valuation: Performing well against peers

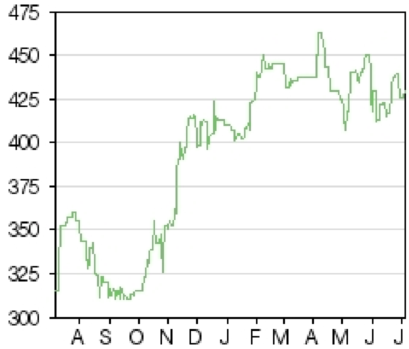
Cohort has experienced a sharp re-rating over the last year. With the prospect of organic growth in FY18 combined with healthy margins, improved free cash flow and strong dividend progression, it continues to perform favourably compared to UK defence peers who have also rerated positively as the outlook for global defence spending improved. Our fair value calculation of 471p (from 485p previously) reflects the sector uplift combined with our reduced earnings estimates.

5 July 2017

Price	**430.00p**
Market cap	**£176m**

Net cash (£m) at 30 April 2017	8.5
Shares in issue	40.4m
Free float	70%
Code	CHRT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.1	(4.6)	42.9
Rel (local)	2.8	(5.3)	25.1
52-week high/low		462.5p	301.0p

Business description

Cohort is an AIM-listed defence and security company operating across four divisions: MASS (30% of FY18e sales); SEA (40%); MCL (15%); and the 57%-owned Portuguese business EID (15%) acquired in FY17.

Next events

AGM	August 2017

Analysts

Andy Chambers	+44 (0)20 3681 2525
Roger Johnston	+44 (0)20 3077 5722

industrials@edisongroup.com

Edison profile page

Cohort is a research client of Edison Investment Research Limited

Current trading and outlook

FY17 a mixed year, but solid overall progress

FY17 turned out to be a year of more mixed fortunes for Cohort's divisions than we had expected. While MASS was lower as expected, MCL profits progressed much as anticipated, and EID made a higher initial 10-month operating contribution, with a much higher margin than had been expected. However, SCS saw business levels contract dramatically, with revenues almost halving from the previous year accompanied by a sharp reduction in order intake. In the period up to its reorganisation it delivered a loss of £0.5m, which was more than offset by savings following the transfers into MASS and SEA of its ongoing activities. SEA also traded slightly below expectations as dismounted soldier research project renewals and follow-ons continued to be deferred.

Divisional key points were as follows:

MASS: excluding the SCS contribution in the second half, MASS experienced a downturn in sales of 7% and operating profits of 10%. A decline had been anticipated but profits were also affected by a one-off cost of £0.3m and continuing investment in the cyber activities. The closing order book of £41.2m (FY16: £41.7m) was broadly unchanged, excluding an SCS contribution of £8.2m. Order intake was much stronger at £32.0m compared to £20.3m.

SEA: on a like-for-like basis, excluding SCS, SEA saw revenues drop to £42.9m (FY16: £48.8m) due to a drop of £6m in R&D contract work for the dismounted soldier programme for the MOD, as well as a tougher trading environment for subsea engineering where revenues dropped to £2m (FY16: £3m). These were partially offset by improved sales to the transport segment and of torpedo launcher systems to overseas customers. The profit performance was also affected by project losses on a one-off towed-array sonar development contract inherited with J+S, which are not expected to recur as the project concludes in the current year. The closing order book of £44.0m included £1.5m from the former SCS businesses and was down from £55.6m in the previous year, largely reflecting the reduction in research contract awards.

MCL: delivered strong profit growth of 50% to £2.1m on revenues that were 8% higher at £14.8m. The closing order book of £15.5m compared to just £7.0m at FY16 close, and points to further strong progress this year, although the strong margin performance may ease.

EID: the initial strong profit contribution of £4.2m was generated on revenues of £16.0m, a margin of 26.4%. The exceptionally high net margin was due to high levels of support work and export activity, which is expected to normalise in FY18.The closing order book stood at £27.6m following order intake of £18.9m in the 10 months it traded as part of Cohort.

SCS: experienced a sharp and persistent reduction in activity in the first half that led management to integrate its ongoing activities between MASS and SEA from November. For the full year, order backlog declined from £11.7m to £9.7m, with intake of just £4.0m. Sales fell to £9.1m from £18.1m in FY16, £5m of which was pre the integration, generating a loss of £0.5m before integration and a profit of £0.8m subsequently. Cost savings of £2.6m should be realised, although an onerous lease accounts for £1m of those and will take time to expire.

Overall the ongoing business saw operating profits decline by 13% on revenues that were 14% lower due to the reductions at SEA and SCS. This was offset by EID's contribution.

The closing order book for FY17 of £136.5m (FY16: £116.0m) included a first contribution from EID of £28.9m. Over £70m of it is due to trade in the current financial year, ahead of the £65m at the same point a year ago. The improvements are despite the sharp reduction at SCS and the contraction of research orders at SEA. MCL has continued to win significant new hearing protection contracts since the start of the current financial year.

Exhibit 1: Cohort estimates revisions

Year to April (£m)	2017			2018e		
	Prior	Actual	% change	Prior	New	% change
MASS	30.7	32.5	5.8%	34.1	37.1	8.8%
SCS	17.5	5.0	-71.4%	17.5	0.0	-100.0%
SEA	47.5	44.4	-6.5%	52.0	49.4	-5.0%
MCL	17.0	14.8	-13.2%	18.0	18.5	2.5%
EID	13.1	16.0	22.5%	17.3	18.9	9.5%
Total group revenues	**125.8**	**112.7**	**-10.4%**	**138.9**	**123.8**	**-10.8%**
EBITDA	**15.5**	**15.7**	**1.5%**	**17.8**	**16.7**	**-6.5%**
MASS	6.1	5.9	-3.3%	6.3	6.7	5.9%
SCS	0.2	-0.5	-326.1%	1.2	0.0	-100.0%
SEA	5.4	5.3	-1.8%	5.9	5.9	0.0%
MCL	2.2	2.1	-6.7%	2.3	2.3	-1.4%
EID	2.9	4.2	47.1%	3.5	3.2	-6.9%
HQ Other and intersegment	-2.5	-2.5	0.8%	-2.7	-2.7	0.7%
EBIT (pre-PPA amortisation)	**14.3**	**14.5**	**1.6%**	**16.5**	**15.4**	**-7.0%**
Underlying PTP	**14.3**	**14.5**	**1.4%**	**16.6**	**15.4**	**-7.1%**
EPS - underlying continuing (p)	**24.1**	**26.6**	**10.5%**	**33.4**	**29.1**	**-12.9%**
DPS (p)	7.0	7.1	1.4%	8.0	8.2	2.5%
Net cash/(debt)	7.0	8.5	21.0%	15.7	11.5	-26.6%

Source: Company reports, Edison Investment Research estimates

Current year expected to show good progress

FY18 will benefit from a full year contribution from EID, albeit margins will revert to more normal levels. In addition, MCL should see healthy revenue and profit gains and the full year benefit of the corrective actions following the SCS restructuring should also boost profitability.

Our FY18 sales forecast is significantly reduced by 11% due to the lower base level of SCS when combined into SEA, although the MASS expectation is broadly maintained. We have increased our revenue expectations for both EID and MCL modestly. Overall our earnings forecasts have been revised downwards by 7%, largely reflecting the reduced contribution from SCS as well as lower margins at EID than we had previously forecast.

We also expect to see steady progression thereafter in line with the improving outlook for defence markets, with the balance sheet expected to benefit from improving cash inflows, which should facilitate the pursuit of further investments.

Valuation

Rolling both our DCF and peer group valuations forward to a new year results in a fair value estimate of 471p (the average of the two metrics) compared to 485p previously, a 3% reduction. While Cohort has performed strongly over the last 12 months, so has the defence sector generally. However, our FY18e EPS estimate has been reduced by c 13% which brings us in line with market consensus but offsets the upside from the improved defence sector outlook. The headroom from the current share price represents an opportunity as Cohort continues to execute its growth strategy.

Exhibit 2: Financial summary

£m	2015	2016	2017	2018e	2019e
Year end 30 April	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	99.9	112.6	112.7	123.8	128.2
Cost of Sales	(70.0)	(79.1)	(73.7)	(87.0)	(90.0)
Gross Profit	30.0	33.5	39.0	36.9	38.2
EBITDA	11.0	13.0	15.7	16.7	17.4
Operating Profit (before amort. and except.)	10.1	11.9	14.5	15.4	16.0
Intangible Amortisation	(3.6)	(6.4)	(11.3)	(5.2)	(3.9)
Exceptionals	(0.6)	(0.3)	(2.3)	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Operating Profit	5.9	5.2	1.0	10.2	12.1
Net Interest	0.1	0.1	0.0	0.0	0.0
Profit Before Tax (norm)	10.2	12.0	14.5	15.4	16.1
Profit Before Tax (FRS 3)	5.9	5.3	1.0	10.2	12.1
Tax	(0.7)	0.1	1.1	(1.9)	(2.2)
Profit After Tax (norm)	8.9	11.2	11.4	12.7	13.2
Profit After Tax (FRS 3)	5.2	5.4	2.1	8.3	10.0
Average Number of Shares Outstanding (m)	40.1	40.6	40.4	40.4	40.4
EPS - normalised (p)*	20.5	27.2	27.9	29.1	31.3
EPS - normalised and fully diluted (p)	20.0	26.7	27.6	28.7	30.9
EPS - (IFRS) (p)	11.2	12.7	9.1	18.3	23.2
Dividend per share (p)	5.0	6.0	7.1	8.2	9.0
Gross Margin (%)	30.0	29.8	34.6	29.8	29.8
EBITDA Margin (%)	11.0	11.5	13.9	13.5	13.5
Operating Margin (before GW and except.) (%)	10.1	10.6	12.9	12.4	12.5
BALANCE SHEET					
Fixed Assets	66.2	59.7	60.6	55.1	50.9
Intangible Assets	55.8	49.5	50.6	45.4	41.5
Tangible Assets	10.3	10.2	9.9	9.7	9.4
Investments	0.0	0.0	0.0	0.0	0.0
Current Assets	40.3	54.0	56.3	70.6	81.5
Stocks	1.1	2.0	5.3	6.0	6.4
Debtors	19.4	27.3	37.3	41.0	42.4
Cash	19.7	23.1	12.0	22.0	31.0
Other	0.1	1.6	1.7	1.7	1.7
Current Liabilities	(26.8)	(40.1)	(39.7)	(33.1)	(29.9)
Creditors	(26.8)	(36.8)	(36.1)	(33.1)	(29.9)
Short term borrowings	(0.0)	(3.3)	(3.5)	0.0	0.0
Long Term Liabilities	(16.9)	(2.7)	(3.2)	(13.7)	(17.2)
Long term borrowings	(0.0)	(0.0)	(0.0)	(10.5)	(14.0)
Other long term liabilities	(16.8)	(2.7)	(3.2)	(3.2)	(3.2)
Net Assets	62.8	70.8	74.0	79.0	85.3
CASH FLOW					
Operating Cash Flow	20.5	8.5	3.8	9.8	12.7
Net Interest	0.1	0.1	0.0	0.0	0.0
Tax	(1.7)	(1.8)	(3.1)	(2.7)	(2.8)
Capex	(1.1)	(1.0)	(0.9)	(1.1)	(1.1)
Acquisitions/disposals	(13.5)	(0.7)	(9.1)	0.0	0.0
Financing	0.8	(3.2)	0.5	0.0	0.0
Dividends	(1.8)	(2.2)	(2.5)	(3.0)	(3.4)
Net Cash Flow	3.3	(0.3)	(11.4)	3.1	5.5
Opening net debt/(cash)	(16.3)	(19.7)	(19.8)	(8.5)	(11.5)
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(0.0)	0.5	0.0	(0.0)	0.0
Closing net debt/(cash)	(19.7)	(19.8)	(8.5)	(11.5)	(17.0)

Source: Company accounts, Edison Investment Research, Note: *Includes non-recurring tax credits in FY16 and FY17.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia