Cohort

H122 results

Stronger H222 underpinned by record backlog

Aerospace & defence

H122 results proved disappointing as Chess failed to deliver against expectations. The weakness at EID was anticipated, although there is a further deferral to its recovery. MCL, SEA, MASS and ELAC are all expected to make progress in FY22. However, this will not compensate for the shortfall at Chess and we have reduced our EPS estimates by 12% in FY22 and 8% in FY23 to reflect that. We expect that following a strong recovery in FY23, Cohort should return to sustainable growth in FY24.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
04/20	131.1	17.5	37.1	10.1	14.6	1.9
04/21	143.3	17.9	33.6	11.1	16.1	2.1
04/22e	149.4	14.6	30.0	12.2	18.0	2.3
04/23e	164.4	17.7	34.5	13.4	15.7	2.5

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H122 depressed by EID and Chess

Revenue grew by 10% to £60.0m (H121: £54.4m), boosted by an initial first-half contribution from ELAC of £10.7m with MCL stronger, SEA progressing positively and a slightly lower performance from MASS. In Portugal, EID was weaker as expected, although there has been some additional delay to domestic orders that is likely to defer the timing of a recovery beyond FY23. The main shortfall was at Chess, where c £9m of revenues were deferred to H222 and FY23, leading to an adjusted H122 operating loss of £2.7m (H121: profit £0.3m) at the division. With measures taken to remedy the contract execution issues including a strengthened management team, the business should return to profit for FY22, as will EID. Cash flow remained strong with a £9.1m (H121: £4.9m) operational inflow, leaving adjusted net funds at £6.1m. The 18% minority in Chess is currently valued at £2.8m and should be bought by the year end, which should benefit the earnings contribution from a recovery in FY23. The dividend was increased by 10% to 3.85p.

Record backlog underpins recovery and growth

The record £285.8m order backlog was up £43.4m from the start of the year. Order cover of 89% for anticipated FY22 sales of c£150m rose to 92% by 10 December with further strong order intake expected in H222. H222 performance should be much stronger as operating profits rise at MASS, SEA, MCL and ELAC in FY22, although not enough to recover the shortfalls at EID and Chess. Management guides for FY22 estimates to be materially below prior expectations. With EID not recovering until FY24 and a lower trajectory for Chess, we expect a stronger performance in FY23. A return to growth in FY24 should be underpinned by the order book, some easing of COVID disruption and additional new opportunities.

Valuation: Successful delivery should boost rating

Growth has been deferred by a year, but underlying demand appears positive, although still subject to potential COVID disruption. Cash flow and dividend growth remain strong and the rating should appear less demanding as the year progresses assuming the recovery and subsequent medium-term growth prospects are reaffirmed. Our capped DCF value stands at 630p from 656p previously.

16 December 2021

Price	**540p**
Market cap	**£222m**

Adjusted net cash (£m) at 31 October 2021 (excludes £8.2m lease liabilities)	6.1
Shares in issue	41.2m
Free float	72%
Code	CHRT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(10.0)	(3.6)	(7.9)
Rel (local)	(7.2)	(4.4)	(16.9)
52-week high/low		678p	494p

Business description

Cohort is an AIM-listed defence and security company operating across six divisions: MASS (32% of H122 sales), SEA (23%), MCL (13%), the 80%-owned Portuguese business EID (4%), the 81%-owned Chess Technologies based in the UK (10%), and ELAC SONAR (18%).

Next events

FY22 results	July 2022

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H122 results summary

The pandemic continued to challenge Cohort's businesses to a degree in H122 through disruption and delays to marketing activities, ordering processes, the ability to deliver services and contract placement by customers. However, the main disappointment was the operational performance at Chess, which was only partly due to these effects. The problems should be remedied by actions taken to strengthen the leadership team and contract management, although some activity has been deferred to FY23. The shortfall added to the already indicated lower trading at EID in Portugal. The key highlights of the H122 results are as follows:

- H122 saw continued strong order intake up 18% to £105.3m (H121: £89.2m), representing a book to bill ratio of 1.75x, with further strong order flow expected in H222. ELAC's order intake of £46.6m included the group's largest ever single system order win of €49m from Italy in July, covering submarine sonars. It more than compensated for the much-reduced order intake of just £6.1m at Chess (H121: £51.0m) against a very strong H121 performance.
- The period-end order book of £285.8m (H121: £218.5m), was again a record and was up from £242.4m at the start of the year.

Exhibit 1: Cohort H122 results summary

Half year to October (£m)	H121	H122	% change
Order intake	89.2	105.3	18%
Book to bill	1..64x	1.75x	
Order backlog	**218.5**	**285.8**	**31%**
Order cover for FY sales expectations	92%	89%	
Revenues			
Chess	11.53	5.93	-49%
EID	4.66	2.63	-44%
ELAC	-	10.69	
MASS	20.25	19.06	-6%
MCL	4.66	7.91	70%
SEA	13.35	13.86	4%
Inter-segment revenue	(0.01)	(0.05)	650%
Group total	**54.44**	**60.04**	**10%**
Adjusted operating profit			
Chess	0.31	(2.66)	-965%
EID	0.33	(0.49)	-249%
ELAC	-	1.52	
MASS	4.61	3.72	-19%
MCL	(0.00)	0.55	N/M
SEA	0.77	1.23	59%
Unallocated central costs	(1.69)	(2.14)	27%
Group total	**4.33**	**1.72**	**-60%**
(Loss)/profit before tax	(0.37)	(1.71)	361%
Adjusted Profit before tax*	**4.00**	**1.33**	**-67%**
Adjusted EPS	**7.74**	**3.04**	**-61%**
DPS	3.50	3.85	10%
Adjusted net funds/(debt) excluding lease liabilities	(6.1)	6.1	

Source: Company reports. Note: *Before exceptional items, amortisation of other intangibles and FX mark to market.

- Revenues rose 10% to £60.0m (H121: £54.4m), with an initial contribution from ELAC of £10.7m. The ongoing businesses experienced a decline of 9% in revenues as growth in MCL and EID combined with a modest reduction at MASS. MASS was affected by lower electronic warfare operational support (EWOS) activity and delivery constraints due to the pandemic.
- There were sharp declines at EID and Chess. While EID's performance had been flagged, the decline of Chess was unexpected. The main shortfall was at Chess due to a combination of

COVID constraints, delayed orders and poor contract execution, which in total deferred some £9m of revenues to H222 and FY23. Order slippage accounted for around £2m, while COVID constraints disrupted some £4m of contract delivery due to difficulties in meeting schedules and cost, compounded by reduced access to customer sites and delayed decision making by customers. Technical and schedule issues resulted in another £3m of revenue reduction against our expectations.

- Chess made a £2.7m adjusted operating loss, £3.0m less than in H121 and EID made a loss of £0.5m a reduction of £0.8m on the prior year. In aggregate, MASS, SEA, MCL and ELAC made an adjusted operating profit of £7.0m (H121: £5.4m) up 30%, although that is before unallocated costs which rose by almost £0.5m to £2.1m.
- As a result, group adjusted operating profit was down 60% to £1.7m (H121: £4.3m).
- Adjusted EPS were 61% lower at 3.04p (H121: 7.74p).
- The interim dividend was increased by 10% to 3.85p (H121: 3.50p), maintaining the group's progressive dividend policy and reflecting management's confidence in recovery and a return to growth underpinned by the order book.
- Adjusted net funds (excluding lease liabilities) of £6.1m (H121: debt £6.1m), was a further strengthening from FY21 net cash of £2.5m, exceeding management expectations.

Exhibit 2: Cohort half yearly results by division and estimates

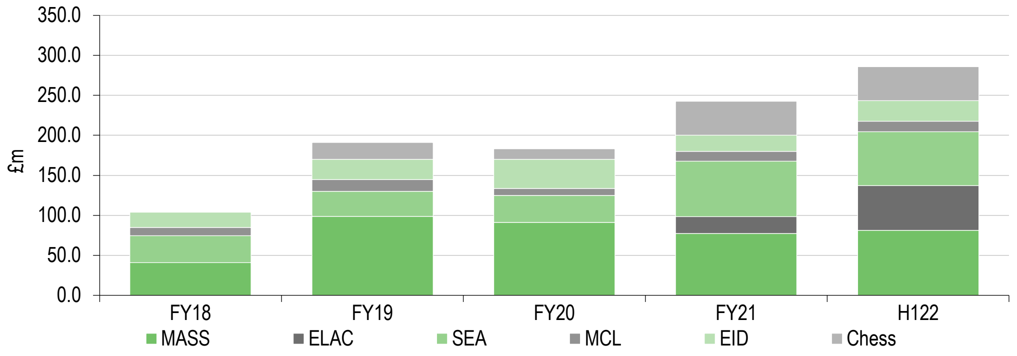
Year end April (£'000)	H121	H221	FY21	H122	H222e	FY22e
Revenue						
Chess	11,528	17,113	28,641	5,925	15.556	21,481
EID	4,660	16,292	20,952	2,630	7,846	10,476
ELAC	-	8,290	8,290	10,692	12,520	23,212
MASS	20,248	19,309	39,557	19,064	23,262	42,326
MCL	4,658	13,322	17,980	7,913	12,764	20,677
SEA	13,350	14,608	27,958	13,859	17,454	31,313
Inter-segment revenue	(6)	(64)	(70)	(45)	(55)	(100)
Group total	**54,438**	**88,870**	**143,308**	**60,038**	**89,347**	**149,385**
Adjusted operating profit						
Chess	308	2,710	3,018	(2,663)	3,630	967
EID	329	4,505	4,834	(489)	908	419
ELAC	-	1,173	1,173	1,515	1,572	3,.087
MASS	4,610	4,132	8,742	3,724	5,164	8,888
MCL	(2)	2,073	2,071	547	2,038	2,585
SEA	774	1,579	2,353	1,228	2,530	3,758
Unallocated central costs	(1,690)	(1,892)	(3,582)	(2,144)	(2,056)	(4,200)
Group total	**4,329**	**14,280**	**18,609**	**1,718**	**13,78**	**15,504**
Adjusted operating margin						
Chess	2.7%	15.8%	10.5%	-44.9%	23.3%	4.5%
EID	7.1%	27.7%	23.1%	-18.6%	11.6%	4.0%
ELAC	-	14.1%	14.1%	14.2%	12.6%	13.3%
MASS	22.8%	21.4%	22.1%	19.5%	22.2%	21.0%
MCL	0.0%	15.6%	11.5%	6.9%	16.0%	12.5%
SEA	5.8%	10.8%	8.4%	8.9%	14.5%	12.0%
Group Total	**8.0%**	**16.1%**	**13.0%**	**2.9%**	**15.4%**	**10.4%**

Source: Company reports, Edison Investment Research estimates

Outlook

Most divisions had higher backlogs at H122 compared to the start of the year, including Chess and EID, except for SEA, which contracted modestly to £67.4m (£69.5m), representing a sizable and long-term backlog. £74m of the H122 backlog should be delivered in H222 providing strong order cover of 89% for FY22 consensus forecast revenue expectations. With further orders secured since the half year, the cover level has increased to 92% by 10 December.

Exhibit 3: Cohort order backlog development

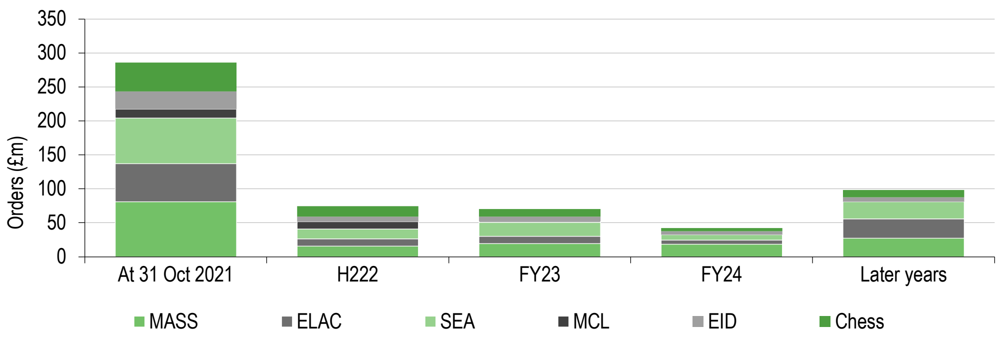


Source: Cohort

The record order backlog supports another strong second half of the year, with 92% of consensus revenue expectations of c £150m now covered by orders, a similar level to a year ago. The performance of both EID and Chess will be key elements of this, as well as delivering more EWOS contracts at MASS subject to COVID constraints.

Overall, the record order backlog also continues to underpin medium and long-term revenues. Management anticipates further good order flow in H222 with only a limited number of major renewals due so mostly new business. The length of the order book also continues to extend, with many long-duration maritime programmes including ELAC's record win in Italy in July.

Exhibit 4: Cohort order backlog and run off



Source: Cohort

Management's current expectations for FY22 adjusted operating profit performance is summarised as:

- MASS: after a slightly weaker H121 margin performance (19%) due to delays in delivering EWOS services to some export customers, the mix of activity is expected to improve in H222, with FY22 margins expected to exceed 20% on stronger full-year revenues.
- SEA benefited from stronger export activity for Torpedo Launcher Systems and KraitArray (towed sonar) systems as well as a healthy opening order book. With strong order intake last year following its restructuring, management expects the positive trends to deliver a stronger H222 performance, with £14.2m of its £67.4m H122 order book deliverable in H222.
- MCL: the short-term ordering patterns at MCL provide the lowest visibility in the group, but increased activity for the UK MOD, including systems for autonomous vehicles, drove a good recovery in H122. The order backlog of £13.0m (FY21: £10.9m) was significantly higher than a year ago, and a good pipeline of opportunities supports management's view of further improved performance in H222 as MOD activity responds to improved budget levels. Management

expects full-year performance to at least match FY21 levels, with a strong start already provided.

- EID: management appears confident that EID will return to profit in FY22. The reduced domestic order intake seems likely to persist through FY23, with an election in Portugal in early 2022 also potentially providing further challenges. Export orders are also currently scarce, so a recovery to historic levels of c £20m total group revenues with c 20% margins is not expected before FY24.
- Chess: with £15.3m of revenue in the backlog of £42.6m (FY21: £42.3m) at the half year to be delivered in H222, Chess should have a far stronger second half, returning the business to profit for FY22. Although much weaker than we expected, H222 performance and the actions taken to resolve the issues and strengthen the business should allow a swift recovery in FY23, in our view, albeit on a lower growth trajectory.
- ELAC SONAR: as it continues work on its new Italian contract and receives regular adjustment payments from Wärtsilä on a delayed order prospect to cover costs incurred, ELAC is expected to at least repeat its H122 debut six-month contribution. £10.8m of revenue to be delivered in H222 is in the opening order book of £55.9m.

The COVID constraints on travel and supply chains are likely to continue to be disruptive at least through the second half. While management is hopeful of some pick-up in activities already effected, eg EWOS services at MASS, the demand still appears to be there, just delayed, so at some point should be reflected in a return to growth. Concerns over renewed defence budgetary constraints have not manifested themselves yet.

Earnings revisions

The Chess performance effectively defers our growth expectations by a year. We drop our revenue expectations by 4% in FY22 and 2% in FY23. The impact on adjusted operating profit is a reduction of 18% and 9% respectively.

Exhibit 5: Cohort earnings estimates revisions

Year to April (£m)	2022e			2023e		
	Prior	New	*% change*	Prior	New	*% change*
Revenue						
MASS	41.9	42.3	*1.1%*	43.5	44.4	*2.1%*
SEA	30.8	31.3	*1.8%*	33.8	34.4	*1.8%*
MCL	19.4	20.7	*6.5%*	20.4	21.7	*6.5%*
EID	13.0	10.5	*(19.4)%*	13.6	11.0	*(19.4)%*
Chess	31.2	21.5	*(31.2)%*	32.8	26.9	*(18.1)%*
ELAC SONAR	19.9	23.2	*16.7%*	23.9	26.0	*8.9%*
Total Group	**156.1**	**149.4**	***(4.3)%***	**168.0**	**164.4**	*(2.1)%*
EBITDA	**22.0**	**18.5**	***(15.6)%***	**23.7**	**21.7**	*(8.1)%*
MASS	9.6	8.9	*(7.7)%*	10.0	9.8	*(2.3)%*
SEA	3.9	3.8	*(3.0)%*	4.3	4.1	*(3.0)%*
MCL	2.2	2.6	*15.6%*	2.3	2.7	*15.6%*
EID	1.2	0.4	*(64.2)%*	1.2	0.9	*(28.3)%*
Chess	3.7	1.0	*(74.2)%*	3.9	2.6	*(35.2)%*
ELAC SONAR	2.2	3.1	*41.1%*	2.6	3.1	*18.8%*
HQ Other and intersegment	(4.0)	(4.2)	*5.0%*	(4.0)	(4.5)	*12.5%*
Adjusted operating profit	**18.8**	**15.5**	***(17.7)%***	**20.4**	**18.7**	*(8.5)%*
Adjusted PBT	**18.0**	**14.6**	***(18.9)%***	**19.5**	**17.7**	*(9.3)%*
EPS - adjusted continuing (p)	**34.3**	**30.0**	***(12.6)%***	**37.4**	**34.5**	*(7.7)%*
DPS (p)	12.2	12.2	*0.0%*	13.4	13.4	*0.0%*
Adjusted net cash/(debt)	0.7	(0.5)	*N/M*	9.7	5.9	*(39.6)%*

Source: Edison Investment Research estimates

After buying out the Chess minority in H222 for an assumed £2.8m, we expect the company to remain in a strong financial position, with near neutrality for adjusted net debt (excluding leases) at the year end. It should also benefit EPS as the dilutive minority is removed on a higher level of anticipated profitability, so the EPS impact in FY23 is only 8% despite an increasing tax charge.

Valuation

Despite the robust financial performance the deferral of cash flow growth does have an impact on our capped DCF valuation which, using our current calculated WACC of 7.2%, returns a value of 630 per share compared to 656p in July.

Exhibit 6: Cohort capped DCF sensitivity analysis to WACC and terminal growth (p/share)

WACC	6.0%	6.5%	7.0%	7.2%	7.5%	8.0%	8.5%	9.0%	9.5%	10.0%
Terminal growth rate										
0%	780	710	651	**630**	600	555	515	480	449	421
1%	786	716	656	635	605	559	519	484	453	424
2%	793	722	662	640	610	564	524	488	456	428
3%	800	728	667	646	615	568	528	492	460	431

Source: Edison Investment Research estimates

Exhibit 7: Financial summary

£m	2020	2021	2022e	2023e
Year end 30 April	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	131.1	143.3	149.4	164.4
Cost of Sales	(80.0)	(90.0)	(93.8)	(103.2)
Gross Profit	51.0	53.4	55.6	61.2
EBITDA	20.9	22.1	18.5	21.9
Operating Profit (before amort. and except.)	18.2	18.6	15.5	18.7
Intangible Amortisation	(7.4)	(10.1)	(6.7)	(3.1)
Exceptionals	(0.1)	(0.7)	0.3	0.0
Other	0.0	0.0	0.0	0.0
Operating Profit	10.7	7.8	9.1	15.6
Net Interest	(0.8)	(0.8)	(0.9)	(1.0)
Profit Before Tax (norm)	17.5	17.9	14.6	17.7
Profit Before Tax (FRS 3)	10.0	7.1	8.1	14.6
Tax	(0.3)	(1.6)	(1.2)	(2.6)
Profit After Tax (norm)	15.2	13.8	12.5	14.3
Profit After Tax (FRS 3)	9.7	5.5	6.9	12.0
Average Number of Shares Outstanding (m)	40.7	40.8	41.0	41.2
EPS - fully diluted (p)	36.7	33.3	29.8	34.2
EPS - normalised (p)	37.1	33.6	30.0	34.5
EPS - (IFRS) (p)	23.5	13.4	16.3	28.9
Dividend per share (p)	10.1	11.1	12.2	13.4
Gross Margin (%)	38.9	37.2	37.2	37.2
EBITDA Margin (%)	15.9	15.4	12.4	13.3
Operating Margin (before GW and except.) (%)	13.9	13.0	10.4	11.4
BALANCE SHEET				
Fixed Assets	74.3	78.4	75.4	73.0
Intangible Assets	55.3	58.8	54.9	51.8
Tangible Assets	12.1	12.5	13.5	14.2
Right of Use assets	6.9	7.1	7.1	7.1
Investments	0.0	0.0	0.0	0.0
Current Assets	80.1	112.5	111.5	123.9
Stocks	11.5	12.9	14.2	15.3
Debtors	47.3	66.6	64.2	69.1
Cash	20.6	32.3	32.3	38.8
Other	0.7	0.8	0.8	0.8
Current Liabilities	(32.8)	(56.6)	(47.7)	(51.2)
Creditors	(32.8)	(56.6)	(47.7)	(51.2)
Short term borrowings	(0.1)	(0.1)	0.0	0.0
Long Term Liabilities	(39.8)	(49.2)	(52.2)	(52.3)
Long term borrowings	(25.2)	(29.8)	(32.8)	(32.9)
Lease liabilities	(7.5)	(7.6)	(7.6)	(7.6)
Other long term liabilities	(7.1)	(11.9)	(11.9)	(11.9)
Net Assets	81.8	85.1	86.9	93.5
CASH FLOW				
Operating Cash Flow	13.0	21.1	10.2	18.8
Net Interest	(0.8)	(0.8)	(0.9)	(1.0)
Tax	(0.6)	(4.1)	(2.0)	(3.4)
Capex	(2.7)	(1.2)	(2.7)	(2.9)
Acquisitions/disposals	(1.2)	(3.3)	(2.8)	0.0
Financing	(2.2)	(0.3)	0.0	0.0
Dividends	(3.9)	(4.2)	(4.7)	(5.1)
Other	0.0	0.0	0.0	0.0
Net Cash Flow	1.7	7.2	(3.0)	6.4
Opening net debt/(cash)	6.4	4.7	(2.5)	0.5
HP finance leases initiated	0.0	0.0	0.0	0.0
Other	(0.0)	(0.0)	0.0	0.0
Closing net debt/(cash) (excluding leases)	4.7	(2.5)	0.5	(5.9)
Total financial liabilities	12.2	5.1	8.1	1.7

Source: Company reports. Edison Investment Research estimates

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