EDISON

Cohort

Set to resume growth in FY23

FY22 closing trading update

Aerospace & defence

Cohort indicated in its closing FY22 trading update that it expects to deliver earnings in line with market expectations despite a c £10m shortfall in revenues. Part of the sales impact is due to a contract adjustment at Chess, but pandemic-related delays continued to affect other group companies. Order intake has remained strong and management expectations for FY23 are maintained, with order cover for FY23 sales of 69% (64% for FY21). With increasing global defence spending and a return to growth anticipated from this year, an FY23e P/E of 14.5x does not look demanding.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
04/20	131.1	17.5	37.1	10.1	13.6	2.0
04/21	143.3	17.9	33.6	11.1	15.0	2.2
04/22e	138.9	14.6	30.1	12.2	16.7	2.4
04/23e	164.2	17.8	34.7	13.4	14.5	2.7

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

FY22 challenges navigated

Management indicated that FY22 earnings should be in line with its H122 expectations, despite lower than anticipated H222 revenues. The improved margin performance reflects improvements at ELAC, MCL, MASS and SEA offsetting weakness at Chess and EID. Order intake remained strong at £183m and the year-end order book was a record of c £287m (FY21: £242.4m). Adjusted net funds (excluding leases) were also stronger than expected, ending the year at c £11m compared to an expectation of a neutral net debt position. Despite the additional burden of inflationary pressures to which it is responding, management is not changing its expectations for FY23 and expects a resumption of organic growth.

Defence environment improving outlook

Despite some supply chain issues arising from the pandemic, the operations of all the group businesses are returning to normal, although management is monitoring and responding to inflationary pressures. Customer engagement is enhanced by the lifting of travel restrictions and resumption of negotiations, and industry events both at home and overseas. The order backlog now extends beyond 2030 and provides enhanced visibility for the group's sales, especially for Chess, ELAC, MCL and SEA for FY23. Order cover for market revenue expectations starts FY23 at almost £113m (69%), which compares to £100m (64%) a year earlier. As well as some direct calls on defence assets, the conflict in Ukraine has highlighted the need for increased security spending, notably for NATO members and its allies.

Valuation: Improving defence backdrop

We have rolled forward our capped DCF valuation to a FY22 base and it returns a value of 678p (previously 630p), in part reflecting the better-than-expected FY22 cash performance. While FY22 has been challenging, a strong rebound in FY23 should leave the rating undemanding ahead of a return to sustainable growth in FY24, all accompanied by the progressive dividend.

27 May 2022

Price	**503p**
Market cap	**£207m**
Adjusted net cash (£m) at 31 April 2022 (excludes c £8m lease liabilities)	c 11
Shares in issue	41.2m
Free float	72%
Code	CHRT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(7.9)	(4.4)	(19.9)
Rel (local)	(9.4)	(4.6)	(23.0)
52-week high/low		630p	450p

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 preliminary results	July 2022

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Edison profile page

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Revisions to earnings estimates

Our earnings estimates are broadly unchanged for both FY22 and FY23, although the divisional mix is different as operations recover and benefit from improving market demand.

The main influence is a contract adjustment at Chess with revenue moving into FY23. In addition, continued supply chain issues and ongoing operational disruptions have reduced sales for several subsidiaries, notably MASS, although all are expected to show earning progress over FY21 except for Chess and EID in Portugal, where issues were apparent at the half-year stage.

Operations are generally returning to a more normal operating environment as travel restrictions are diminishing and client engagement is improving. It is therefore expected that areas which have seen delays should improve as FY23 progresses, for example Electronic Warfare Operational Support (EWOS) contracts and other export activity. There have already been encouraging orders in respect of overseas clients apparent during H222, for example SEA won a multi-million-pound contract to supply its Torpedo Launcher System (TLS) to Hyundai Heavy Industries (HHI) for two new corvettes for the Philippines Navy for delivery in 2023 and 2025.

While the Ukraine conflict is expected to provide a long-term uplift in global defence requirements, as seen by the restored commitments of future investment by NATO partners, the near-term impacts are a bit mixed. Chess and MCL should see improved demand for products arising from the increased security demands, particularly among NATO members and its allies but, as some customer resources are diverted by shifting short-term priorities, some services work is being necessarily deferred.

We expect the accommodation of both existing and new customer requirements to improve as the year progresses. FY23 should see a marked improvement, with sustainable growth from FY24.

Exhibit 1: Cohort earnings revisions

Year to April (£m)	2022e			2023E		
	Prior	New	*% change*	Prior	New	*% change*
Revenues						
MASS	42.3	38.8	*(8.4)%*	44.4	43.4	*(2.3)%*
SEA	31.3	30.2	*(3.6)%*	34.4	33.8	*(1.8)%*
MCL	20.7	21.2	*2.6%*	21.7	23.6	*8.5%*
EID	10.5	8.4	*(20.0)%*	11.0	10.1	*(8.6)%*
Chess	21.5	18.0	*(16.0)%*	26.9	26.5	*(1.2)%*
ELAC SONAR	23.2	22.4	*(3.6)%*	26.0	26.9	*3.3%*
Intra group sales	(0.1)	(0.1)		0.0	0.0	
Total Group	**149.4**	**138.9**	***(7.0)%***	**164.4**	**164.2**	***(0.1)%***
EBITDA	**18.5**	**18.3**	***(1.0)%***	**21.9**	**21.9**	***0.1%***
MASS	8.9	8.9	*0.3%*	9.8	9.6	*(2.3)%*
SEA	3.8	3.8	*0.4%*	4.1	4.2	*2.3%*
MCL	2.6	2.8	*6.7%*	2.7	2.9	*8.5%*
EID	0.4	0.3	*(20.0)%*	0.9	0.6	*(31.4)%*
Chess	1.0	0.9	*(6.7)%*	2.6	2.7	*4.0%*
ELAC SONAR	3.1	3.0	*(3.6)%*	3.1	3.2	*3.3%*
HQ Other and intersegment	(4.2)	(4.2)	*0.0%*	(4.5)	(4.5)	*0.0%*
Adjusted operating profit	**15.5**	**15.5**	***(0.3)%***	**18.7**	**18.7**	***0.1%***
Adjusted PBT	**14.6**	**14.6**	***0.1%***	**17.7**	**17.8**	***0.4%***
EPS - adjusted continuing (p)	**30.0**	**30.1**	***0.2%***	**34.5**	**34.7**	***0.6%***
DPS (p)	12.2	12.2	*0.0%*	13.4	13.4	*0.0%*
Adjusted net cash/(debt)	(0.5)	10.6	*N/M*	5.9	5.1	*(14.4)%*

Source: Edison Investment Research

Valuation

We have rolled forward our capped DCF valuation forward to a FY22 base, and the returned value increases to 678p from 630p in December. Around half of the uplift is due to the better-than-expected FY22 cash performance, with the balance relating to the characteristics of the methodology as a company grows cash flows. The sensitivity of the DCF value per share to the WACC and terminal growth rate is shown in Exhibit 2 below.

Exhibit 2: 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 value growth rate										
0%	834	760	697	**678**	642	595	553	515	482	452
1%	841	766	703	683	647	599	557	519	486	456
2%	848	773	708	689	652	604	561	523	489	459
3%	855	779	714	694	658	609	565	527	493	462

Source: Edison Investment Research estimates

Exhibit 3: Financial summary

£m	2020	2021	2022e	2023e
Year end 30 April	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	131.1	143.3	138.9	164.2
Cost of Sales	(80.0)	(90.0)	(87.2)	(103.1)
Gross Profit	51.0	53.4	51.7	61.1
EBITDA	20.9	22.1	18.3	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	9.0	15.6
Net Interest	(0.8)	(0.8)	(0.9)	(0.9)
Profit Before Tax (norm)	17.5	17.9	14.6	17.8
Profit Before Tax (FRS 3)	10.0	7.1	8.2	14.7
Tax	(0.3)	(1.6)	(1.2)	(2.6)
Profit After Tax (norm)	15.2	13.8	12.5	14.4
Profit After Tax (FRS 3)	9.7	5.5	6.9	12.1
Average Number of Shares Outstanding (m)	40.7	40.8	41.1	41.2
EPS - fully diluted (p)	36.7	33.3	29.8	34.4
EPS - normalised (p)	37.1	33.6	30.1	34.7
EPS - (IFRS) (p)	23.5	13.4	16.4	29.1
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	13.2	13.3
Operating Margin (before GW and except.) (%)	13.9	13.0	11.1	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	13.4	14.1
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	110.0	125.5
Stocks	11.5	12.9	12.8	15.6
Debtors	47.3	66.0	55.6	70.6
Cash	20.6	32.3	40.3	37.8
Other	0.7	1.4	1.4	1.5
Current Liabilities	(32.8)	(56.6)	(49.3)	(52.8)
Creditors	(32.8)	(56.6)	(49.3)	(52.8)
Short term borrowings	(0.1)	(0.1)	0.0	0.0
Long Term Liabilities	(39.8)	(49.2)	(49.1)	(52.2)
Long term borrowings	(25.2)	(29.8)	(29.7)	(32.7)
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	21.0	6.8
Net Interest	(0.8)	(0.8)	(0.9)	(0.9)
Tax	(0.6)	(4.1)	(2.0)	(3.4)
Capex	(2.7)	(1.2)	(2.5)	(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)	(5.2)
Other	0.0	0.0	0.0	0.0
Net Cash Flow	1.7	7.2	8.1	(5.6)
Opening net debt/(cash)	6.4	4.7	(2.5)	(10.6)
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)	(10.6)	(5.1)
Total financial liabilities	12.2	5.1	(3.0)	2.5

Source: Company reports, Edison Investment Research estimates

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