

Cohort

FY18 results

Marching on

Cohort has delivered better than-expected operating profit growth in FY18 as it continues to address the changing dynamics of its end markets. The company believes that the decline in the order book represents delays rather than a reduction in demand and, if this is the case, 2018/19 presents exciting business prospects. Cohort continues to invest and address new business areas while further acquisition presents an opportunity.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
04/17	112.7	14.5	26.6	7.1	13.7	1.9
04/18	111.8	15.5	29.4	8.2	12.4	2.2
04/19e	118.4	16.0	31.2	9.2	11.7	2.5
04/20e	124.8	17.0	33.2	10.1	11.0	2.8

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

FY18 demonstrated performance improvement

FY18 reported a closing order book of £102.5m, down from the H118 report of £132.1m and FY17 £136.5m. The company cited delays for the lower order intake in the year. However, FY19 has a larger than normal concentration of opportunities, as expected orders have been delayed. Reported FY18 revenues were £111.8m (FY17: £112.7m), with all divisions reporting growth except for SEA, which is to undergo cost restructuring in FY19. Encouragingly, reported adjusted operating profit was £15.6m (FY17: £14.5m) up 8% with reported adjusted EPS (excluding one-off tax credits) up 10% at 29.4p (FY17: 26.6p). FY18 DPS was 8.2p (FY17: 7.1p), a 15.5% increase in line with the group's progressive dividend policy. Net cash of £11.3m (FY17 £8.5m) was up from £5.7m at the half year, where a net cash flow had been expected on higher operating profit contribution.

Growth beyond within and across borders

While a UK defence review is in process, the overall pace of contracting at the MOD has yet to show any major signs of improvement. However, Cohort has been able to identify and serve new business areas. At the moment this is reflected in shorter-term contracts; however, the company is excited by the opportunities that 2018/19 presents both in the UK and export markets. Indeed, there appears to be a growing consensus that an increase in UK defence spending may be warranted, not just by the shortages in frontline and administrative personnel, but also because of varying and often resurgent threats. Cohort remains comparatively robust with the financial fire power to invest in its own businesses and pursue acquisitions.

Valuation: Premium to peers deserved

The average of our DCF and peer group SOP valuation approaches generates a fair value of 549p, an increase on our prior fair value of 508p. This fair value gives a 2019e P/E of 16.5x. Although Cohort is developing in line with expectations, it continues to trade on a FY19e P/E discount to its UK defence peers. In our view, such a discount to its peers is not warranted.

Aerospace & defence

3 July 2018

Price **365p**
Market cap **£149m**

Net cash (£m) at 30 April 2018 11.3

Shares in issue 40.7m

Free float 70%

Code CHRT

Primary exchange AIM

Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	4.3	3.6	(15.1)
Rel (local)	6.4	(3.0)	(17.7)

52-week high/low 430.0p 285.0p

Business description

Cohort is an AIM-listed defence and security company operating across four divisions: MASS (34% of FY18 sales); SEA (34%); MCL (16%); and the 80%-owned Portuguese business EID (17%).

Next events

AGM July 2018

Analysts

Andy Chambers +44 (0)20 3681 2525

Annabel Hewson +44 (0)20 3077 5700

industrials@edisongroup.com
[Edison profile page](#)

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FY18 results

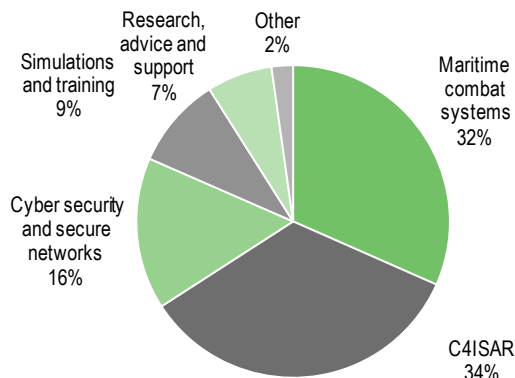
The salient features of the interim results are as follows:

- Reported closing order book of £102.5m was down from the H118 report of £132.1m and FY17 £136.5m. The company cited delays for the lower order intake in the year. However, FY19 has a larger than normal concentration of opportunities, as the contracts expected in FY18 are pushed out into FY19.
- Reported revenues were £111.8m (FY17: £112.7m).
- Reported adjusted operating profit was £15.6m (FY17: £14.5m).
- Reported adjusted EPS was 30.00p (FY17: 27.93p) including one-off tax credits.
- Reported DPS was 8.2p (FY17: 7.1p), a 15.5% increase in line with the group's progressive dividend policy.
- Net cash of £11.3m (FY17 £8.5m) was up from £5.7m at the half year, where a net cash flow had been expected on higher operating profit contribution. Within the year the company paid £2.5m as the final payment on MCL and £3.5m on the 23% EID acquisition.

Exhibit 1: H1 and FY divisional analysis							
April year end (£m)	H117	H217	FY17	H118	H218	FY18	FY % change
Order intake							
MASS			32			29.1	(9.1)%
SCS*			3				
SEA			31.4			27	(14.0)%
MCL			23.3			12.1	(48.1)%
EID			18.9			8.4	(55.6)%
Total order intake			108.6			76.6	-29.5%
Order book							
MASS			49.4	42.6		40.9	(17.2)%
SCS*							
SEA			44	41.4		33.1	(24.8)%
MCL			15.5	18.4		10.3	(33.5)%
EID			27.6	29.7		18.2	(34.1)%
Total order book			136.5	132.1		102.5	(24.9)%
Revenue							
MASS	14.5	18	32.5	17.2	20.3	37.5	15.4%
SCS*	5	0	5		0		
SEA	18	26.4	44.4	15.7	22.1	37.8	(14.9)%
MCL	7.9	6.9	14.8	5.1	12.3	17.4	17.6%
EID	4.6	11.4	16	6.8	12.3	19.1	19.4%
Total revenue	50	62.7	112.7	44.8	67	111.8	-0.8%
Adjusted operating profit							
MASS	2.4	3.5	5.9	2.549	4.551	7.1	20.2%
SCS*	-0.5	0.0	-0.5				
SEA	1.0	4.3	5.3	1.0	3.4	4.4	-16.9%
MCL	0.8	1.3	2.1	0.2	1.9	2.1	2.3%
EID	1.4	2.8	4.2	1.2	3.5	4.7	11.0%
HQ & Other	(1.3)	(1.2)	(2.5)	(1.3)	(1.4)	(2.7)	5.8%
Total adjusted operating profit	3.9	2.8	14.5	3.6	7.4	15.6	7.7%
Operating profit	(3.2)	4.2	1.0	0.8	9.2	10.0	
Finance costs	0.0	0.0	0.0	0.0	(0.1)	(0.1)	
Profit before tax	(3.2)	4.2	1.0	0.8	9.1	9.9	
Tax expense	0.6	0.6	1.1	(0.1)	(1.3)	(1.4)	
Net income	(2.7)	4.8	2.1	0.6	7.8	8.5	
EPS (p) reported	6.0	3.1	9.1	6.3	13.6	19.9	118.6%
DPS (p)	2.2	4.9	7.1	2.55	5.65	8.2	15.5%
Net cash	8.5		8.5	5.7		11.3	32.9%

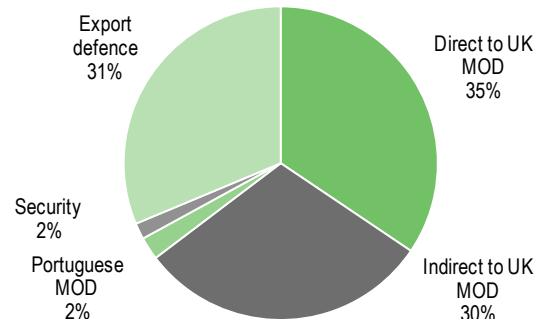
Source: Company reports. Note: *SCS business was restructured into MASS and SEA in December 2016.

Exhibit 2: FY18 defence and security revenue by market segment



Source: Company reports

Exhibit 3: FY18 defence and security revenue by end customer



Source: Company reports

MASS (FY18 sales: £37.5m; 34% of group sales) returned to growth. A key input was the completion of the biennial joint forces exercise, driving topline and margin. The division started deliveries to the Metropolitan Police Service for the Digital Forensics Programme, secured at the end of FY17. Lower electronic warfare operational support activity was countered by higher training support (ex SCS) and cyber volumes to increase the division operating margin.

SEA (FY18 sales: £37.8m; 34% of group sales) delivered a lower top-line result, as seen in the H118 report. The higher adjusted operating margin, up from 11.1% in FY16 reflects the higher export content and a trend towards more product sales. There is a natural lull between the completed design work on the Astute Class and the increased activity on Dreadnought Class, expected to last 18-24 months. To put this in context, the submarine revenue contribution was £21.1m in FY16 and just £7.3m in FY18. While the company is taking costs out of this area, it should be noted how successful the division has been to counter this decline with other business areas, including increased export sales of torpedo launch systems. In addition, the submarine communications programme has been considerably derisked and has allowed some contingency to be released. This division is also balancing the longer term contracts and the predictability that brings, with shorter term contracts within its simulation, support and product activity. While the ROADflow product range has seen growth, it experienced tough comparisons in H218 given the prior year peak. Given the reduced research and submarine activity, the business will face restructuring during FY19 at an anticipated cost of £0.5m, targeting annual savings of £1.0m per year.

EID (FY18 £19.1m; 17% of group sales) performance exceeded group expectations, with a higher naval contribution at 60% of the division, up from 30% last year. This is expected to move back in FY19 with lower naval support work and higher intercom and radio products. The company notes that the higher bought in element will bring the division's expected operating margin levels close to 20%. Within the year, Cohort acquired an additional 23% of EID, taking the total holding to 80% as expected, enhancing future EPS.

MCL (FY18 sales £17.4m; 17% of group sales) delivered a flat performance, with increased volume and margin offset by slightly higher overheads. The company won a further £6m contract for hearing protection systems, building on the success of the business to date. Overall, MCL is moving to shorter-term order book visibility, of around three to six months on average.

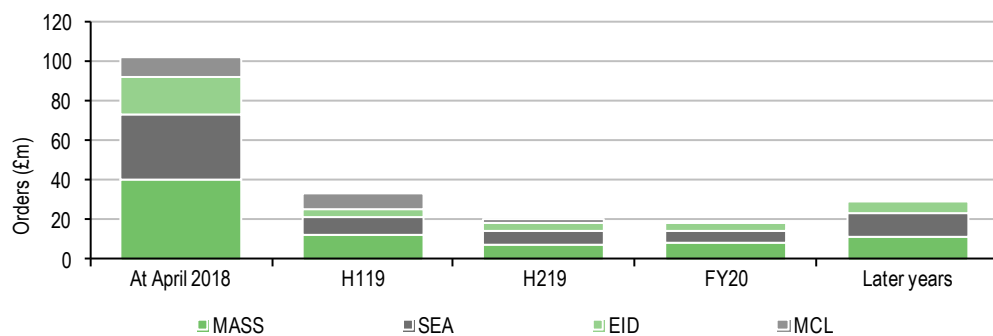
Outlook

The current review and tightening of spending at the UK MOD is likely to have an ongoing impact on FY19 and beyond. However Cohort continues to broaden its exposure to different programmes

and project areas. While the current order book stands at a lower level year-on-year, the company stresses this is due to contract delays rather than lack of demand. Outside the UK, Portugal is seeing a relatively robust level of spending with upgrades to maritime and land communication systems, from which EID should benefit. In addition, the company is well placed to leverage the growing requirement for defence and counter terrorism capability around the globe.

While FY18 order progression reflected delays, Cohort’s order book progression shows additional strength overall. Exhibit 4 gives a picture of the visibility of the order book across the divisions. Part of the strategy has been to stabilise and build visibility. Cohort’s delivery schedule does stretch out to 2025; however, order cover is typically in the range of 55-65% at the start of any given year. Cohort can also operate with an increasing level of shorter-term contracts, which can be supportive at the operating margin level but may not be visible in order book charts.

Exhibit 4: Delivery of the group’s order book into revenue



Source: Company reports

The company expects net cash to remain flat on FY18, as working capital is expected to rise to support contract work. However, beyond that the company expects cash contribution in FY20 to be strong, as the working capital unwinds. The group continues to be agile and will consider further suitable acquisitions.

Valuation

We continue to derive a fair value for Cohort from the simple average of a capped DCF and a peer-based group SOP. Our DCF approach generates a value of 550p (previous 529p) while our peer group SOP generates a value of 548p (previous 460p). This gives an average of 549p, an increase on our prior fair value of 508p. This reflects the uplift from moving our DCF on by one year but also, more significantly, the improvement in value of the peer group. This fair value gives a 2019e P/E of 16.5x. Although Cohort continues to develop in line with expectations, it continues to trade on a FY19e P/E discount to its UK defence peers. In our view, such a large discount is not warranted.

Exhibit 5: Peer group valuation sheet

		Fiscal year end	Market Cap	Share Price	FX	FY1 PE	FY2 PE	FY1 EV/EBI TDA	FY2 EV/EBI TDA	FY1 EV/Sales	FY2 EV/Sales	FY1 Div Yield	FY2 Div Yield
COHORT PLC	CHRT LN	04/2018	149.5	365.0	GB P	11.7X	11.2X	8.6X	8.1X	1.21X	1.22X	2.5%	2.7%
BAE SYSTEMS PLC	BA/ LN	12/2017	20,437.1	640	GB P	14.7X	13.6X	9.6X	9.1X	1.15X	1.11X	3.5%	3.6%
CHEMRING GROUP	CHG LN	10/2017	636.7	227.5	GB P	17.8X	16.1X	9.0X	8.5X	1.43X	1.45X	1.4%	1.6%
COBHAM PLC	COB LN	12/2017	3,067.7	128.3	GB P	27.3X	19.4X	12.3X	11.2X	1.83X	1.80X	0.5%	1.7%
MEGGITT PLC	MGMT LN	12/2017	4,070.3	524.2	GB P	16.3X	15.2X	11.3X	10.5X	2.56X	2.44X	3.1%	3.3%
QINETIQ GROUP PLC	QQ/ LN	03/2018	1,535.5	270.4	GB P	15.8X	15.5X	8.6X	8.2X	1.51X	1.48X	2.4%	2.6%
ROLLS-ROYCE	RR/ LN	12/2017	18,228.4	975	GB P	65.4X	35.6X	13.9X	10.7X	1.25X	1.20X	1.3%	1.5%
ULTRA ELECTRONICS	ULE LN	12/2017	1,195.7	1611.000	GB P	14.7X	13.2X	10.1X	9.4X	1.70X	1.59X	3.1%	3.2%
Uk Average						24.6X	18.4X	10.7X	9.6X	1.6X	1.6X	2.2%	2.5%
AIRBUS SE	AIR FP	12/2017	75,810.6	97.7	EU R	21.8X	17.6X	8.6X	7.3X	1.02X	0.92X	1.8%	2.1%
FACC AG	FACC AV	02/2018	751.9	16.4	EU R	19.0X	15.4X	9.7X	8.4X	1.17X	1.06X	1.5%	2.1%
LATECOERE	LAT FP	12/2017	429.7	4.5	EU R	27.5X	14.7X	10.6X	6.7X	0.63X	0.61X	0.0%	0.7%
LEONARDO SPA	LDO IM	12/2017	4,838.0	8.4	EU R	10.7X	8.5X	5.4X	5.0X	0.73X	0.70X	1.7%	1.9%
MTU AERO ENGINES AG	MTX GR	12/2017	8,382.4	161.2	EU R	19.9X	18.5X	12.1X	11.4X	2.31X	2.00X	1.7%	1.9%
RHEINMETALL AG	RHM GR	12/2017	4,029.2	92.5	EU R	14.6X	12.6X	5.9X	5.3X	0.65X	0.60X	2.1%	2.4%
SAAB AB-B	SAAB SS	12/2017	40,047.3	366.9	SE K	21.4X	17.2X	12.2X	10.1X	1.27X	1.17X	1.7%	1.9%
SAFRAN SA	SAF FP	12/2017	45,388.5	102.3	EU R	22.8X	19.0X	12.3X	10.6X	2.18X	1.99X	1.7%	2.1%
THALES SA	HO FP	12/2017	23,196.7	109.0	EU R	20.7X	17.3X	9.8X	8.6X	1.29X	1.13X	1.8%	2.2%
						19.8X	15.6X	9.6X	8.2X	1.3X	1.1X	1.6%	1.9%

Source: Bloomberg. Note: Priced at close 2 July 2018

Financials

While revenues were below expectations, margins have continued to deliver the operating performance expected. SEA is likely to improve profitability in the current year, with the £0.5m charge for restructuring being taken as an exceptional cost, with MASS and MCL continuing to grow and EID performing well despite some margin reduction. Overall our EBIT expectation is essentially unchanged.

In FY19 the company expects to invest in working capital in the current year. As a result, our pre-tax profit declines by 0.3% and with a slightly higher weighted average number of shares than we had anticipated our EPS stays flat against our previous forecast. It should be noted that the one-off tax credits (FY18 0.6p) in each of the last three years are not expected to continue.

We introduce our FY20 estimates, which show accelerating earnings performance and a significantly improved cash flow following the FY19 investment.

Exhibit 6: Revisions							
Year to April (£m)	2018e	2018		2019e	2019e		2020e
	Prior	Actual	% change	Prior	New	% change	New
Revenues							
MASS	39.0	37.6	-3.8%	41.4	39.8	-3.8%	42.2
SEA	43.0	37.8	-12.0%	46.4	38.2	-17.7%	40.1
MCL	17.4	17.4	-0.2%	19.7	19.7	-0.2%	20.9
EID	19.5	19.1	-2.4%	20.7	20.8	0.4%	21.6
Total Group	119.0	111.8	-6.0%	128.2	118.4	-7.6%	124.8
EBITDA							
	16.6	16.7	0.4%	17.4	17.2	-1.0%	18.3
EBIT (Pre PPA amortisation)							
MASS	7.0	7.1	1.2%	7.4	7.6	2.1%	8.0
SEA	5.2	4.4	-14.0%	5.4	4.6	-15.6%	4.8
MCL	2.1	2.1	-0.9%	2.4	2.4	0.6%	2.5
EID	3.9	4.7	19.6%	3.7	4.4	17.1%	4.5
HQ Other and intersegment	-2.8	-2.7	-3.6%	-2.9	-2.8	-3.5%	-2.8
EBIT (Pre PPA amortisation)	15.4	15.6	1.4%	16.0	16.1	0.4%	17.1
Underlying PTP							
	15.4	15.5	0.8%	16.1	16.0	-0.3%	17.0
EPS - underlying continuing (p)*							
	29.1	30.0	3.0%	31.2	31.2	0.0%	33.2
DPS (p)	8.2	8.2	0.0%	9.0	9.2	2.2%	10.1
Net cash / (debt)	9.7	11.3	16.9%	17.3	11.9	-30.1%	24.7

Source: Company reports, Edison Investment Research estimates. Note: *EPS includes one-off tax credit in FY18.

Exhibit 7: Financial summary

	£m	2016	2017	2018	2019e	2020e
Year end 30 April		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		112.6	112.7	111.8	118.4	124.8
Cost of Sales		(79.1)	(73.7)	(72.4)	(76.7)	(80.8)
Gross Profit		33.5	39.0	39.4	41.7	44.0
EBITDA		13.0	15.7	16.7	17.3	18.3
Operating Profit (before amort. and except).		11.9	14.5	15.6	16.1	17.1
Intangible Amortisation		(6.4)	(11.3)	(5.3)	(4.7)	(0.3)
Exceptionals		(0.3)	(2.3)	(0.3)	(0.5)	0.0
Other		0.0	0.0	0.0	0.0	0.0
Operating Profit		5.2	1.0	10.0	11.0	16.8
Net Interest		0.1	0.0	(0.1)	(0.1)	(0.1)
Profit Before Tax (norm)		12.0	14.5	15.5	16.0	17.0
Profit Before Tax (FRS 3)		5.3	1.0	9.9	10.9	16.7
Tax		0.1	1.1	(1.4)	(1.9)	(2.7)
Profit After Tax (norm)		11.2	12.8	13.1	13.5	14.3
Profit After Tax (FRS 3)		5.4	2.1	8.5	9.0	14.0
Average Number of Shares Outstanding (m)		40.6	40.4	40.7	40.7	40.7
EPS - fully diluted (p)		26.7	31.0	29.7	30.9	32.9
EPS - normalised (p)		27.2	31.5	30.0	31.2	33.2
EPS - (IFRS) (p)		12.7	9.1	18.6	20.3	32.6
Dividend per share (p)		6.0	7.1	8.2	9.2	10.1
Gross Margin (%)		29.8	34.6	35.2	35.2	35.2
EBITDA Margin (%)		11.5	13.9	15.0	14.6	14.7
Operating Margin (before GW and except.) (%)		10.6	12.9	14.0	13.6	13.7
BALANCE SHEET						
Fixed Assets		59.7	60.6	54.9	49.9	49.2
Intangible Assets		49.5	50.6	45.3	40.7	40.4
Tangible Assets		10.2	9.9	9.6	9.2	8.8
Investments		0.0	0.0	0.0	0.0	0.0
Current Assets		54.0	56.3	60.7	80.1	89.9
Stocks		2.0	5.3	6.4	8.9	8.4
Debtors		27.3	37.8	32.9	40.9	41.2
Cash		23.1	12.0	20.5	29.5	39.5
Other		1.6	1.2	0.8	0.8	0.9
Current Liabilities		(40.1)	(39.7)	(38.1)	(29.3)	(31.1)
Creditors		(36.8)	(36.1)	(28.9)	(29.3)	(31.1)
Short term borrowings		(3.3)	(3.5)	(9.2)	0.0	0.0
Long Term Liabilities		(2.7)	(3.2)	(1.9)	(19.2)	(16.6)
Long term borrowings		(0.0)	(0.0)	0.0	(17.4)	(14.8)
Other long term liabilities		(2.7)	(3.2)	(1.9)	(1.9)	(1.9)
Net Assets		70.8	74.0	75.6	81.4	91.3
CASH FLOW						
Operating Cash Flow		8.5	2.4	15.7	7.7	20.1
Net Interest		0.1	0.0	(0.1)	(0.1)	(0.1)
Tax		(1.8)	(1.7)	(2.4)	(2.6)	(2.7)
Capex		(1.0)	(0.9)	(0.7)	(0.8)	(0.8)
Acquisitions/disposals		(0.7)	(9.1)	0.0	0.0	0.0
Financing		(3.2)	0.5	(6.8)	0.0	0.0
Dividends		(2.2)	(2.5)	(3.0)	(3.5)	(3.9)
Net Cash Flow		(0.3)	(11.4)	2.6	0.8	12.6
Opening net debt/(cash)		(19.7)	(19.8)	(8.5)	(11.3)	(12.1)
HP finance leases initiated		0.0	0.0	0.0	0.0	1.0
Other		0.5	0.0	0.2	(0.0)	0.0
Closing net debt/(cash)		(19.8)	(8.5)	(11.3)	(12.1)	(25.7)

Source: Company reports, Edison Investment Research estimates. Note: *FY16, FY17, FY18 EPS include one-off tax credits

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