Citadel Group (CGL)

Rating: Buy | Risk: Medium | Price Target: $6.50

FY17 A Solid "Beat" with Several Opportunities in the Pipeline for FY18. Retain BUY

Key Information

Current Price ($ps)	5.50
12m Target Price ($ps)	6.50
52 Week Range ($ps)	4.23 - 5.56
Target Price Upside (%)	18.2%
TSR (%)	20.7%
Reporting Currency	AUD
Market Cap ($m)	257.0
Sector	Information Technology
Avg Daily Volume (m)	0.0
ASX 200 Weight (%)	0.02%

Fundamentals

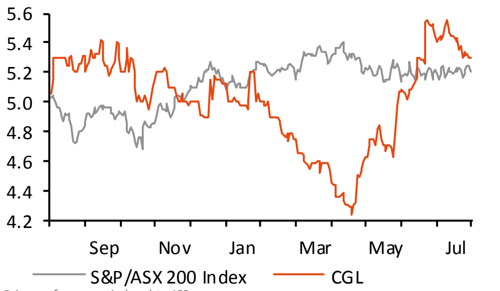
YE 30 Jun (AUD)	FY17A	FY18E	FY19E	FY20E
Sales ($m)	98.8	113.7	129.6	147.7
NPAT ($m)	15.4	17.4	18.3	19.6
EPS (cps)	32.0	36.0	38.0	40.6
EPS Growth (%)	82.2%	12.8%	5.3%	7.0%
DPS (cps) (AUD)	12.8	14.0	16.0	17.0
Franking (%)	100%	100%	100%	100%

Ratios

YE 30 Jun	FY17A	FY18E	FY19E	FY20E
P/E (x)	15.9	15.3	14.5	13.5
EV/EBITDA (x)	7.5	7.5	7.2	6.7
Div Yield (%)	2.5%	2.5%	2.9%	3.1%
Payout Ratio (%)	40.1%	38.9%	42.2%	41.9%

Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	1.5%	7.1%	19.3%	(7.5%)
Absolute (%)	1.9%	8.5%	19.6%	(3.5%)
Benchmark (%)	0.4%	1.4%	0.3%	4.0%



Price performance indexed to 100 Source: FactSet

Major Shareholders

Miles Jakeman	17.8%
Mark McConnell	14.2%
New Territories Fund Trust	9.2%
Copia Investment Partners Ltd.	7.3%
Pja Australia Pty Ltd.	6.4%

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Event

CGL reported FY17 NPAT of $15.4m (1H $6.7m, 2H $8.7m) which was an impressive +81% above pcp, and 9% above Shaw's $14.1m forecast. We have slightly upgraded our FY18 and FY19 NPAT by 7% and 8% based on a lower effective tax rate from 30% to 28%. This has increased our price target from $6.00 to $6.50.

Highlights

ASX: CGL	FY17	FY15	Change	Shaw	Difference	Consensus	Difference
Revenue ($m)	98.8	77.3	28%	97.7	1%	97.8	1%
EBITDA ($m)	30.1	20.4	48%	29.0	4%	28.4	6%
EBITDA margin	*30.5%*	*26.4%*	*407bp*	*29.7%*	*74bp*	*29.0%*	*143bp*
Reported NPAT ($m)	8.9	6.5	37%	14.1	-37%	137.7	-94%
NPAT ($m)	15.4	8.5	81%	14.1	9%	14.0	10%
Adjusted EPS (cents)	24.0	16.9	42%	29.7	-19%	29.0	-17%
Total DPS (cents)	12.8	9.6	33%	10.8	19%	11.0	16%

Adjusted NPAT excl. material one-off items

- **Group revenue for the year increased 28% to $98.8m (1H $44.1m, 2H $54.7m)** which was a touch above Shaw's estimate (stripping out the Education contribution).
- **Significant positive was margin growth, well above our expectations, with both GM (from 39.5% to 46.7% vs. Shaw's 44.1%) and EBITDA (from 26.4% to 30.1% vs. Shaw's 29.7%)** – the growth was derived from a combination of organic growth strategies, Citadel Health in particular (PJAS), the Federal Agency system integration contract, and positive Monash and Kapish contributions. This continues CGL's significant margin expansion from FY15 to FY16 widening from 14% to 25% (vs. ~25% LT).
- **A big turnaround in operating cashflow was a highlight, +122% from $11.2m to $24.9m, equating to a solid cash conversion of 83%,** turning around the poor 1H17 result (which plummeted from $8.9m to just $0.5m in the half due to various factors like a rise in tax paid, ramp up in working cap commitments for Monash and Federal Agency contracts, late payments for work executed and payments for PJAS and Kapish acquisition were also made).
- **All key contracts for Technology locked in for 2018, with no renewals until FY19** – at which point there are 3 contracts coming up for renewal. Further to this, the average length of managed services contracts now ~4 years in duration, which provides some transparency to earnings in the short to medium term.
- **Exit from Education yielded a $2.8m loss** – CGL announced last year the exit owing to: (1) continuing adverse media about the vocational education sector (translating into lower student numbers), (2) the conduct of certain providers, (3) additional compliance costs, and (4) changing regulatory environment.
- **Balance Sheet remains solid post PJAS / Kapish / filosophy-e acquisitions** – cash at $30m with debt of only $9m, post PJAS 2nd tranche payment.
- **Final DPS of 8.0cps** – taking FY DPS to 12.8cps, equating to 40% payout ratio.
- **Outlook continues to be positive** – CGL will continue to pursue organic and acquisitive opportunities as part of its growth strategy, primarily in Technology and Health, and the pipeline remains robust with opportunities. The recent acquisitions of PJAS and Kapish have also pushed the company into the very attractive Health and Hewlett Packard Enterprise (HPE) Content Management markets respectively.

Recommendation

Retain BUY (TSR of 21%). The 15x PE is compelling. How many companies can you buy on ~15x (below ASX200 market multiple) that will, in our forecasts, comfortably deliver double-digit earnings growth for each of the next 3 years, improving ROE to >20%, have net cash on the balance sheet, is free cashflow positive despite two acquisitions, with strong EBITDA margins of ~30% and strong management and Board? Downside is the lack of liquidity and lack of clarity around both contracts and reporting (latter being addressed).

Citadel Group
Information Technology

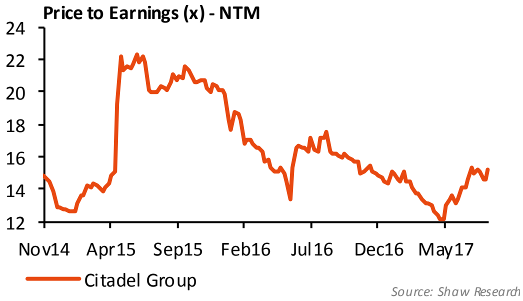
FactSet: CGL-AU / Bloomberg: CGL AU

Key Items	Data
Recommendation	BUY
Risk	MEDIUM
Price ($ps)	5.50
Target Price ($ps)	6.50
52 Week Range ($ps)	4.23 - 5.56
Shares on Issue (m)	46.7
Market Cap ($m)	257.0
Enterprise Value ($m)	249.9
TSR (%)	20.7%

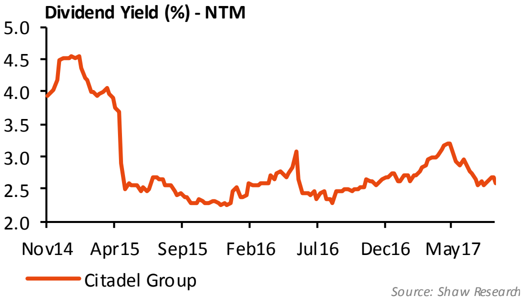
Valuation NPV	Data
Beta	1.10
Cost of Equity (%)	11.9%
Cost of Debt (net) (%)	6.0%
Risk Free Rate (%)	5.3%
Terminal Growth (%)	3.0%
WACC (%)	11.0%

Company Description

Citadel Group engages in development and delivery of technology solutions to state and federal government departments and the private sector. The company was founded on September 6, 2007 and is headquartered in Canberra, Australia.



Source: Shaw Research



Source: Shaw Research

Financial Year End: 30 June

Investment Summary (AUD)	FY16A	FY17A	FY18E	FY19E	FY20E
EPS (Reported) (cps)	**18.3**	**26.2**	**36.0**	**38.0**	**40.6**
EPS (Underlying) (cps)	**17.5**	**32.0**	**36.0**	**38.0**	**40.6**
EPS (Underlying) Growth (%)	26.4%	82.2%	12.8%	5.3%	7.0%
PE (Underlying) (x)	**30.8**	**15.9**	**15.3**	**14.5**	**13.5**
EV / EBIT (x)	**14.4**	**9.2**	**9.2**	**8.9**	**8.1**
EV / EBITDA (x)	**11.2**	**7.5**	**7.5**	**7.2**	**6.7**
DPS (cps) (AUD)	9.6	12.8	14.0	16.0	17.0
Dividend Yield (%)	1.8%	2.5%	2.5%	2.9%	3.1%
Franking (%)	100%	100%	100%	100%	100%
Payout Ratio (%)	54.7%	40.1%	38.9%	42.2%	41.9%
Free Cash Flow Yield (%)	3.4%	7.3%	4.0%	5.0%	8.8%

Profit and Loss (AUD) (m)	FY16A	FY17A	FY18E	FY19E	FY20E
Sales	77.3	98.8	113.7	129.6	147.7
Sales Growth (%)	*6.8%*	*27.9%*	*15.0%*	*14.0%*	*14.0%*
Other Operating Income	0.0	0.0	0.0	0.0	0.0
EBITDA	**20.4**	**30.1**	**33.4**	**35.0**	**36.9**
EBITDA Margin (%)	*26.4%*	*30.4%*	*29.4%*	*27.0%*	*25.0%*
Depreciation & Amortisation	(4.6)	(5.7)	(6.2)	(6.4)	(6.5)
EBIT	**15.8**	**24.3**	**27.2**	**28.6**	**30.4**
EBIT Margin (%)	*20.5%*	*24.6%*	*24.0%*	*22.1%*	*20.6%*
Net Interest	(3.6)	(3.0)	(3.1)	(1.5)	(1.6)
Pretax Profit	12.2	21.3	24.2	27.1	28.8
Tax	(3.8)	(5.9)	(6.8)	(7.1)	(7.6)
Tax Rate (%)	*(30.7%)*	*(27.7%)*	*(28.0%)*	*(26.3%)*	*(26.5%)*
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	**8.5**	**15.4**	**17.4**	**18.3**	**19.6**
Significant Items	0.4	(2.8)	0.0	0.0	0.0
NPAT Reported	**8.8**	**12.7**	**17.4**	**18.3**	**19.6**

Cashflow (AUD) (m)	FY16A	FY17A	FY18E	FY19E	FY20E
EBIT	15.8	24.3	27.2	28.6	30.4
Tax Paid	(2.8)	(5.4)	(6.8)	(7.1)	(7.6)
Net Interest	(3.6)	(3.0)	(3.1)	(1.5)	(1.6)
Change in Working Capital	0.0	0.0	0.0	0.0	0.0
Depreciation & Amortisation	4.6	5.7	6.2	6.4	6.5
Other	(3.6)	(1.7)	(10.7)	(10.7)	(1.6)
Operating Cashflow	**10.4**	**19.9**	**12.9**	**15.7**	**26.1**
Capex	(1.6)	(1.9)	(2.2)	(2.5)	(2.8)
Acquisitions and Investments	(1.5)	(23.2)	(20.0)	(20.0)	(20.0)
Disposal of Fixed Assets/Investments	0.0	0.0	0.0	0.0	0.0
Other	0.3	0.0	0.0	0.0	0.0
Investing Cashflow	**(2.8)**	**(25.1)**	**(22.2)**	**(22.5)**	**(22.8)**
Free Cashflow	**8.8**	**18.0**	**10.7**	**13.2**	**23.3**
Equity Raised / Bought Back	0.1	0.3	0.3	0.3	0.3
Dividends Paid	(4.9)	(7.7)	(6.1)	(7.1)	(7.6)
Change in Debt	(0.2)	7.6	0.3	0.3	0.4
Other	(4.6)	0.2	9.9	9.9	9.9
Financing Cashflow	**(9.6)**	**0.4**	**4.4**	**3.4**	**2.9**
Exchange Rate Effect	0.0	0.0	0.0	0.0	0.0
Net Change in Cash	**(2.0)**	**(4.8)**	**(4.9)**	**(3.4)**	**6.2**

Balance Sheet (AUD) (m)	FY16A	FY17A	FY18E	FY19E	FY20E
Cash	34.6	29.8	24.9	21.5	27.8
Accounts Receivable	12.5	17.1	20.7	25.0	30.3
Inventory	1.1	2.0	2.2	2.3	2.4
Other Current Assets	3.3	7.2	7.2	7.2	7.2
PPE	6.0	6.2	6.7	7.3	7.9
Goodwill & Intangibles	59.3	68.4	68.4	68.4	68.4
Investments	0.0	0.0	0.0	0.0	0.0
Other Non Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	**116.7**	**130.8**	**130.1**	**131.7**	**143.9**
Accounts Payable	9.9	16.8	20.9	26.0	32.4
Short Term Debt	0.3	3.7	3.7	3.7	3.7
Long Term Debt	1.0	5.1	5.5	5.8	6.1
Income Taxes Payable	0.0	0.0	0.0	0.0	0.0
Other	41.0	29.6	29.6	29.6	29.6
Total Liabilities	**52.2**	**55.3**	**59.7**	**65.1**	**71.8**
Total Shareholder Equity	**60.9**	**71.0**	**65.9**	**62.1**	**67.6**

Ratios	FY16A	FY17A	FY18E	FY19E	FY20E
ROE (%)	15.0%	19.2%	25.4%	28.6%	30.2%
Net Debt / Book Equity (x)	(0.5)	(0.3)	(0.2)	(0.2)	(0.3)
Net Debt / EBITDA (x)	(1.6)	(0.7)	(0.5)	(0.3)	(0.5)
Price to Book (x)	nm	nm	nm	nm	nm

Earnings Changes

Figure 1: Earnings Revisions Post FY17 Results

	FY18			FY19		
	Old	New	*Chg*	Old	New	*Chg*
Sales (A$m)	111.8	113.7	*2%*	127.4	129.6	*2%*
EBITDA (A$m)	32.8	33.4	*2%*	37.4	35.0	*-6%*
NPAT (A$m)	16.1	17.4	*8%*	18.9	18.3	*-3%*
EPS (cents)	34.0	36.0	*6%*	39.9	38.0	*-5%*
DPS (cents)	13.0	14.0	*8%*	15.0	16.0	*7%*

Source: Shaw and Partners

Raft of Contract Wins across Three Pillars: Knowledge, Health & Tech.

Knowledge Cloud-as-a-Service

Expansion into broader markets, with new engagements with Unity Water (enterprise IM), Melbourne City Council (5-year content and collaboration service), Suncorp (core banking and claims programs), Transport & Main Roads (hosted TRIM), Qld. Police (digital strategy), NSW Police and Sunshine Coast Council (TRIM premium support), CenITex (integrated SharePoint/TRIM for Vic. Government), SA university (lab IM system) and Dept. of Defence (extension of electronic document and records management [ERDM], including support and updating both hardware and software) renewed for $23m.

Health Solutions-as-a-Service

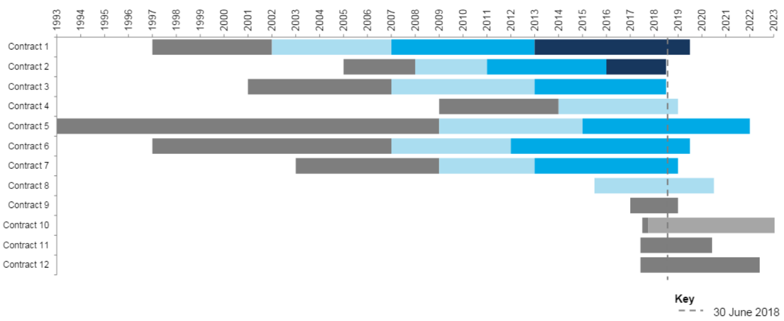
Post the recent securing of a 5-year contract with Qld. Health, CGL has also picked up an additional cloud-based laboratory information management (LIS) solution worth $6.7m. The company is also having success in other areas: e.g. National Blood Authority's Bloodnet initiative trial. The company has also successfully deployed the Evolution LIS solution into Peter MacCallum Hospital in Victoria with Austin and Melbourne health is planned in 1H18.

Technology

Monash Uni contract expanded in scope (5 years + 5), plus integrated collaborative solutions to Defence in Amberley and Williamtown re: attack Growler aircraft fleet, and commencing new work via a 5-year managed services contract for New Royal Adelaide Hospital's (NRAH) on facilities management side.

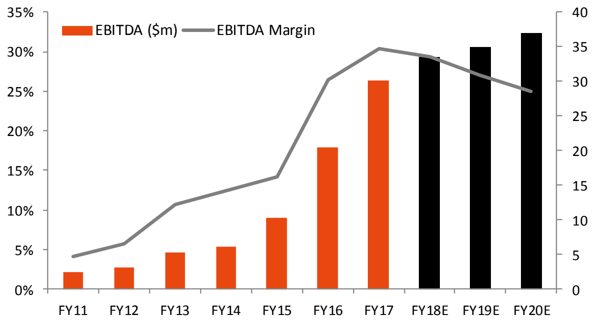
Contracts Amortisation – No Renewals until FY19

Figure 2: Pipeline of Contracts Summary



Source: Shaw and Partners

Figure 3: CGL Earnings Summary



Source: Shaw and Partners

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Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

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