Date	**Theme**
23 August 2016	Financial results

WILSONS

Company

The Citadel Group (CGL)

Wealth by stealth

Citadel announced a 36% increase in net profit to $8.9m and rewarded holders with a 20% lift in dividends paid over FY16. It was a solid set of figures from the Technology division, with well-diversified EBITDA gains and higher profitability in evidence. We have our eyes peeled for any further details concerning the unnamed federal agency contract, for which we have implemented a small upgrade. This was offset by downgrades in the Education area, which lost money in the 2H and must work hard to break even in FY17. Our FY17e forecast is sitting at c.35% EBITDA growth with no new contracts, so new work announced from this point is likely accretive. We are interested in the company's e-health plans but see earnings quality developing from across Technology. We maintain a BUY rating. Revised target is $6.09 per share.

Key points

FY16 underlying NPAT of $8.9m was in line with our forecasts (reported was $8.2m ex-minorities). An unequivocally good result for Technology with EBITDA of $24.1m (excluding $1.8m revaluation gains) in line with our forecast of $23.7m. Margins appeared materially better than what we had assumed. Normalised, we calculate 32.7% underlying EBITDA margin in Technology versus our forecast of 28.4%, explaining the apparent "miss" on revenue. Technology result implies delivery of forecast PJA (Health) earnings and at least 35% across other Tech verticals (scalability, new contracts, synergies). Education was a drag on the FY16 result with just $1m EBITDA v W16e:$2.9m.

Adding in a nominal upgrade for recently announced federal government agency contract. We have assumed ~$1m in incremental EBITDA in FY18 and a very low contribution in 2HFY17, assuming that initial start-up costs will be required. Downgrades in Education offset this gain – aggregate EBITDA forecasts only down ~1% from last time. EPS revisions ~4%.

Price target revised to $6.09 per share, BUY maintained. Our 12-month price target of $6.09 per share is derived from our DCF valuation and implies 21.6x FY17e EPS and 9.3x FY17e EV/EBITDA. We remain bullish about Citadel "re-rating" over the course of FY17-18 as the market comes to appreciate its objectives in e-health, the delivery of above-market earnings growth and multiple avenues for earnings surprise in Technology division.

Risks and catalysts

Catalysts: a) reported revenue growth; b) evidence of margin expansion; c) new contract wins and/or renewals; d) accretive acquisitions.

Risks: a) loss of key contracts; b) reduced volume through changes to vocational education and training funding; c) loss of key management; d) technology obsolescence; e) competition.

Recommendation	BUY
12-mth target price (AUD)	**$6.09**
Share price @ 22-Aug-16 (AUD)	$5.00
Forecast 12-mth capital return	21.8%
Forecast 12-mth dividend yield	2.5%
12-mth total shareholder return	**24.4%**

Market cap	$234m
Enterprise value	$219m
Shares on issue	47m
Sold short	
ASX 300 weight	n/a
Median turnover/day	$0.0m

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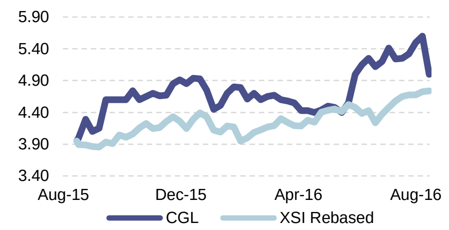
12-mth price performance ($)



	1-mth	6-mth	12-mth
Abs return (%)	-5.7	7.5	29.7
Rel return (%)	-8.8	-9.3	8.9

Earnings forecasts

Year-end June (AUD)	FY15A	FY16A	FY17F	FY18F	FY19F
NPAT rep ($m)	6.5	8.2	11.2	14.7	16.5
NPAT norm ($m)	6.5	8.2	13.4	16.7	16.7
Consensus NPAT ($m)			12.8	15.2	
EPS norm (cps)	16.0	17.0	28.1	35.0	35.0
EPS growth (%)	29.1	6.1	65.6	24.5	-0.1
P/E norm (x)	31.2	29.4	17.8	14.3	14.3
EV/EBITDA (x)	21.6	10.5	7.6	6.9	6.3
FCF yield (%)	2.6	3.2	6.2	8.7	9.9
DPS (cps)	5.8	9.6	13.0	16.0	19.0
Dividend yield (%)	1.2	1.9	2.6	3.2	3.8
Franking (%)	100	100	100	100	100

Source: Company data, Wilsons estimates, S&P Capital IQ

Key changes

		10-Jun	After	Var %
NPAT:	**FY17F**	13.8	13.4	-2.7%
norm	**FY18F**	17.0	16.7	-1.7%
($m)	**FY19F**		16.7	
EPS:	**FY17F**	29.5	28.1	-4.8%
norm	**FY18F**	36.4	35.0	-3.8%
(cps)	**FY19F**		35.0	
DPS:	**FY17F**	13.5	13.0	-3.7%
(cps)	**FY18F**	16.5	16.0	-3.0%
	FY19F		19.0	
Price target:		6.25	6.09	-2.5%
Rating:		**BUY**	**BUY**	

Price target		
	Valuation	Price target
WACC (%)	11.9	
Tg (%)	3.0	
NPV fcst FCF	97.8	
NPV perpetuity	172.1	
Net debt/(cash)	14.7	
Valuation ($m)	284.6	
DCF ($/share)		6.09
Price target ($/share)		**6.09**

Interims ($m)				
Half-year (AUD)	**Dec 15**	**Jun 16**	**Dec 16**	**Jun 17**
	1HA	**2HA**	**1HE**	**2HE**
Sales revenue	46.4	36.2	54.4	59.0
EBITDA	12.3	8.7	12.9	16.1
EBIT	10.1	5.8	10.0	13.2
Net profit	**5.6**	**2.7**	**5.6**	**7.8**
Norm EPS	**11.5**	**5.5**	**11.7**	**16.4**
EBIT/sales (%)	21.9	15.9	18.4	22.4
Dividend (c)	4.8	4.8	6.5	6.5
Franking (%)	100.0	100.0	100.0	100.0

Financial stability			
Year-end June (AUD)	**FY16A**	**FY17F**	**FY18F**
Net debt	-33.3	-14.7	-10.7
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	**<0**	**<0**	**<0**
Current ratio (x)	3.5	3.8	4.3
Interest cover (x)	5.1	7.3	12.6
Adj cash int cover (x)	**4.6**	**7.7**	**14.3**
Debt/cash flow (x)	0.1	0.1	0.5
Net debt (cash)/share ($)	<0	<0	<0
NTA/share ($)	1.3	1.4	1.6
Book value/share ($)	1.3	1.4	1.5
Payout ratio (%)	57	46	46
Adj payout ratio (%)	66	37	31

EPS reconciliation ($m)				
	FY16A		**FY17F**	
	Rep	**Norm**	**Rep**	**Norm**
Sales revenue	83	83	113	113
EBIT	15.9	15.9	23.2	25.4
Net profit	**8.2**	**8.2**	**11.2**	**13.4**
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	**8.2**	**8.2**	**11.2**	**13.4**
Diluted shrs (m)	48	48	48	48
Diluted EPS (c)	**17.0**	**17.0**	**23.5**	**28.1**

Returns				
	FY16A	**FY17F**	**FY18F**	**FY19F**
ROE (%)	14	20	23	21
ROIC (%)	42	38	30	31
Incremental ROE	9	96	60	0
Incremental ROIC	39	42	8	11

Key assumptions								
Year-end June (AUD)	**FY13A**	**FY14A**	**FY15A**	**FY16A**	**FY17F**	**FY18F**	**FY19F**	**FY20F**
Revenue growth (%)		-0.8	45.9	14.3	37.2	5.6	11.9	7.0
EBIT growth (%)		22.6	77.2	77.6	59.7	7.9	1.5	5.7
NPAT growth (%)		20.2	58.0	26.0	63.1	24.5	-0.1	6.7
EPS growth (%)		**22.5**	**29.1**	**6.1**	**65.6**	**24.5**	**-0.1**	**6.7**
EBIT/sales (%)	8.2	10.2	12.4	19.2	22.4	22.9	20.8	20.5
Tax rate (%)	20.3	22.0	22.5	30.4	34.0	27.9	27.0	27.0
ROA (%)	**10.2**	**10.2**	**7.1**	**11.6**	**17.3**	**16.2**	**15.5**	**16.0**
ROE (%)	**15.9**	**16.4**	**11.5**	**12.8**	**20.0**	**21.6**	**19.6**	**19.8**

Profit and loss ($m)								
Year-end June (AUD)	**FY13A**	**FY14A**	**FY15A**	**FY16A**	**FY17F**	**FY18F**	**FY19F**	**FY20F**
Sales revenue	50.0	49.6	72.3	82.7	113.4	119.8	134.0	143.4
EBITDA	4.9	5.8	10.1	20.9	29.0	31.9	34.5	36.5
Depn & amort	0.8	0.7	1.2	5.0	5.8	6.5	6.9	7.1
EBIT	**4.1**	**5.1**	**9.0**	**15.9**	**23.2**	**25.4**	**27.6**	**29.4**
Net interest expense	-0.2	-0.2	-0.1	3.1	3.2	2.0	1.9	1.8
Tax	0.9	1.2	2.0	3.9	6.8	6.5	6.9	7.5
Minorities/pref divs	0.0	0.0	0.0	0.7	2.0	2.2	2.3	2.4
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	**3.4**	**4.1**	**7.1**	**8.2**	**11.2**	**14.7**	**16.5**	**17.8**
Abns/exts/signif	0.0	0.0	-0.5	0.0	0.0	0.0	0.0	0.0
Reported net profit	**3.4**	**4.1**	**6.5**	**8.2**	**11.2**	**14.7**	**16.5**	**17.8**

Cash flow ($m)								
Year-end June (AUD)	**FY13A**	**FY14A**	**FY15A**	**FY16A**	**FY17F**	**FY18F**	**FY19F**	**FY20F**
EBITDA	4.9	5.8	10.1	20.9	29.0	31.9	34.5	36.5
Interest & tax	-0.2	-1.1	-1.8	-4.3	-3.6	-4.5	-5.0	-5.7
Working cap/other	-1.5	1.9	-1.5	-6.2	-9.2	-5.0	-4.0	-2.9
Operating cash flow	**3.3**	**6.6**	**6.9**	**10.4**	**16.2**	**22.4**	**25.5**	**27.9**
Maintenance capex	-0.6	-1.4	-0.8	-2.9	-1.8	-2.1	-2.4	-2.7
Free cash flow	**2.7**	**5.3**	**6.1**	**7.5**	**14.4**	**20.4**	**23.1**	**25.2**
Dividends paid	-1.3	-1.3	-4.1	-4.9	-5.3	-6.3	-8.4	-9.3
Growth capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Invest/disposals	0.0	0.0	-9.1	-1.5	-27.8	-18.0	0.0	0.0
Other inv flows	1.1	3.1	-1.9	-1.1	0.0	0.0	0.0	0.0
Cash flow pre-financing	**2.6**	**7.1**	**-8.9**	**0.0**	**-18.6**	**-4.0**	**14.7**	**15.8**
Funded by equity	0.0	0.0	25.0	0.1	0.0	0.0	0.0	0.0
Funded by debt	-1.9	-0.6	1.4	-1.9	10.0	15.0	0.0	0.0
Funded by cash	-0.6	-6.5	-17.5	1.9	8.6	-11.0	-14.7	-15.8

Balance sheet summary ($m)								
Year-end June (AUD)	**FY13A**	**FY14A**	**FY15A**	**FY16A**	**FY17F**	**FY18F**	**FY19F**	**FY20F**
Cash	13.0	19.3	37.2	34.6	25.9	37.0	51.7	67.5
Current receivables	11.2	12.1	21.3	12.5	14.3	15.0	16.7	17.9
Current inventories	0.4	1.5	1.8	1.1	1.8	1.8	2.0	2.2
Net PPE	0.9	1.7	2.6	6.0	15.3	20.0	15.7	11.4
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles/capitalised	13.8	13.7	59.9	59.3	73.4	82.0	81.8	81.8
Other	1.1	1.2	3.8	3.3	3.3	3.3	3.3	3.3
Total assets	**40.3**	**49.4**	**126.7**	**116.7**	**134.1**	**159.3**	**171.3**	**184.1**
Current payables	14.5	14.4	21.9	9.9	11.0	12.0	13.0	14.0
Total debt	0.6	0.1	1.5	1.3	11.3	26.3	26.3	26.3
Other liabilities	3.6	9.5	46.4	41.0	44.0	45.6	48.2	50.2
Total liabilities	**18.7**	**24.1**	**69.7**	**52.2**	**66.3**	**83.9**	**87.5**	**90.4**
Minorities/convertibles	0.0	0.0	0.0	3.6	3.6	3.6	3.6	3.6
Shareholder equity	**21.6**	**25.3**	**57.0**	**64.6**	**67.8**	**75.4**	**83.9**	**93.6**
Total funds employed	**22.2**	**25.4**	**58.4**	**65.8**	**79.1**	**101.7**	**110.1**	**119.9**

Citadel Group – FY16 results

Table 1: CGL FY16 results vs pcp and Wilsons' estimates, FY17-FY18 outlook

Earnings summary								
Y/E: 30 Jun		FY15a	FY16a	%chg	Wilsons	%var	FY17e	FY18e
Sales revenue	**$m**	**72.3**	**83.1**	**15%**	**93.7**	**-11%**	**113.4**	**119.8**
Technology		61.1	75.3	23%	83.1	-9%	109.4	115.8
Education		11.2	7.8	-31%	10.6	-26%	4.0	4.0
Operating Expenses	$m	62.1	61.7	-1%	73.1	-16%	84.4	87.9
EBITDA	**$m**	**10.2**	**21.4**	**110%**	**20.7**	**4%**	**29.0**	**31.9**
Margin	*%*	*14.1%*	*25.8%*		*22.1%*		*25.6%*	*26.6%*
D&A	$m	1.2	5.0	nm	5.1	**-2%**	5.8	6.5
EBIT	$m	9.0	15.9	78%	15.5	2%	23.2	25.4
Margin	*%*	*12.4%*	*19.1%*		*16.6%*		*20.5%*	*21.2%*
Net interest expense (benefit)	$m	(0.1)	3.1	nm	1.6	92%	3.2	2.0
Tax expense (benefit)	$m	2.0	3.9	90%	4.9	-20%	6.8	6.5
Non-controlling interests	$m		0.7		-		2.0	2.2
NPAT (normalised)	**$m**	**6.5**	**8.2**	**26%**	**9.0**	**-9%**	**13.4**	**16.7**
NPAT (reported)	$m	5.6	8.2	47%	9.0	-9%	11.2	14.7
EPS (normalised)	**cps**	**16.0**	**17.0**	**6%**	**19.4**	**-12%**	**28.1**	**35.0**
DPS	**cps**	**5.8**	**9.6**	**66%**	**10.0**	**-4%**	**13.0**	**16.0**

Source: Citadel, Wilsons

Results notes

INCOME STATEMENT

Apparent revenue miss explained by higher Technology margins. Citadel's segmental revenue aggregate was up 15% to $83.1m but was below our forecast of $93.7m, illustrating some underlying margin assumption errors on our part, when "grossing up" some of the individual contract earnings lines in our Technology forecast. The group EBITDA result of $21.4m compared well with our forecast of $20.7m but we note the inclusion of ~$1.8m in fair value revaluation gains, which should be excluded in comparing to FY15 and to our forecasts. After adjusting for that variation, Technology EBITDA was $0.4m ahead of our forecast.

Education a drag – but increasingly irrelevant to the investment view. There was a certain amount of "sticker shock" in the Market's reaction to Citadel's ~$600K 2H loss from Education, with revenue more than halving 2H v 1H. The challenge in FY17 will be to achieve a break-even result in aggregate, so as not to detract from what is being achieved across Technology in all verticals. We assess a $1.9m EBITDA shortfall from Education.

Underlying NPAT. Aggregate NPAT of $8.9m compared well with our forecast of $9.0m. However, the characterisation of ~$0.7m NPAT relating to non-controlling interests in the 2H accounts put the reported year Group NPAT at $8.2m or ~9% lower than our forecast. Similarly, the FY16 EPS result of 17.0cps (fully diluted basis) was also lower than our forecast on account of those non-controlling interests. Non-controlling interests were already contemplated in our FY17e forecast, so there is no change on that basis.

Dividends. Citadel announced a 4.8cps final dividend (W16e: 5.2cps), bringing the full-year payout to 9.6cps (+66%) but 4% below our forecast of 10.0cps. Citadel's ~$4.95m in dividend outflows were 20% higher than in the prior year.

DIVISIONAL NOTES

Technology. Unequivocally, FY16 was a very good year and result for Technology with EBITDA of $24.1m (excluding the $1.8m in fair value revaluations) ahead of our forecast of $23.7m. Margins appeared materially better than what we had assumed. Again, if we exclude the revaluation gains, we calculate 32.7% underlying EBITDA margin in Technology versus 17.2% in FY15 our forecast of 28.4%. The margin difference explains the apparent revenue "miss" versus our forecast. Growth in Technology featured the full-year impact of Citadel Health, which includes PJA Solutions, which was originally guided at $9.5m sustainable EBITDA for FY16. Excluding the impact of this acquisition, Technology EBITDA grew at least 35% through scalability, new contract starts and other initiatives.

Education. A very weak 2H result, losing 600K and reporting just $1m in EBITDA full year (down 76% on pcp and missing our $2.9m forecast by 66%).

Table 2: Segmental EBITDA versus pcp and Wilsons' estimates

		FY15a	FY16a	%chg	Wilsons	%var
EBITDA	**$m**	**10.2**	**21.4**	**110%**	**20.7**	**4%**
Margin	*%*	*14.1%*	*25.8%*		*22.1%*	
Technology	$m	10.6	25.9	144%	23.7	9%
margin	*%*	*17.2%*	*34.4%*		*28.4%*	
Education		4.1	1.0	-76%	2.9	-66%
margin	%	*36.6%*	*12.8%*		*28.2%*	
Corporate, other	$m	(4.5)	(5.5)	21%	(5.9)	7%

Source: Citadel, Wilsons

Table 3: FY15/16 HY P&L comparisons

	1HFY15a	2HFY15a	FY15a	1HFY16a	2HFY16a	FY16a
REVENUE	**29.4**	**42.9**	**72.3**	**46.7**	**36.4**	**83.1**
Technology	23.8	37.3	61.1	41.4	33.9	75.3
Education	5.7	5.6	11.2	5.3	2.5	7.8
- revenue growth (v pcp)	*37%*	*53%*	*46%*	*59%*	*-15%*	*15%*
Operating EBITDA	**4.9**	**9.9**	**14.8**	**15.3**	**11.6**	**26.9**
Technology	2.6	8.1	10.7	13.7	12.2	25.9
Education	2.4	1.8	4.1	1.6	(0.6)	1.0
- EBITDA growth (v pcp)	*76%*	*55%*	*61%*	*211%*	*17%*	*131%*
EBITDA (WHTM adj.)	**3.3**	**6.8**	**10.1**	**12.3**	**8.7**	**20.9**
- growth	*209%*	*102%*	*64%*	*270%*	*27%*	*106%*
- margin	*11.3%*	*15.9%*	*14.0%*	*26.3%*	*23.8%*	*25.2%*
EBIT	**2.9**	**6.0**	**9.0**	**10.1**	**5.8**	**15.9**
- growth	*287%*	*40%*	*77%*	*248%*	*-5%*	*78%*
- margin	*9.9%*	*14.1%*	*12.4%*	*21.7%*	*15.8%*	*19.1%*
Net interest	0.2	(0.0)	0.1	(1.5)	(1.6)	(3.1)
PBT	**3.1**	**6.0**	**9.1**	**8.6**	**4.1**	**12.8**
Tax	0.3	1.8	2.0	3.1	0.8	3.9
Minorities	-	-	-	-	0.7	-
NPAT	**1.4**	**5.2**	**6.5**	**5.6**	**2.7**	**8.2**
EPS (cps)	**3.7**	**11.5**	**16.0**	**11.5**	**5.5**	**17.0**
- growth	*48%*	*16%*	*29%*	*211%*	*-52%*	*6%*
DPS (cps)	**0.0**	**5.8**	**5.8**	**4.8**	**4.8**	**9.6**

Source: Citadel, Wilsons

CASH FLOW

Operating cash flow. Full-year operating cash flow was $10.3m, up 50% but below our forecast of $14.4m, noting that Citadel's statutory EBITDA included $5.6m in net non-cash expenses. Working capital included ~$6.9m change in deferred revenue (paid in FY15, booked in FY16). We are forecasting further improvement to $16.2m operating cash flow in FY17.

BALANCE SHEET

Citadel reported net cash of $33.3m having consumed $1.9m cash over FY16 including $5.0m paid in dividends.

Forecasts

Adding in a nominal upgrade for recently announced federal government agency contract. The contract was under Citadel's materiality threshold, so we assess EBITDA less than $2m per annum as a rough basis. We have assumed ~$1m in incremental EBITDA in FY18 with a very low contribution in 2HFY17, assuming that initial start-up costs will be required to establish the work.

Offset by downgrades in Education. Management said that it had worked hard to get operating costs down in Education to match the decline in revenues. Prior to the result we had Education making ~$1m in FY17e EBITDA but have cut that to zero, a 1H loss netted out in the 2H. Management has set internal goals to return Education to profit over the course of the year.

Minor changes to Technology EBITDA but re-calibrating revenue forecasts. It was apparent that we had underestimated the profitability in some contracts in Technology. We have adjusted our revenue forecasts to better reflect the profitability metrics observed across the FY16. Aggregate EBITDA forecast revisions are very modest.

Table 4: Changes to forecasts

Earnings revisions			
Y/E: 30 Jun		**FY17e**	**FY18e**
Sales revenue - Before	$m	122.4	128.2
Sales revenue - After	**$m**	**113.4**	**119.8**
- Change	*%*	*-7.4%*	*-6.6%*
EBITDA - Before	$m	29.3	32.1
EBITDA - After	**$m**	**29.0**	**31.9**
- Change	*%*	*-1.0%*	*-0.6%*
NPAT (normalised) - Before	$m	13.8	17.0
NPAT (normalised) - After	**$m**	**13.4**	**16.7**
- Change	*%*	*-2.8%*	*-1.7%*
EPS (normalised) - Before	cps	29.5	36.4
EPS (normalised) - After	**cps**	**28.1**	**35.0**
- Change	*%*	*-4.6%*	*-3.8%*
DPS - Before	cps	13.5	16.5
DPS - After	**cps**	**13.0**	**16.0**
- Change	*%*	*-3.7%*	*-3.0%*

Source: Wilsons

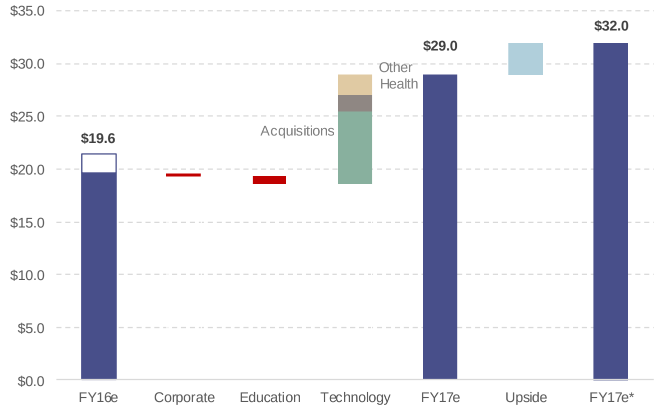
Other factors affecting the FY17 outlook

QLD Health LIS contract re-test (Citadel Health). Our forecasts and valuation both work on the basis of Citadel being returned in Queensland on similar commercial terms to what they have now. We understand that if the Queensland decision does go against Citadel in early 2017, revenue remains contracted over a transitional period, measured in years. That surety, coupled with likely cost-out options, may limit the near-term earnings impact, relative to our forecasts. The Queensland contract is more material to valuation, of course. In pure DCF valuation terms, we assess the share price downside impact at ~8% to 10%, having explored a range of DCF scenarios in previous research.

Acquisitions. We model contributions from Kapish (~$4m EBITDA) and from Citadel's increased equity interest in filosoph-e. Citadel will consolidate 100% of the revenue and EBITDA of that latter business in FY17, having moved to 50% ownership.

No new contracts in forecasts so everything new is accretive. At this stage we have not forecast anything new from the NRAH project, although the market understands that Citadel is pitching for a long-term managed service contract for that facility, alongside Spotless as the facility manager. Citadel's recent contract win with Monash University is a partial replacement for the NRAH earnings.

Figure 1: Forecast EBITDA drivers in FY17 waterfall



Source: Wilsons

Valuation, recommendation

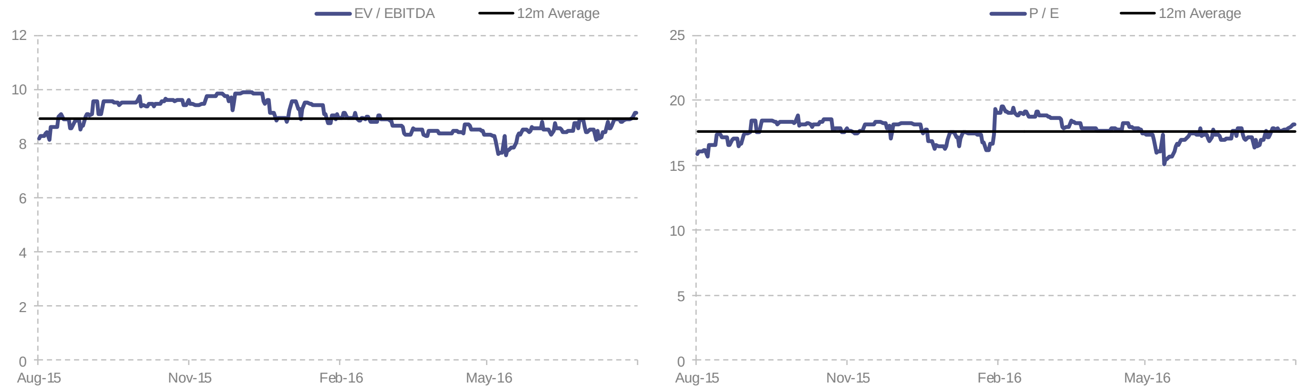
We value Citadel using a discounted cash flow methodology. Our revised 12-month price target of $6.09 per share is derived from our discounted cash flow valuation. Our price target implies 21.6x FY17e EPS and 9.3x FY17e EV/EBITDA.

Table 5: DCF valuation summary

Valuation		The Inputs	
PV of FCFF ($M) =	97.8	Forecast period	FY17-27e
PV of Terminal Value ($M) =	172.1	Risk-free rate	3.50%
Value of Operating Assets of the firm ($M)=	270.0	Risk premium	7.00%
- Net cash ($M)	14.7	Beta	1.2
Equity value ($M) =	**284.6**	Targe D/E	7%
Shares on issue	46.7		
New issuance and options	-	WACC	11.9%
Fully diluted shares	46.7	Tg	3.0%
Value of Equity per share =	**$6.09**		
Implied multiples consistent with DCF			
FY17e PER (x)	21.6x		
FY17e EV/EBITDA	9.3x		

Source: Wilsons

Figure 2: Last 12-month time series valuation data for CGL



Source: Bloomberg, Wilsons

The Citadel Group (CGL)

Business description

The Citadel Group's business is the development, marketing, contracting, implementation and support of integrated knowledge management and business software. Citadel operates at the premium end of this market with respect to both its technology offering and clientele. Core clients are those that seek to capture and manage sensitive data in complex environments such as defence, immigration, health, education and government. These are a key verticals in which Citadel today demonstrates its national security and personal privacy credentials. Complexity takes many forms including logistics, geography, linguistic, technological and the challenge of integrating solutions with supporting infrastructure.

Investment thesis

Citadel differentiates itself from other enterprise systems/software developers by providing an end-to-end service which starts by helping clients define the desired application through to the development and implementation of the hardware and software. Many of Citadel's contracts translate into lengthy relationships with a high proportion of recurring revenue under a managed service model. Citadel's business model offers clients a complete solution managed by one company, with a premium applied to trusted incumbency.

Our core thesis is that Citadel's valuation multiples can re-rate over the next 12-18 months as the market recognises and values the link between these differentiation points and earnings quality.

Revenue drivers

- Education segment – number of students and revenue per student
- Technology – managed services contracts with an average ~4.6 year duration

Margin drivers

- Cross-sales across the customer base and business units
- New contracts

Key issues/catalysts

- New contracts
- Divestment of education business
- Increased visibility into PJA Solutions driving a re-rating

Risk to view

- Contract losses
- Regulatory change in education segment

Balance sheet

- Strong balance sheet with net cash of $42m

Board

- Kevin McCann, Independent Chairman
- Dr Miles Jakeman, Managing Director
- Mark McConnell, Executive Director
- Ms Deena Shiff, Non-Executive Director
- Lt General Peter Leahy, Non-Executive Director

Management

- Dr Miles Jakeman, CEO
- Mark McConnell
- Darren Stanley, COO and Deputy CEO
- R. Andrew Burns, CFO

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Disclaimers and disclosures

Recommendation structure and other definitions

Definitions at wilsonsadvisory.com.au/Disclosures.

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