

Citadel Group (CGL)

Rating: Buy | Risk: Medium | Price Target: \$8.00

Strong 2H18 + Double-Digit Earnings Growth For Each Of The Next Three Years = BUY.

Key Information

Current Price (\$ps)	7.29
12m Target Price (\$ps)	8.00
52 Week Range (\$ps)	5.38 - 7.30
Target Price Upside (%)	9.7%
TSR (%)	11.9%
Reporting Currency	AUD
Market Cap (\$m)	340.6
Sector	Information Technology
Avg Daily Volume (m)	0.1
ASX 200 Weight (%)	0.02%

Fundamentals

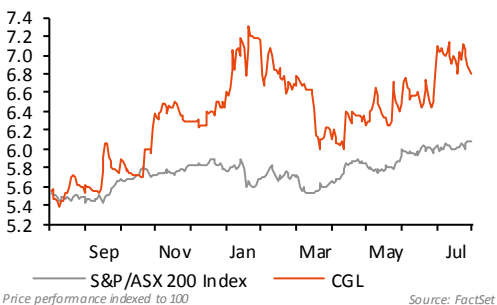
YE 30 Jun (AUD)	FY18A	FY19E	FY20E	FY21E
Sales (\$m)	108.5	127.0	148.5	173.8
NPAT (\$m)	19.4	21.6	24.2	28.5
EPS (cps)	39.0	43.5	48.6	57.2
EPS Growth (%)	22.2%	11.5%	11.8%	17.6%
DPS (cps) (AUD)	13.8	16.0	17.0	20.0
Franking (%)	100%	100%	100%	100%

Ratios

YE 30 Jun	FY18A	FY19E	FY20E	FY21E
P/E (x)	16.9	16.8	15.0	12.8
EV/EBITDA (x)	9.4	9.1	7.9	6.6
Div Yield (%)	2.1%	2.2%	2.3%	2.7%
Payout Ratio (%)	35.4%	36.8%	35.0%	35.0%

Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	1.9%	9.7%	10.4%	27.1%
Absolute (%)	2.8%	12.5%	14.6%	37.5%
Benchmark (%)	0.9%	2.8%	4.2%	10.4%



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 FY18 continuing NPAT of \$19.4m (1H18 \$6.6m, 2H18 \$12.8m) which was a solid +81% above pcp, and 5% ABOVE Shaw's \$32.4m forecast and 2% above market consensus of \$33.2m. We have increased our FY19 and FY20 EPS by 8% and 6% respectively, and our price target rises from \$7.40 to \$8.00. Retain BUY recommendation.

Highlights

ASX: CGL	FY18	FY17	Change	Shaw	Difference	Consensus	Difference
Revenue (\$m)	108.5	98.8	10%	113.9	-5%	116.5	-7%
EBITDA (\$m)	34.0	30.1	13%	32.4	5%	33.2	2%
EBITDA margin	31.3%	30.5%	87bp	28.4%	289bp	28.5%	284bp
NPAT (\$m)	19.4	15.4	26%	16.7	16%	13.6	43%
Adjusted EPS (cents)	32.5	24.0	35%	33.8	-4%	28.0	16%
Total DPS (cents)	13.8	12.8	8%	13.9	-1%	14.0	-1%

Adjusted NPAT excl. material one-off items

- After a 'miss' in 1H18 (a rarity for CGL), like the Leo the MGM Lion CGL roared back with vengeance as previously delayed contracts, the rise of SaaS and the benefits of scalability emerged in 2H18 – with contract extensions, new work won, supremely good management of costs, higher margin SaaS contracts and higher cross-selling all underpinned the strong 2H18 'beat' (1H / 2H NPAT skew 34% / 66%).
- Only weak spot was group revenue for the year, which although increasing 10% to \$109m, was -5% below Shaw's estimate and 7% below market.
- Significant positive was gross margin growth, but below our expectations (from 46.7% to 50.0% vs. Shaw's 48.7%) – with EBITDA +48% to \$34.0m (5% above Shaw) and EBITDA margins a very robust 31.3% (vs. Shaw's 28.4%). This was due to further dollar investment in new software technology (such as Citadel-IX) and the uptick in SaaS work.
- Operating cashflow, which is traditionally low in 1H (\$2.1m), came in at \$20.1m, well above Shaw's \$8.9m – y-o-y -18% was lower customer receipts and milestone billing delays on a large program.
- All key contracts for locked in for 2019, with two renewals in FY19 executed – 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.
- Balance sheet remains solid post Charm / PJAS / Kapish / philosophy-e acquisitions – cash at \$25m with debt of only \$18m (net debt \$7m), post PJAS final tranche payment of \$12.8m and payments for Charm and APP.
- Total DPS of 13.8cps (ff) – 8% increase on pcp and a touch below Shaw's 13.9cps.
- 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 record 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. The company is also exposed to \$480m of a \$800m pipeline to higher margin SaaS opportunities.

Recommendation

Retain BUY. CGL is further educating the market on its unique, differentiated and multi-faceted offering across Health, Technology and Advisory/Knowledge. We acknowledge that it isn't the easiest company to understand, especially given the absence of segmental splits now. The stock has had a solid run from \$4.23 in May 2017 to now \$7.29 (+72%). The company retains very attractive metrics: double-digit earnings growth over the next 3 years (our forecasts are very conservative we might add), improving ROE to >20%, robust balance sheet, free cashflow positive despite two acquisitions, generates strong EBITDA margins of >30% and has a strong management and Board. Downside is the lack of liquidity and lack of clarity around both contracts and reporting (latter being addressed as noted).

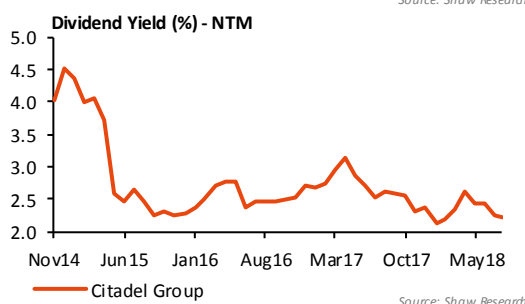
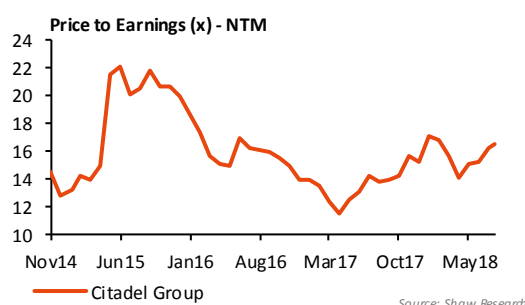
Citadel Group Information Technology

FactSet: CGL-AU / Bloomberg: CGL AU

Key Items	Data
Recommendation	BUY
Risk	MEDIUM
Price (\$ps)	7.29
Target Price (\$ps)	8.00
52 Week Range (\$ps)	5.38 - 7.30
Shares on Issue (m)	46.7
Market Cap (\$m)	340.6
Enterprise Value (\$m)	351.6
TSR (%)	11.9%
Valuation NPV	Data
Beta	1.20
Cost of Equity (%)	12.5%
Cost of Debt (net) (%)	6.0%
Risk Free Rate (%)	5.3%
Terminal Growth (%)	3.0%
WACC (%)	11.5%

Company Description

Citadel Group develops and delivers technology solutions to state / federal government departments and the private sector. The company was founded on September 6, 2007 and is headquartered in Canberra, Australia. CGL listed in Dec-2014 at \$2.25 per share.



Financial Year End: 30 June

Investment Summary (AUD)	FY17A	FY18A	FY19E	FY20E	FY21E
EPS (Reported) (cps)	26.1	36.0	43.5	48.6	57.2
EPS (Underlying) (cps)	31.9	39.0	43.5	48.6	57.2
EPS (Underlying) Growth (%)	81.8%	22.2%	11.5%	11.8%	17.6%
PE (Underlying) (x)	16.0	16.9	16.8	15.0	12.8
EV / EBIT (x)	9.2	12.0	11.4	9.9	8.1
EV / EBITDA (x)	7.5	9.4	9.1	7.9	6.6
DPS (cps) (AUD)	12.8	13.8	16.0	17.0	20.0
Dividend Yield (%)	2.5%	2.1%	2.2%	2.3%	2.7%
Franking (%)	100%	100%	100%	100%	100%
Payout Ratio (%)	40.1%	35.4%	36.8%	35.0%	35.0%
Free Cash Flow Yield (%)	9.4%	5.1%	5.4%	6.5%	6.5%
Profit and Loss (AUD) (m)	FY17A	FY18A	FY19E	FY20E	FY21E
Sales	98.8	108.5	127.0	148.5	173.8
Sales Growth (%)	27.9%	9.8%	17.0%	17.0%	17.0%
Other Operating Income	0.0	0.0	0.0	0.0	0.0
EBITDA	30.1	34.0	38.8	43.1	50.4
EBITDA Margin (%)	30.4%	31.3%	30.6%	29.0%	29.0%
Depreciation & Amortisation	(5.7)	(7.2)	(7.9)	(8.6)	(9.5)
EBIT	24.3	26.8	30.9	34.5	40.9
EBIT Margin (%)	24.6%	24.7%	24.3%	23.2%	23.6%
Net Interest	(3.0)	(1.5)	(1.6)	(1.8)	(1.9)
Pretax Profit	21.3	25.3	29.3	32.7	39.0
Tax	(5.9)	(5.9)	(7.6)	(8.5)	(10.5)
Tax Rate (%)	(27.7%)	(23.3%)	(26.0%)	(26.0%)	(27.0%)
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT Underlying	15.4	19.4	21.6	24.2	28.5
Significant Items	(2.8)	(1.5)	0.0	0.0	0.0
NPAT Reported	12.6	17.9	21.6	24.2	28.5
Cashflow (AUD) (m)	FY17A	FY18A	FY19E	FY20E	FY21E
EBIT	24.3	26.8	30.9	34.5	40.9
Tax Paid	(5.4)	(5.9)	(7.6)	(8.5)	(10.5)
Net Interest	(3.0)	(1.5)	(0.9)	(0.7)	(1.6)
Change in Working Capital	10.6	(6.3)	(5.0)	(6.1)	(8.0)
Depreciation & Amortisation	5.7	7.2	7.9	8.6	9.5
Other	(7.3)	0.0	(0.2)	2.0	0.7
Operating Cashflow	24.9	20.4	25.1	29.8	31.0
Capex	(1.9)	(3.7)	(5.4)	(6.3)	(7.3)
Acquisitions and Investments	(23.2)	(20.2)	(20.0)	(20.0)	(20.0)
Disposal of Fixed Assets/Investments	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	(25.1)	(24.0)	(25.4)	(26.3)	(27.3)
Free Cashflow	23.0	16.6	19.7	23.6	23.6
Equity Raised / Bought Back	0.3	1.4	1.4	1.4	1.4
Dividends Paid	(7.7)	(10.5)	(8.3)	(8.3)	(8.8)
Change in Debt	7.6	8.9	(2.7)	(1.8)	(1.4)
Other	0.2	(1.0)	12.5	12.5	12.5
Financing Cashflow	0.4	(1.2)	2.9	3.9	3.8
Exchange Rate Effect	(5.0)	(1.2)	0.0	0.0	0.0
Net Change in Cash	(4.8)	(5.9)	2.6	7.5	7.4
Balance Sheet (AUD) (m)	FY17A	FY18A	FY19E	FY20E	FY21E
Cash	29.8	24.9	26.6	34.0	41.4
Accounts Receivable	17.1	15.2	18.0	21.4	25.4
Inventory	2.0	2.0	0.9	0.4	0.2
Other Current Assets	7.2	20.8	20.8	20.8	20.8
PPE	6.2	7.9	10.4	13.8	18.3
Goodwill & Intangibles	68.4	73.9	73.9	73.9	73.9
Investments	0.0	0.0	0.0	0.0	0.0
Total Assets	130.8	145.0	150.9	164.6	180.3
Accounts Payable	16.8	21.0	27.7	36.7	48.5
Short Term Debt	3.7	5.9	5.9	5.9	5.9
Long Term Debt	5.1	11.9	9.2	7.5	6.0
Income Taxes Payable	0.0	0.0	0.0	0.0	0.0
Other	29.6	19.1	19.1	19.1	19.1
Total Liabilities	55.3	57.9	62.0	69.2	79.6
Total Shareholder Equity	71.0	83.3	85.1	91.7	96.9
Ratios	FY17A	FY18A	FY19E	FY20E	FY21E
ROE (%)	19.1%	23.2%	25.7%	27.4%	30.2%
Gearing (%)	(41.9%)	(9.3%)	(15.5%)	(29.1%)	(43.8%)
Net Debt / EBITDA (x)	(0.7)	(0.2)	(0.3)	(0.5)	(0.6)
Price to Book (x)	nm	nm	nm	nm	nm

Earnings Changes

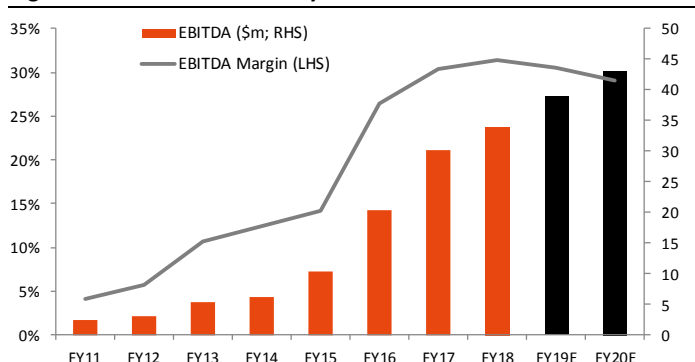
Figure 1: Shaw and Partners Earnings Revisions

	FY19			FY20			FY21		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales (A\$m)	133.2	127.0	-5%	155.9	148.5	-5%	167.5	173.8	4%
EBITDA (A\$m)	36.2	38.8	7%	40.5	43.1	6%	45.2	50.4	12%
NPAT (A\$m)	19.0	21.6	14%	21.5	24.2	13%	25.9	28.5	10%
EPS (cents)	39.9	43.5	9%	44.6	48.6	9%	50.6	57.2	13%
DPS (cents)	17.0	16.0	-6%	16.0	17.0	6%	19.0	20.0	5%

Source: Shaw and Partners

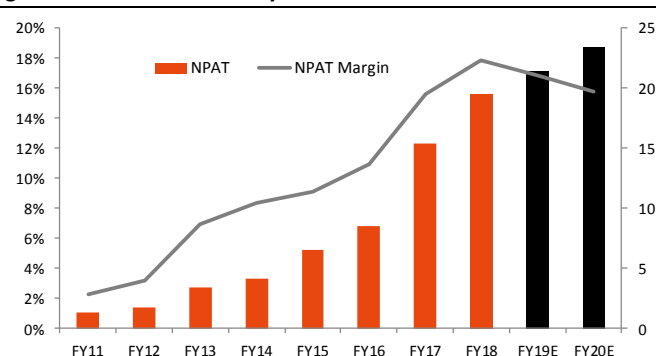
CGL ... Chart Summary

Figure 2: CGL EBITDA Summary



Source: Shaw and Partners

Figure 3: CGL NPAT Summary



Source: Shaw and Partners

Figure 4: CGL P&L Summary – By FY

Profit & Loss (\$m)	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E
Revenue	72.3	77.3	98.8	108.5	127.0	148.5
EBITDA	10.3	20.4	30.1	34.0	38.8	43.1
EBITDA Margin	14.2%	26.4%	30.4%	31.3%	30.6%	29.0%
Depreciation	(0.9)	(0.7)	(1.0)	(1.5)	(2.3)	(3.7)
EBITA	9.4	19.7	29.1	32.5	36.5	39.4
EBITA Margin	13.0%	25.5%	29.4%	29.9%	28.7%	26.5%
Amortisation	(0.3)	(3.9)	(4.7)	(5.7)	(5.9)	(5.9)
EBIT	9.1	15.8	24.3	26.8	30.6	33.5
EBIT Margin	12.6%	20.5%	24.6%	24.7%	24.1%	22.5%
Net interest	(0.5)	(3.6)	(3.0)	(1.5)	(1.6)	(1.8)
Pretax Profit	8.6	12.2	21.3	25.3	29.0	31.7
Tax	(2.0)	(3.8)	(5.9)	(5.9)	(7.5)	(8.2)
Tax Rate	23.3%	30.7%	27.7%	23.3%	26.0%	26.0%
Minorities	0.0	0.0	0.0	0.0	0.0	0.0
Normalised NPAT	6.6	8.5	15.4	19.4	21.4	23.5
NPAT Margin	9.1%	11.0%	15.6%	17.9%	16.9%	15.8%
Significant Items	(1.5)	0.4	(2.8)	(1.5)	0.0	0.0
Reported NPAT	5.1	8.8	12.6	17.9	21.4	23.5

Source: Shaw and Partners

Figure 5: CGL P&L Summary – By HY

Half Yearly P&L (\$m)	2H15A	1H16A	2H16A	1H17A	2H17A	1H18A	2H18A
Revenue	42.6	41.4	35.9	42.0	56.9	47.3	61.2
EBITDA	8.2	11.0	9.4	11.7	18.4	13.1	20.9
EBITDA Margin	19.3%	26.6%	26.2%	27.9%	32.3%	27.7%	34.1%
Dep & Amort	(0.5)	(1.9)	1.2	(2.8)	1.8	(3.3)	1.8
EBITA	7.8	9.1	10.6	8.9	20.1	9.8	22.7
EBITA Margin	18.2%	22.0%	29.5%	21.3%	35.4%	20.7%	37.0%
Amortisation	(0.3)	0.0	(3.9)	0.0	(4.7)	0.0	(5.7)
EBIT	7.4	9.1	6.7	8.9	15.4	9.8	17.0
EBIT Margin	17.4%	22.0%	18.7%	21.3%	27.1%	20.7%	27.7%
Net interest	(0.5)	(1.8)	(1.8)	(1.5)	(1.6)	(0.8)	(0.7)
Pretax Profit	7.0	7.3	4.9	7.5	13.8	9.0	16.3
Tax	(1.7)	(2.7)	(1.1)	(2.1)	(3.8)	(2.4)	(3.5)
Tax Rate	24.8%	36.9%	21.5%	27.7%	27.7%	26.3%	21.7%
Minorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Normalised NPAT	5.2	4.6	3.9	5.4	10.0	6.6	12.8
NPAT Margin	12.3%	11.1%	10.8%	12.9%	17.6%	14.0%	20.9%
Significant Items	(1.5)	0.0	0.0	(1.4)	(1.4)	(1.2)	(0.3)
Reported NPAT	3.7	4.6	3.9	4.0	8.6	5.4	12.5

Source: Shaw and Partners

CGL's Unique Product / Service Offering is 2nd to None

- **Key competitive advantage is the 100%-owned and developed IP used to run critical operations** – it is for this reason that Shaw and Partners believe CGL generates industry leading margins by a significant quantum. Examples include: Kapish (productivity/workflow/automation), e-Blood (managing blood products through health system), Charm (oncology), Auscare (clinical work) and Evolution (lab IS).
- **Another advantage is the intellectual capital used to design, integrate and deploy enterprise solutions** – e.g. secure video conferencing, hospital unified communications, and counter-terrorism services (facial recognition, identifying threats, etc.).
- **In Health field, CGL runs the largest Australian-based laboratory information system** supporting over 34 labs, 3,500 staff on a 24/7 basis, with >50,000 daily transactions.

- **In National Security, CGL is at the forefront of field communications, real-time situational awareness, decision support and visualisation.** For example, the CitadelASSIST platform delivers connectivity to emergencies and security incidents.
- **In Secure Enterprise Content Management (SECM), CGL monitors all social media for potential threats** like phishing, malware, hacking, fake accounts, breaches, digital impersonation, etc. (Citadel-SOCIAL). Citadel-IX utilises the cloud to provide connectivity anywhere, anytime and from any device. Kapish focusses exclusively on Hewlett Packard Enterprise (HPE) Content Management (record keeping integration). Citadel-AIM provides agency compliance to government standards.

The result of all this aforementioned IP strength is industry-leading margins. Notably, as per the FY17 and FY18 results, the margin growth remains well above our expectations, with both GM (from 39.5% in FY16 to 46.7% to 50.0% in FY18) and EBITDA (from 26.4% in FY16 to 30.4% in FY17 to 31.3% in FY18) continuing to surprise on the upside – the growth was derived from a combination of organic growth, Citadel Health in particular (PJAS), the Federal Agency contract, and positive Monash and Kapish contributions. This continues CGL’s significant margin expansion from FY15 to FY18 widening from 14% to 31% (vs. ~25% LT).

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Rating Classification

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

RISK STATEMENT: Where a company is designated as ‘High’ risk, this means that the analyst has determined that the risk profile for this company is significantly higher than for the market as a whole, and so may not suit all investors. Clients should make an assessment as to whether this stock and its potential price volatility is compatible with their financial objectives. Clients should discuss this stock with their Shaw adviser before making any investment decision.

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