Swift Networks (SW1)

First Half FY2018 Trading Update

1. **SwiftNetworks (SW1)** is a high growth technology business, that is forecast to grow revenue by ~40% in FY18
2. **Strong recurring revenue** at 80%+
3. **Substantial operating leverage** and an inherently scalable technology platform
4. **Blue chip client base, a strong reseller network and international expansion** offers a high quality pipeline for growth

Market Prices	
Current Price	$0.43
12 mth range	$0.20 - $0.55
Company Data & Ratios	
Issued capital	112.9
Fully diluted capital	163.5
Market Capn diluted	$70.3
Net Cash	$1.3
Enterprise Value	$69.0
PE (FY18)	32.3
PE (FY19)	19.1
EV/EBITDA (FY18)	22.6
Valuation	**$0.67**

Financials

	FY17	FY18f	FY19f
Revenue	$17.1	$24.5	$34.3
EBITDA	$1.0	$3.1	$5.7
Margin	*5.9%*	*12.5%*	*16.6%*
EBIT	-$0.1	$2.4	$4.9
NPAT	-$0.1	$2.2	$3.7
EPS	-.01	1.3	2.2

Key Highlights

SW1 has established an industry-leading position in the supply of in-room entertainment systems to the international resource, aged care, maritime and hospitality sectors.

SW1 designs, develops, implements and supports fully integrated systems that keep residents and guests entertained, informed and in touch with family and friends, through their technology platform.

SW1 has a highly scalable business model that is expanding into new geographies and industry segments.

SW1 released a strong first half update with revenue of $10.4m up 32% and EBITDA of $1.0m up significantly on the prior period. We expect this growth profile to accelerate slightly into the second half of FY18.

There is significant upside to SW1's growth profile if they are able to win further material contracts with large multinational clients, deliver significant contracts through their reseller network or they are able to monetise their platform through advertising revenue.

Given the fixed cost nature of SW1's business, we should see continued in EBITDA margins over the FY17 to FY20 period.

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Investment Thesis

SW1 is a high growth technology business, that is expanding geographically, as evidenced through their recent contract wins in the maritime space and industry expansion through their recent **wins in both aged care and hospitality**. This expansion complements their core business in the resource space which is experiencing strong tailwinds on the back of an improving resources market.

From an addressable market perspective, the IPTV market continues to grow at double digit rates, with a total addressable market of $35B in FY15. There are 327,000 aged care rooms in Australia of which SW1 has only penetrated 10,000. There are over 500,000 merchant ships globally each with numerous rooms, a significant opportunity for SW1 given their unique international licensing agreements.

SW1 is able to offer an attractive cross boarder solution given their international distribution rights with premium content providers. Some content providers include; 20th Century Fox, Warner Bros., Sony Pictures, DreamWorks, Village Roadshow, Discovery, ABC, CNN, BBC, Foxtel to name a few.

SW1 is charged by content providers on a per screen basis, after they have invoiced clients, meaning their working capital cycle does not lag revenue, in short **operating cash flow broadly matches EBITDA.**

SW1 generates revenue on a 'number of screens basis' being $12AUD right up to $68AUD per screen per month, with the **average more in the order of $30AUD to $35AUD**. For example, a large maritime contract of 500 vessels with 25 rooms per vessel could add $3m+ to revenue per annum. Contracts of this magnitude or greater would result in material upside to our forecasts.

Based on a strong pipeline and development of their reseller network, we expect screen numbers to grow from 74,000 in FY18 to 105,000 in FY19.

Revenue is approximately 80% recurring in nature, with the remaining 20% related to onsite installations and other services. This capex is funded by the clients so **SW1's organic growth is not capital hungry** and return on equity will be high.

Our investment thesis relies on the successful on boarding of new customers through their direct sales channel and their reseller network. SW1 has incremental gross margins in the order of 40%+ and a relatively fixed corporate cost base. In fact they would only require an additional $1m in fixed costs to more than double the business from current levels. This would see corporate costs in the order of $7.5m supporting revenue of $40m+, resulting in EBITDA margins more than doubling from current levels.

If we take a medium term outlook, SW1 looks reasonable on a FY19 PE multiple of 19x growing at 30%+ and a more modest FY20 multiple of less 12.5x. If management are successful in delivering these results, there is material upside to the current share price.

The quality of SW1 business model is demonstrated by their high recurring revenues, capital light business model, fixed cost base, and industry leading retention rates of 97%.

Financials

Bull Case

Will see 120,000 rooms achieved by the end of FY19 at an average revenue per room per month of $30 to $35. This would represent success through both their reseller network being Telstra, AST, DXC and other Hospitality resellers.

This would see revenue in the order of $38 to 40m compared to our current forecast of $34.3m in FY19. For every additional $1m of revenue above our forecast, SW1 will add roughly $400k in EBITDA given the fixed cost nature of the business.

Bear Case

90,000 rooms at the end of FY19 would represent limited contribution from the reseller network and reasonable success through their direct channel. This would see revenue in the order of $28 to $31m, compared to our current forecast of $34.3m.

Expected Case

We expect that SW1 through a combination of success in the reseller channel and continued organic growth should achieve between 100,000 and 110,000 rooms in FY19.

This would result in revenue in the order of $34m to 36m, and would represent success in both the reseller and direct channels.

Income Statement

- We have excluded $1.5m of amortisation related to customer contracts in FY18 as this does not truly reflect real earnings.
- We have excluded $6.0m in performance shares as they are included in the diluted market capitalisation.
- We have excluded $1.0m in expected share based payments as these have also been included in the diluted market capitalisation.
- Due to $3.0m in applicable accumulated losses, it is likely SW1 will not pay tax in FY18 however we have forecast a $1m tax bill in FY19 and a reversion to full tax rates in FY20.

Income Statement	FY16	H1 FY17	FY17	H1 FY18f	*FY18f*	*FY19f*	*FY20f*
Number of rooms at year end	30,000	--	39,000	64,000	*74,000*	*105,000*	*126,000*
Revenue	$14.4	$7.8	$17.1	$10.4	*$24.5*	*$34.3*	*$42.9*
Revenue growth	*--*	*--*	*18.8%*	*32.3%*	*43.7%*	*40.0%*	*25.0%*
Gross Profit	**$1.7**	**$2.4**	**$5.4**	**$4.1**	***$9.3***	***$13.4***	***$17.2***
Gross margin	*11.5%*	*31.0%*	*31.9%*	*39.0%*	*38.0%*	*39.0%*	*40.0%*
U - EBITDA	**-$3.5**	**$0.5**	**$1.0**	**$1.0**	***$3.1***	***$5.7***	***$9.2***
U- EBIT	**-$3.7**	**$0.2**	**-$0.1**	**$0.7**	***$2.4***	***$4.9***	***$8.3***
U - PBT	**-$3.7**	**$0.2**	**-$0.1**	**$0.5**	***$2.2***	***$4.7***	***$8.1***
Income Tax	$0.1	$0.0	$0.0	$0.0	*$0.00*	*-$1.00*	*-$2.60*
U - PAT	**-$3.6**	**$0.2**	**-$0.1**	**$0.5**	***$2.2***	***$3.7***	***$5.6***
EPS	--	--	--	--	1.3c	2.2c	3.4c
PE Multiple	--	--	--	--	32.3	19.1	12.5
EV / EBITDA Multiple	--	--	--	--	22.6	12.2	7.5

Key notes from H1 FY18 Trading Update:

- Gross profit margins have increased over the period from 32% to 39%, ahead of our expectations;
- Due to the inherent operating leverage in SW1's business, EBITDA margins have expanded from 6.5% to 9.9% against the pcp;
- 100% conversion of EBITDA to operating cash flow;
- Net cash of $1.3m at December 31, which includes cash of $4.1m and drawn debt of $2.8m;
    - $4.5m was raised in August 2017
- Revenue of $10.4m and EBITDA of $1.0m for the first half of FY18.

Depreciation & Amortisation

We note that capex deprecation will be in the $0.5m to $0.7m range in FY18, while amortisation of intangibles relating to customer contracts of acquired businesses will be $1.5m in FY18. Amortisation of customer contracts should halve in FY19, however we have excluded this from the table above as it does not accurately reflect the economic value of the business.

Other Expenses

Other significant one off expenses during the period are likely to include:

- FY18; $6m performance share charge related to acquisitions
- FY18; $1m share based payments charge

These figures have been excluded as they are included in the diluted market capitalisation number.

Research and Development

Management have stated that approximately $8m has been invested in the technology platform to date and that ongoing R&D should be maintained around the $600 - 700k mark.

While this technology spend seems lows, SW1 competitive edge also comes from their distribution network and content licensing agreements.

Growth in Quarterly Cash Flows:

SW1 delivered a strong second quarter with annual contracted revenue a key financial indicator up 35%. Further the business saw a strong increase in operating cash flow driven by both an increase in revenue and a decline in total expenses. This led to total operating cash flow of $1m.

It is expected that this trend will continue, with the benefit of a largely fixed cost base and continued revenue growth expected to benefit profit moving forward. A few highlights from the quarterly results:

- $5.0m of cash receipts up 30% compared to the pcp;
- Operating cash flows of $1.0m compared to a loss of $0.5m in the pcp;
- Annual contracted revenue up 35%.

	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18
Cash flow operating activities	$3,539,000	$3,867,000	$4,017,000	$4,763,000	$4,807,000	$5,023,000
	--	*9.3%*	*3.9%*	*18.6%*	*0.9%*	*4.5%*
Net cash operating activities	-$570,000	-$527,000	$29,000	$107,000	$248,000	$1,004,000
Total outgoings	$4,109,000	$4,394,000	$3,988,000	$4,656,000	$4,559,000	$4,019,000

Financial Outlook

Assumptions:

- Gross margins converge and stabilise at 40% in FY19;
- Corporate costs remain relatively steady over the next few financials years, with limited investment in new growth areas;
- The company pays the full corporate tax rate over this period.

Income Statement	***FY18f***	***FY19f***	***FY20f***
End of year rooms	*74,000*	*105,000*	*126,000*
Revenue	$24.5	$34.3	$42.9
Revenue growth	*43.7%*	*40.0%*	*25.0%*
Gross Profit	**$9.3**	**$13.4**	**$17.2**
Gross margin	*38.0%*	*39.0%*	*40.0%*
EBITDA	**$3.1**	**$5.7**	**$9.2**
EBITDA margin	*12.5%*	*16.6%*	*21.3%*
EBIT	**$2.4**	**$4.9**	**$8.3**
PBT	**$2.2**	**$4.7**	**$8.1**
PAT	**$2.2**	**$3.7**	**$5.6**
EPS	1.3c	2.2c	3.4c
Valuation @ 20x (cps)	--	45.0c	68.9c
Valuation @ 30x (cps)	--	67.5c	103.4c

Outlook

SW1 has a solid pipeline of opportunities through both their reseller and direct channels. As such we believe that SW1 has several years of runway to grow the business. Our shorter term forecasts rely on strong success through the reseller channel along with continued success in direct channels. Below are our high level assumptions, based on recent company reports, industry analysis and discussions with management:

- **Gross margin to expand** from 32% in FY17, to 38% in FY18 to 40% by FY20; noting that SW1 achieved 39% in the first half of this financial year;
- **We anticipate end of year room numbers to grow** from 39,000 in FY17 to 75,000 in FY18, to 105,000 in FY19 and 126,000 in FY20;
- **We expect corporate costs to be relatively steady** with $6.3m in FY18, $7.2m in FY19 and $7.5m in FY20;
- **Management have stated a strategic long term objective of 250,000 rooms** over the next three years which would see revenue 3 to 4x more than the first half FY18 run rate. While this may be achievable, it is our belief that this would require strategic acquisitions, which the company is well positioned to complete given their domain expertise.

It is too early to predict with any certainty the FY19 and in particular the FY20 results, however by including reasonable estimates of room number growth, expected gross margins and corporate costs which are relatively steady. It is clear that continued execution of management's stated strategy would result in substantial upside to the current share price.

Key Growth Drivers

Aged care

SW1 have been successful in contracting 10,000 rooms in the aged care space. This is a fraction of the addressable market of 327,000 rooms. This is up from no rooms at the time of their listing in June 2016.

Further the industry as a whole is expanding rapidly. Management have stated that aged care will be an increasing contributor to overall revenue through FY19 and FY20.

Maritime

Maritime represents the most prospective opportunity, given the potential of selling to large multinational clients.

The current addressable market is 500,000 merchant ships, each with several individual cabins.

The recent reseller agreement signed with AST, a maritime satellite communications specialist, has the potential to scale revenue quickly. While no large contracts have been signed to date, we understand that management have good visibility of the pipeline.

Reseller Network

The reseller network offers SW1 the opportunity to scale quickly, for example the agreements signed with AST & DXC technologies could add 20,000 new rooms over the next 12 months. This goes a substantial way to covering our forecast of 29,000 net room adds in FY19.

It is our understanding that the pipeline through the entire reseller network could add greater than 25,000 rooms in the next 24months. This would represent incremental revenue of roughly $9m.

Resource Sector

While the resource sector has shrunk from 100% of revenue in FY16 to an expected 60% in FY18, it is still growing. We anticipate this sector will continue to grow at 10% p.a. over the medium term, after strong growth in FY18, where room’s numbers are expected to grow from 30,000 rooms to 37,000+ rooms.

Monetising the platform through advertising

While we have limited details on the monetary potential of advertising, we understand that SW1 will achieve 60 million unique visitors to its platform in CY18. This is not a long dated strategy, as SW1 should begin generating revenue through this channel with the next 6 months.

Comparable Companies

Based on FY17 numbers

Company	Ticker	EV / REV	EV / Recurring REV	EV / EBITDA x	PE x	Medium growth rate
Altium	ALU	12.2	22.8	40.5	52.0	20%
Class Super	CL1	11.3	11.3	23.3	43.3	25%
Isentia Group	ISD	2.1	2.3	7.8	10.1	-10%
Technology1*	TNE	5.1	11.7	22.6	33.3	12%
Wisetech	WTC	26.7	27.1	76.3	132.2	30%
	Av. ratios =	11.5	15.0	34.1	54.2	15%

**Calendar year financial year 2017*

Taking a cross section of businesses across both the technology and platform sector, we see that both revenue multiples and earnings multiples are at historically high levels. If we extrapolate these numbers out to FY19, we achieve average multiples as follows:

- EV / REVx = 8.5x
- EV / Recurring REVx = 16.5x
- EBITDAx = 25x
- PEx = 38x

I will note that these are largely mature businesses, that are at or nearing optimal earning margins. While SW1 is less mature, it has the opportunity to expand earnings margins over time. This will be a key driver of EPS over the coming period, and likely result in above average earnings growth over the medium term.

If we apply a 20% discount to the above FY19 EBITDAx and PEx, we arrive at a valuation of 69c and 86c respectively. This would result in upside of 60% and 100% respectively.

Valuation

FY19 EBITDA ($m)	10	13	16	20	24
$5.39	$0.48	$0.62	$0.76	$0.96	$1.15
$5.7	$0.50	$0.65	$0.80	$1.01	$1.21
$5.96	$0.53	$0.69	$0.84	$1.06	$1.27
$6.26	$0.55	$0.72	$0.89	$1.11	$1.33
FY19 NPAT ($m)	**20**	**23**	**25**	**30**	**35**
$3.49	$0.62	$0.71	$0.77	$0.93	$1.08
$3.7	$0.65	$0.75	$0.81	$0.98	$1.14
$3.9	$0.68	$0.79	$0.85	$1.03	$1.20
$4.05	$0.72	$0.83	$0.90	$1.08	$1.26

Given the strong revenue growth and largely fixed cost base we have opted to use a FY19 multiple to value the business. FY19 is more indicative of the true earning potential of SW1 and is a solid base that the business will continue to grow off.

By taking a blended valuation, we arrive at the following:

- EBITDA valuation range $0.69 to $0.84
- NPAT valuation range of $0.79 to $0.85
- Taking the median of both EBITDA and NPAT, we arrive at a valuation of $0.79

Given there is a moderate level of execution risk and the FY19 result is 17months away, we believe it is prudent to provide a 15% risk adjustment.

This results in a valuation of $0.67 or upside of 56% over the next 12months.

Recently Announced Contracts

Date	Company	Notes
30.01.2018	Tripleplay	Swift to provide content services to oil rigs in the Gulf of Mexico via Tripleplay International commercial maritime sector expansion continues Swift's premium international content services drives global partnership success
14.12.2017	AST	Swift signs reseller agreement with global satellite communications provider AST Australia to offer Swift's full suite of services to AST clients.
23.11.2017	Oz Minerals	Swift wins multi-year contract to provide telco services and entertainment content to new client OZ Minerals Ltd (ASX: OZL). Swift will provide a broad suite of world-class content and connectivity to 550 end users at OZ's Carrapateena project in South Australia for an initial period of three years.
11.10.2017	DXC Connect	Swift signs reseller agreement with DXC Connect, a DXC Technology company, to be able to offer Swift's full suite of services to DXC Connect client accounts. Agreement expected to contribute to growth in sites, end users and recurring revenue across Swift's target markets
10.10.2017	Baptcare	Baptcare currently operates around 1,800 rooms across 13 sites. Swift will deploy its full suite of services to 'The Orchards' (Doncaster, Victoria) and all new greenfield sites developed during the term (of which 3 are currently planned).
22.06.2017	McKenzie Aged Care Group	Swift signs material contract to provide its award-winning entertainment and connectivity solution to McKenzie Aged Care Group, comprising 16 aged care facilities with 1,700 bed licenses across the Australian east coast. This significant agreement further validates Swift's recent acquisitions in the Aged Care sector and proves Swift's ability to capitalise on these acquisitions by offering a fully integrated, aged care specific solution which assists customers in providing high quality entertainment and connectivity services to residents.
20.06.2017	Rio Tinto	Swift wins a material contract to upgrade and provide entertainment and communication works to Rio Tinto's Hope Downs 1 Village, extending across 1,064 residences in the remote Pilbara region of Western Australia.
02.06.2017	Defence	Swift wins multi-year contract to provide entertainment and communications to staff and contractors conducting major construction activities at a government defence facility in Australia's Northern Territory.
24.05.2017	BlueCross	▪ Swift wins initial three-year contract with aged care provider BlueCross Community and Residential Services in Victoria Swift to supply its Aged Care Entertainment System and content to BlueCross' new 178 room Ivanhoe residence.
22.05.2017	Rosewood Care Group	Swift wins three-year contract with aged care provider Rosewood Care Group in WA Rosewood's five-star facility to be the first customer of Swift's new Aged Care content. This capitalises on Swift's acquisition of the Web2TV and Living Networks businesses in the Aged Care sector.
02.03.2017	Shell	Swift Networks wins material contract to provide entertainment, connectivity, maintenance and support to Shell's Prelude LNG Project offshore WA. □ Contract to run for an initial period of five years and continues Swift's healthy recent organic and acquisition-led growth in recurring revenue
18.01.2017	INPEX	Swift Networks wins material contract to provide entertainment, connectivity, maintenance and support services to the INPEX operated Ichthys LNG Project.

Key Risks

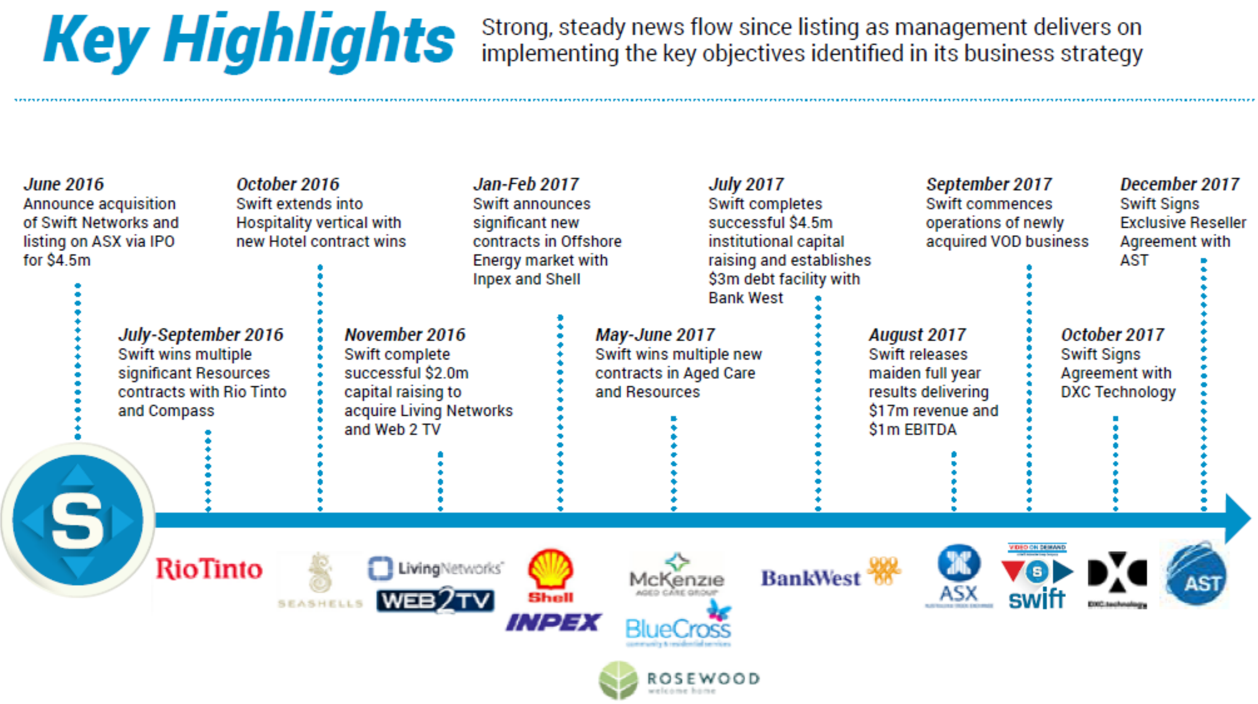
1. **Strong reseller pipeline does lead to additional users**
2. **Loss of important global content licenses**
3. **Increased competition**
4. **Limited R&D spend is not sufficient to maintain technology leadership**

Appendix 1 – Additional Information

Strong content library

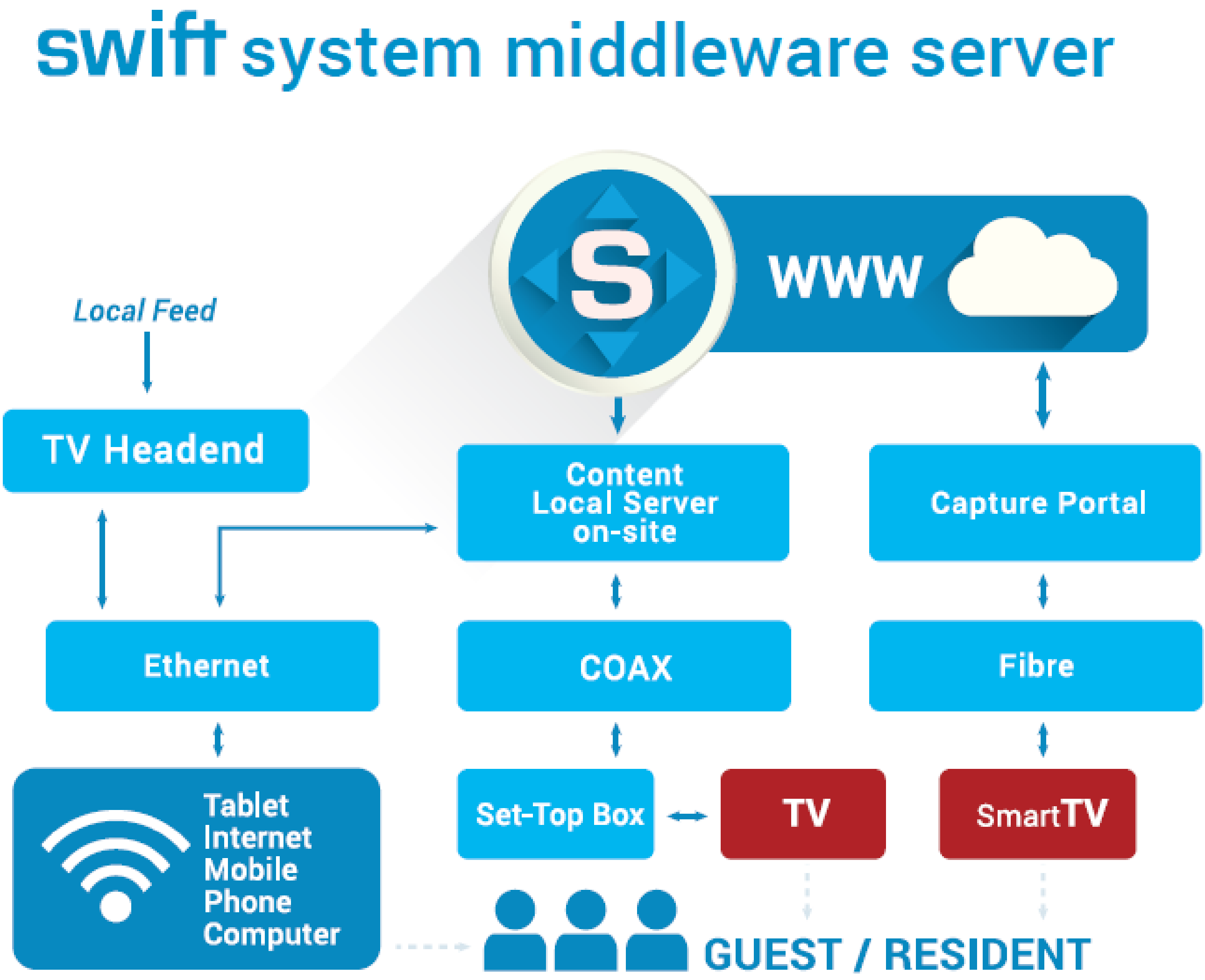
**From company presentation*

Company History



**From company presentation*

The Business



**From company presentation*

Selection of SW1 Clients

**From company presentation*

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