WA Industrial: IT Services

Hartleys

SW1.asx
Speculative Buy

SWIFT NETWORKS GROUP LTD (SW1)

FY18 – A Good Start, A Better Finish

Swift reported its 1H18 Preliminary Result. Revenue for the half was $10.4m, an increase of 32% yoy. 1H18 Revenue included a contribution from the acquired VOD Pty Ltd. business, excluding this we believe yoy revenue growth was closer to 20%. Despite Corporate Costs being higher than we expected, an improvement in gross margin (from 32% to 39% yoy) underpinned an over 100% yoy increase in EBITDA to $1.0m (EBITDA margin of 9.9% versus 6.5% in 1H17).

Post 1H18 little change to our forecasts

1H18 Revenue represents just 38% of our full year number. We expect a material contribution from the reseller agreements signed in 1H18 and as such it is important that contract awards are executed and announced in the coming months. While there is downside risk to our FY18 estimate if there are delays in room delivery from the reseller arrangements, there is also material upside risk to FY19 and beyond if these arrangements deliver as expected by the Company. Corporate Costs in 1H18 were ahead of our expectation, $3.03m in the first half versus our FY estimate of $5.75m. As a result, we have lifted our FY estimate to $6.36m. Overall however our EBITDA and NPAT forecasts have largely remained unchanged due to the better expected gross margins recorded in the first half. A 1H18 gross profit margin of 39% compared to our full year forecast of just 31%.

FY19 Blue Sky; Upgrade Price Target, Retain Speculative Buy

SW1 has achieved strong growth in the resource sector which has in turn provided the cash flow to build a leader within its industry. The upside now from the reseller agreements is substantial, providing material upside to our FY19 forecasts if they deliver in line with Company expectations. Given this potential blue-sky revenue potential we feel comfortable that SW1 should now trade at a modest premium (+20%) to the multiples of the ASX IT Services sector (EBITDA growth for this sector is expected to be 'just' 16% in FY18 and 17% in FY19). We also view SW1 as an attractive takeover target for a larger Group focusing on similar sectors and clients. The Company again after a period of strong share price appreciation has reached our former target price. Based on our current forecasts, and the modest premium we feel is warranted to the much slower growing ASX IT Services sector, we view fair value (and set our 12-month target price) at A$0.58 per share. Post recent strong share price appreciation there is now 18% upside to our 12-month target price. We retain our Speculative Buy Recommendation, room awards from the reseller agreements the likely key news flow in the coming months.

Key Chart: Hartleys Earnings Changes

		FY17 Act	Change	FY18 Old	FY18 New	Change	FY19 Old	FY19 New	Change
Revenue	A$m	17.01	0%	27.58	27.58	0%	32.09	32.09	0%
COGS	A$m	-11.61	0%	-18.27	-17.65	-3%	-21.31	-20.86	-2%
EBITDA	A$m	1.01	0%	3.55	3.56	0%	4.39	4.29	-2%
NPAT	A$m	-0.08	0%	1.35	1.36	0%	1.96	1.89	-4%
Capex	A$m	-1.74	0%	-7.20	-7.20	0%	-1.20	-1.20	0%
Change Cash	A$m	-0.97	0%	4.33	4.16	-4%	1.55	1.53	-1%

Source: Hartleys Research

31 Jan 2018

Share Price:	$0.493
12mth price target:	$0.58

Brief Business Description:
SW1 provides fully integrated digital entertainment solutions for the Resource, Hotel, Lifestyle village and Aged Care sectors.

Hartleys Brief Investment Conclusion
With a proven product the Company is now well positioned to expand beyond the resource sectors and into other industry verticals such as hospitality, aged care and lifestyle.

Chairman & CEO:

Carl Clump	Chairman (Non Executive)
Xavier Kris	CEO
George Nicholls	CFO

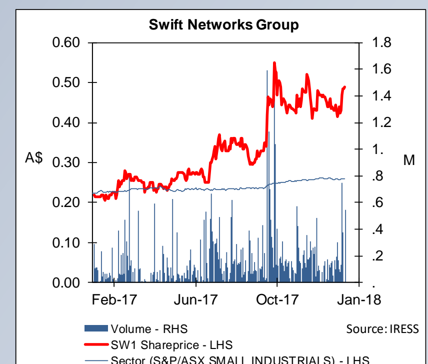
Top Shareholders:	Shares Held (m)
Robert Sofoulis	30.2
Wilson Asset Management	7.9

Company Address:
1 Watts Place
Bentley
W.A., 6102

Issued Capital:	74.9m
- fully diluted	166.0m
Market Cap:	$36.9m
- fully diluted	$81.8m
Net Cash (post VOD)	$1.4m

	FY16a	FY17a	FY18e
Screens - end FY	29,604	39,354	68,804
Screen adds	8,054	9,750	29,450
Revenue	14.4	17.0	27.6
EBITDA	-1.5	1.0	3.6
EBIT	-1.8	-0.1	2.0
NPAT	-1.8	-0.1	1.4
EPS	0.000	0.008	0.011
EV/EBITDA	-54.3x	79.8x	22.5x
EV/EBIT	-45.1x	-692x	40.5x

Source: Hartleys Research. * normalised



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Hartleys has completed capital raisings in the past 12 months for Swift Networks Group Limited ("Swift Networks") for which it has earned fees. Hartleys has provided corporate advice within the past 12 months and continues to provide corporate advice to Swift Networks for which it has earned and continues to earn fees. Hartleys has a beneficial interest in 3.8 million escrowed options in Swift Networks.

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SUMMARY MODEL

Swift Networks Group Ltd (SW1)

Recommendation: Speculative Buy

Company Information		
Date	31 Jan 2018	1 Watts Place
Share Price	$0.493	Bentley
52 Week High-Low	$0.6 - $0.205	W.A., 6102
Market Cap ($m)	$36.9	www.swiftnetworks.com.au
Market Cap - FD ($m)	$81.8	
Enterprise Value ($m)	$35.5	
Enterprise Value - FD ($m)	$80.3	
Ordinary Shares	74.9	
Fully Diluted Shares	166.0	
Net Cash (post VOD)	1.4	

Valuation

ASX IT Peer Group Multiples (+20%)

	12M forward - Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	18x	60%	0.49
Earnings	29x	20%	0.33
DCF		20%	0.48
Synergy/Cost Out			0.13

Valuation	$0.58
Upside / downside from current share price	18%
P / E (6/18F) at price target	*71.2x*
P / E (6/19F) at price target	*51.2x*
EV / EBITDA (6/18F) at price target	*26.7x*
EV / EBITDA (6/19F) at price target	*22.2x*

Multiples (S/price at $0.49)	6/16A	6/17A	6/18F	6/19F
P / E (reported, basic weighted)	-20.7x	-481.6x	27.2x	19.6x
P / E (normalised, dil. weighted)	-45.9x	-1,066.8x	60.2x	43.3x
EV/EBITDA multiple	-54.3x	79.8x	22.5x	18.7x
EV/EBIT multiple	-45.1x	-691.9x	40.5x	30.4x

Capital Structure		m	Expiry	Strike
Current shares on issue		74.9		
Restricted Shares		38.0		
Options		8.3	30-Apr-18	0.25
		6.9	19-May-21	0.15
		2.3	Various	Various
Performance Shares	Class A	16.7		
	Class B	16.7		
	Other	2.2		
Full Diluted		166.0		

Class A - Milestone 44,000 rooms or $24,000,000 Consolidated Revenue (earliest)
Class B - Milestone 53,000 rooms or $29,000,000 Consolidated Revenue (earliest)

Name	Positon	Shares Held (m)	
Carl Clump	Chairman (Non Executive)	1,259,879	1%
Xavier Kris	CEO	3,580,833	3%
George Nicholls	CFO	0	0%
Ryan Sofoulis	Executive Director	54,000	0%
Robert Sofoulis	NED	30,185,000	27%
Paul Doropoulos	NED	2,456,437	2%

Major Shareholders		%
Robert Sofoulis	30,185,000	27%
Wilson Asset Management	7,917,988	7%

Operating Model		6/16A	6/17A	6/18F	6/19F
Resources					
	Screens - start	21,550	29,604	29,854	37,054
	New rooms	8,054	250	7,200	250
	Screens - end	29,604	29,854	37,054	37,304
	Revenue	13.35	14.27	14.85	16.51
Aged Care / Lifestyle					
	Screens - start			8,000	12,500
	New rooms		8,000	4,500	4,500
	Screens - end		8,000	12,500	17,000
	Revenue		0.48	4.31	6.20
Hospitality & Other					
	Screens - start			1,500	19,250
	New rooms		1,500	17,750	1,900
	Screens - end		1,500	19,250	21,150
	Revenue		0.09	4.44	6.06
Total					
	Screens - start	21,550	29,604	39,354	68,804
	New rooms	8,054	9,750	29,450	6,650
	Screens - end	29,604	39,354	68,804	75,454
Recurring Revenue		13.35	14.84	23.60	28.76
Other Revenue		1.07	2.17	3.98	3.33

P&L (A$m)	6/16A	6/17A	6/18F	6/19F
Revenue	14.42	17.01	27.58	32.09
COGS	-12.30	-11.61	-17.65	-20.86
Gross Profit	2.12	5.39	9.93	11.23
Margin	*15%*	*32%*	*36%*	*35%*
Corporate Overheads	-3.60	-4.39	-6.36	-6.94
Growth	*5.1%*	*21.9%*	*45.0%*	*9.0%*
EBITDA	-1.48	1.01	3.56	4.29
Margin	*-10%*	*6%*	*13%*	*13%*
Depreciation	-0.30	-1.12	-1.58	-1.65
EBIT	-1.78	-0.12	1.98	2.64
Net Interest	0.00	0.01	-0.05	0.05
PBT	-1.78	-0.11	1.94	2.70
Tax	0.00	0.03	-0.58	-0.81
Tax Rate	0%	30%	30%	30%
Normalised NPAT	-1.78	-0.08	1.36	1.89
EPS - basic	-0.024	-0.001	0.018	0.025
EPS - FD	-0.011	0.000	0.008	0.011

Cashflow Statement (US$m)	6/16A	6/17A	6/18F	6/19F
Net Operating Cash Flow	-0.7	-0.1	3.0	3.7
Investing Cash Flow	0.3	-1.7	-7.2	-1.2
Financing Cash Flow	3.2	0.9	8.4	-1.0
Net Change in Cash	2.7	-1.0	4.2	1.5

Balance Sheet (A$m)	6/16A	6/17A	6/18F	6/19F
Cash	*3.2*	*2.2*	*6.4*	*7.9*
Total Current Assets	5.4	5.3	11.2	13.5
Non-Current Assets	6.0	9.2	14.8	14.4
Total Assets	11.4	14.5	26.0	27.9
Current debt	*0.9*	*0.0*	*1.0*	*1.0*
Total Current Liabilities	4.1	3.7	6.5	7.5
Non-Current Debt	*0.0*	*0.0*	*2.0*	*1.0*
Non-Current Liabilities	1.9	4.6	4.6	4.6
Total Liabilities	6.0	8.3	13.1	13.1
Net Assets	5.3	6.1	12.9	14.8
Equity	5.3	6.1	12.9	14.8

Analyst: Aiden Bradley
Phone: +61 8 9268 2876

31-January-2018

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

Swift reported its 1H18 Preliminary Result. Cash receipts for the first six months of the financial year were $9.83m, an increase of 33% on the prior year. Revenue for the half was $10.4m, an increase of 32% yoy.

1H18 Revenue included a contribution from the acquired VOD Pty Ltd. business, excluding this we believe yoy revenue growth was closer to 20%.

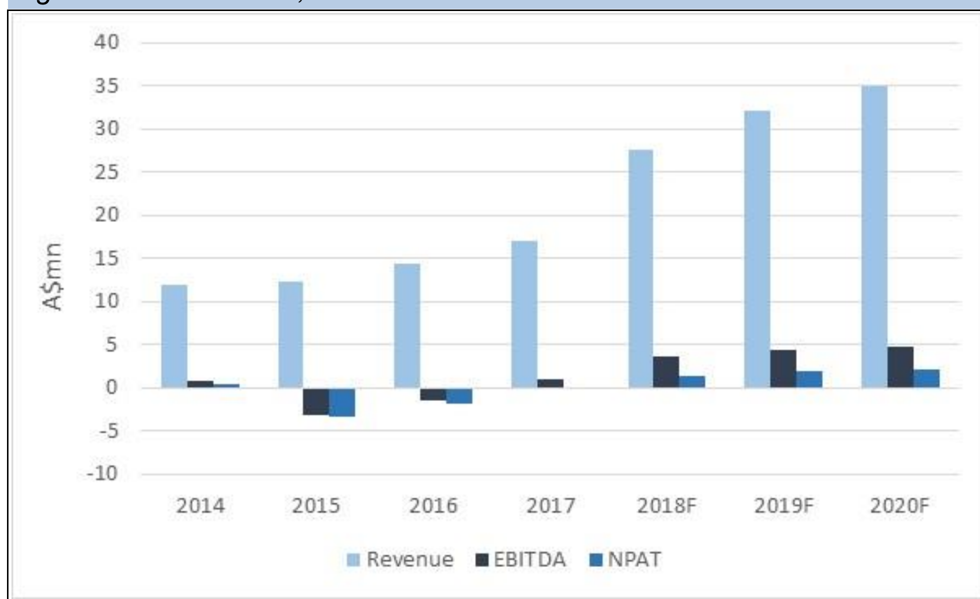
The key positive in the first half result was the very strong gross margin reported. The gross margin in 1H18 was 39%, compared to 32% in 1H17. This improvement was driven by cost control (and we suspect business mix, we have previously noted that there was early evidence that the move into Age Care was generating a higher gross margin than historically achieved in the Resource sector). Despite Corporate Costs being higher than we expected, this improvement in gross margin underpinned an over 100% yoy increase in EBITDA to $1.0m (EBITDA margin of 9.9% versus 6.5% in 1H17).

FY18 Outlook – Big Second Half.

1H18 Revenue grew 32% yoy, including a contribution from VOD Pty Ltd. Excluding VOD, the growth rate was closer to 20%. This result was only marginally up (2-3%+) on the second half of 2017.

Our FY18 revenue forecast of $27.58m implies an annualised growth rate of 62%. So, a big second half of the year is required to meet our number. A full half contribution from VOD Pty Ltd will help (prior to the SW1 acquisition, unaudited full year revenue for VOD was $3.75m). SW1 announced the completion of the VOD acquisition on the 1st of September 2017.

Fig. 1: Revenue, EBITDA and NPAT



Source: Company and Hartleys Research

Key to achieving our forecast will be the contribution from reseller agreements announced in the first half of FY18. Swift have indicated previously that they would enter reseller arrangements with 3rd parties who could provide visibility on 25,000 rooms as a minimum. This is obviously a very large potential uplift considering we

view current rooms contracted at around 65,000. The reseller arrangements if they deliver as expected could contribute 10,000 rooms by the end of FY18 and 20,000 per reseller in FY19.

We currently do not have anything close to these expectations in our numbers (our current forecasts are 68,000 rooms by year end FY18 and 75,000 by the end of FY19). So, there is considerable upside to our FY19 and beyond numbers if they deliver as management expect.

Two reseller agreements signed in 1H18;

a) In October 2017, SW1 signed an agreement with DXC Connect (an Australian based DXC Technology company).

http://www.uxcconnect.com.au/

http://www.dxc.technology/

DXC Technology is a NYSE listed US$25bn market cap company and locally are the largest IT services company in the Australia/NZ region. DXC Technology globally provides IT services/solutions to 6,000 private and public-sector clients across 70 countries. So, this agreement provides a platform for SW1 to further expand Internationally.

Swift becomes Connect's preferred vendor for the provision of digital entertainment systems, content and services to complement Connect's system integration solutions. Working together over 4,000 rooms are currently being jointly pursued in the resources and aged care sectors.

b) In December 2017, SW1 signed a 3-year exclusive reseller agreement with global satellite communications provider AST Australia to offer SW1's full suite of services to AST clients in Asia Pacific and internationally.

https://www.theastgroup.com/au/

AST services the commercial maritime and cruise ship markets and has a global client base (2,000 clients) in the resources, government, energy and utilities sectors.

Earnings Outlook;

1H18 Revenue represents just 38% of our full year number. A full half year contribution from VOD, combined with underlying organic growth is unlikely to be enough to reach our full year estimate. We expect a material contribution from the reseller agreement signed in 1H18 (circa $4-4.5m) and as such it is important that contract awards are executed and announced in the coming months. While there is downside risk to our FY18 estimate if there are delays in room delivery from the reseller arrangements, there is also material upside risk to FY19 and beyond if these arrangements deliver as expected by the Company.

Corporate Costs in 1H18 were ahead of our expectation, $3.03m in the first half versus our FY estimate of $5.75m. As a result, we have lifted our FY estimate to $6.36m. Overall however our EBITDA and NPAT forecasts have largely remained unchanged due to the better expected gross margins recorded in the first half. A 1H18 gross profit margin compared to our full year forecast of just 31%.

Fig. 2: Hartleys Earnings Changes post 1H18 Preliminary Result

		FY17 Act	Change	FY18 Old	FY18 New	Change	FY19 Old	FY19 New	Change
Revenue	A$m	17.01	*0%*	27.58	27.58	*0%*	32.09	32.09	*0%*
COGS	A$m	-11.61	*0%*	-18.27	-17.65	*-3%*	-21.31	-20.86	*-2%*
EBITDA	A$m	1.01	*0%*	3.55	3.56	*0%*	4.39	4.29	*-2%*
NPAT	A$m	-0.08	*0%*	1.35	1.36	*0%*	1.96	1.89	*-4%*
Capex	A$m	-1.74	*0%*	-7.20	-7.20	*0%*	-1.20	-1.20	*0%*
Change Cash	A$m	-0.97	*0%*	4.33	4.16	*-4%*	1.55	1.53	*-1%*

Source: Company and Hartleys Research

Fig. 3: P&L Summary

P&L (A$m)	6/16A	6/17A	6/18F	6/19F
Revenue	14.42	17.01	27.58	32.09
COGS	-12.30	-11.61	-17.65	-20.86
Gross Profit	2.12	5.39	9.93	11.23
Margin	*15%*	*32%*	*36%*	*35%*
Corporate Overheads	-3.60	-4.39	-6.36	-6.94
Growth	*5.1%*	*21.9%*	*45.0%*	*9.0%*
EBITDA	-1.48	1.01	3.56	4.29
Margin	*-10%*	*6%*	*13%*	*13%*
Depreciation	-0.30	-1.12	-1.58	-1.65
EBIT	-1.78	-0.12	1.98	2.64
Net Interest	0.00	0.01	-0.05	0.05
PBT	-1.78	-0.11	1.94	2.70
Tax	0.00	0.03	-0.58	-0.81
Tax Rate	0%	30%	30%	30%
Normalised NPAT	-1.78	-0.08	1.36	1.89
EPS - basic	-0.024	-0.001	0.018	0.025
EPS - FD	-0.011	0.000	0.008	0.011

Source: Company and Hartleys Research

INVESTMENT VIEW, VALUATION AND PRICE TARGET

Our positive view on SW1 has been predicated on their industry leading technology and services being transferable from their historical focus on the Australian resource sector into higher growth industries (e.g. Age Care, Hospitality) and International markets. The reseller deals are further evidence of this ability to diversify away from their historical reliance on the Australian resource sector (while achieving high top line growth rates and maintaining margins).

Resource sector provides a solid base and industry conditions starting to improve. SW1 has established an industry leading position in the supply of in room entertainment systems to the resource and energy industry in Australia. However, market conditions for this sector have slowed in recent years. While we do not forecast significant near-term growth from this sector, we do believe that the resource sector capex cycle has bottomed at least in WA. This provides SW1 with a strong revenue base (covering all Corporate costs) from which to expand into new higher growth markets. We have had concerns that as contracts with resource companies signed three or so years ago expired they may not be renewed (and subsequently the number of rooms contracted in the resource sector would start to fall). Evidence to date suggests this has not occurred, removing a key risk to the growth outlook for SW1.

Rapid penetration into new industry segments and internationally. SW1 have a proven track record over a number of years in the challenging resource sector, and this experience provides confidence they can make substantial in roads into both the fast-growing hospitality and lifestyle/age care sectors. Recent strategic acquisitions in the latter has expanded their geographical footprint and opened doors to key customers. While this expansion is still in its infancy, the potential is simply enormous.

Fig. 4: Australian Addressable Market Opportunity (units)

Source: Hartleys Research

The acquisition of VOD has further strengthened SW1's presence in the hospitality sector (with key clients such as Accor Hotels and IHG) while providing a strong foothold in the Education and Healthcare sectors. The VOD deal also for the first time also provided SW1 with an overseas presence and we view growth in the HEAT sectors (Healthcare, Education, Age Care and Tourism) in the Pacific region of equal

or greater opportunity to Australia for SW1 longer term. The reseller arrangements have the potential to assist in this broader industry expansion and also assist in the international expansion of SW1's business.

Valuation – New Sector Growth key to Upside

SW1 has achieved strong growth and market penetration in the resource sector which has in turn provided the cash flow to build a leader within its industry. Looking forward top line unit growth should translate to strong EBITDA and NPAT growth. The upside from the reseller agreements is substantial. Given this potential blue-sky revenue potential we feel comfortable that SW1 should now trade at a modest premium (+20%) to the multiples of the ASX IT Services sector (EBITDA growth for this sector is expected to be 'just' 16% in FY18 and 17% in FY19).

We also view SW1 as an attractive takeover target for a larger Group focusing on similar sectors and clients. Significant potential also still exists for SW1 to grow through further acquisitions. Hence our inclusion of a 'synergy value' also in our valuation.

The Company again after a period of strong share price appreciation has reached our former target price. Our initial price target ('Glued to The Box' 19th May 2017) was A$0.36 per share, which we upgraded to 42c ('More positive news on two fronts' 9th August 2017) post the announced acquisition of VOD Pty Ltd.

Based on our current forecasts and the modest premium we feel is warranted to the much slower growing ASX IT Services sector we view fair value (and set our 12-month target price) at A$0.58 per share.

On the back of the recent strong appreciation in the share price there is now 18% upside to our 12-month target price. We retain our Speculative Buy Recommendation with updates on the delivery of rooms from the reseller agreements the likely key news flow in the coming months.

Fig. 5: Valuation Multiples

Valuation			
ASX IT Peer Group Multiples (+20%)			
	12M forward - Target Multiple	**Wgt.%**	**Tgt Price**
EV/EBITDA	18x	60%	0.49
Earnings	29x	20%	0.33
DCF		20%	0.48
Synergy/Cost Out			0.13
Valuation			**$0.58**
Upside / downside from current share price			21%

Source: Hartleys Research

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

On the back of the recent strong appreciation in the share price there is now 18% upside to our 12-month target price of 58c per share. We retain our Speculative Buy Recommendation. We remain very positive on the outlook for both organic (continue to assume that SW1 will continue to win contracts and acquire customers (cheaply) in the Hospitality, Education, Healthcare and Aged care / Lifestyle Village sectors) and

inorganic growth (industry remains relatively fragmented) and the Company could continue to surprise on the upside.

Overseas growth is also a highly likely positive catalyst in the coming years as the product offering is easily transferable to overseas markets that are also experiencing rapid development in these industry segments. We note that the product is mature and therefore capital can be used to win new contracts rather than being spent on product development. Key risks to our thesis include a slower than expected penetration into new industry verticals and an increase in the cost of content.

RISKS

An inability to penetrate other industry verticals, outside of the resources sector is a risk to our investment thesis. SW1 has a proven track record of gaining significant market share in the resources sectors but is in the relatively early stages of penetrating other target markets.

An increase in the cost of content is a key risk for SW1. The Company should be commended at negotiating content agreements that do not include minimum subscriber hurdles. Should any of the key content providers, such as Foxtel and providers of movie content, decide to change their pricing structure then SW1 may suffer margin erosion.

SIMPLE S.W.O.T. TABLE

Strengths	Dominant market share in the Australian resource market for the provision of telecommunication and entertainment systems. Product development complete. The product is fully developed and requires only minimal capital to update systems.
Weaknesses	Majority of revenue is still generated from a single industry vertical (resources), although the Company is diversifying rapidly. The majority of revenue is still generated from W.A., however, acquisitions such as VOD are diversifying this exposure.
Opportunities	Resources: Opportunity to continue to gain market share in the resource sector and be well positioned for an upturn in the capital expenditure cycle. Hospitality: An opportunity exists for SW1 to win additional contracts from hotel chains both in Australia and offshore. Lifestyle Village/Age Care: An aging population is likely to drive increased demand for aged care and lifestyle facilities in Australia. Overseas: There is real scope for SW1 to transfer its success in Australia to much larger overseas markets.
Threats	Large media and telco's, such as NTT DoCoMo will be difficult to replace with major hotel chains. A significant increase in the cost of content and or the pricing structure of content represents a risk for SW1.

Source: Hartleys Research

HARTLEYS CORPORATE DIRECTORY

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Note: personal email addresses of company employees are structured in the following manner:firstname.lastname@hartleys.com.au

Hartleys Recommendation Categories

Category	Description
Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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