Hartleys

SW1.asx
Speculative Buy

WA Industrial: IT Services

SWIFT NETWORKS GROUP LTD (SW1)

3Q strong growth but expectations are very high

Swift Networks Group Ltd (‘Swift’, ‘SW1’ or the ‘Company) recently reported its 3QFY18 result. Cash receipts were $5.325m in the quarter, compared to $5.023m in 2Q18 and $4.017m in the same period last year. Cash receipts for the first nine months of the financial year were $15.155m. This compares to our former FY revenue forecast of $27.58m, which implies a substantial further uplift in the 4th quarter. The outlook for the final quarter looks positive with the Company flagging that during the 3rd quarter the Company took the opportunity to order stock in advance for newly secured and anticipated contracts due to be deployed in 4QFY18. Despite this we feel our 4th quarter revenue was set too high and have downgraded our full year revenue forecast to $23.07m.

Cash at bank at the end of the quarter was $3.98m. Subsequent to the quarter, SW1 collected $2.297 million in proceeds from option holders, (97% of the 25 cent options which expired on 30 April 2018 converted). These funds and a portion of existing cash will be used to repay its outstanding $2.625m loan by the end of May 2018, at which time the Company will be debt free.

FY18 slower growth a timing issue – retain Speculative Buy

While any downgrade to revenue is disappointing, given the continued strong growth in room numbers (the Company likely reached our year end number in the 3rd quarter) we view this translation to revenue and earnings as little more than a timing issue. Our forecasts for FY19 remain relatively unchanged and the Company does retain the potential to surprise on the upside. Key to achieving our FY19 revenue forecast will be the contribution from the 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 close to 70,000. 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.

Post the recent share price correction there is now 54% upside to our 12-month target price of 55c per share (down 4c 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.

Key Chart: Earnings Changes

		FY17 Act	*Change*	FY18 Old	FY18 New	*Change*	FY19 Old	FY19 New	*Change*
Revenue	A$m	17.01	*0%*	27.58	23.07	*-16%*	32.09	32.26	*1%*
COGS	A$m	-11.61	*0%*	-17.65	-14.07	*-20%*	-20.86	-20.97	*1%*
EBITDA	A$m	1.01	*0%*	3.56	2.50	*-30%*	4.29	4.21	*-2%*
NPAT	A$m	-0.08	*0%*	1.36	0.61	*-55%*	1.89	1.86	*-2%*
Capex	A$m	-1.74	*0%*	-7.20	-7.20	*0%*	-1.20	-1.20	*0%*
Change Cash	A$m	-0.97	*0%*	4.16	2.40	*-42%*	1.53	2.81	*83%*

Source: Company and Hartleys Research

2 May 2018

Share Price:	$0.36
12mth price target:	$0.55

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

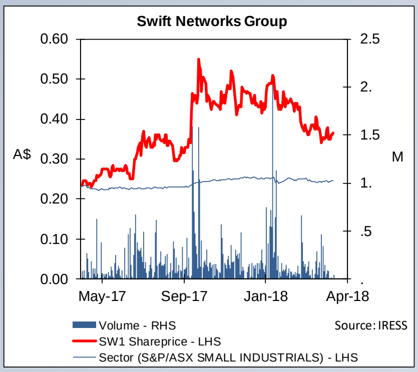
Top Shareholders:	**Shares Held (m)**
Robert Sofoulis	30.2
Wilson Asset Management	7.9

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

Issued Capital:	79.9m
- fully diluted	170.7m
Market Cap:	$28.8m
- fully diluted	$61.4m
Net Cash (end FY18e)	$4.6m

	FY16a	FY17a	FY18e
Screens - end FY	29,604	39,354	75,304
Screen adds	8,054	9,750	35,950
Revenue	14.4	17.0	23.1
EBITDA	-1.5	1.0	2.5
EBIT	-1.8	-0.1	0.9
NPAT	-1.8	-0.1	0.6
EPS	0.000	0.004	0.011
EV/EBITDA	-38.4x	56.5x	22.7x
EV/EBIT	-31.9x	-489x	61.7x

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.

SUMMARY MODEL

Swift Networks Group Ltd (SW1)

Company Information		
Date	2 May 2018	1 Watts Place
Share Price	$0.360	Bentley
52 Week High-Low	$0.6 - $0.225	W.A, 6102
Market Cap ($m)	$28.8	www.swiftnetworks.com.au
Market Cap - FD ($m)	$61.4	
Enterprise Value ($m)	$24.1	
Enterprise Value - FD ($m)	$56.8	
Ordinary Shares	79.9	
Fully Diluted Shares	170.7	
Net Cash (end FY18e)	4.6	

Valuation

ASX IT Peer Group Multiples (+20%)

	12M forward - Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	18x	60%	0.48
Earnings	29x	20%	0.31
DCF		20%	0.37
Synergy/Cost Out			0.13

Valuation	$0.55
Upside / downside from current share price	54%
P / E (6/18F) at price target	*154.0x*
P / E (6/19F) at price target	*50.8x*
EV / EBITDA (6/18F) at price target	*35.9x*
EV / EBITDA (6/19F) at price target	*21.3x*

Multiples (S/price at $0.36)	6/16A	6/17A	6/18F	6/19F
P / E (reported, basic weighted)	-16.2x	-375.4x	47.0x	15.5x
P / E (normalised, dil. weighted)	-34.5x	-801.7x	100.3x	33.1x
EV/EBITDA multiple	-38.4x	56.5x	22.7x	13.5x
EV/EBIT multiple	-31.9x	-489.3x	61.7x	22.2x

Capital Structure

		m	Expiry	Strike
Current shares on issue		79.9		
Restricted Shares		38.0		
Options		8.0	30-Apr-18	0.25
		6.9	19-May-21	0.15
		1.0	31-May-21	0.35
		1.0	31-May-21	0.42
		0.3	05-Sep-22	0.00
Performance Shares	Class A*	16.7		
	Class B**	16.7		
	Other	2.2		
Full Diluted		170.7		

*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	2%
George Nicholls	CFO	0	0%
Ryan Sofoulis	Executive Director	54,000	0%
Robert Sofoulis	NED	30,185,000	20%
Paul Doropoulos	NED	2,456,437	2%

Major Shareholders		%
Robert Sofoulis	30,185,000	20.0%
Wilson Asset Management	6,847,462	4.5%

Recommendation: Speculative Buy

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	500
Screens - end	29,604	29,854	37,054	37,554
Revenue	13.35	14.27	13.65	15.22
Aged Care / Lifestyle				
Screens - start			8,000	19,000
New rooms		8,000	11,000	7,000
Screens - end		8,000	19,000	26,000
Revenue		0.48	2.43	5.40
Hospitality & Other				
Screens - start			1,500	19,250
New rooms		1,500	17,750	7,500
Screens - end		1,500	19,250	26,750
Revenue		0.09	2.13	4.14
Total				
Screens - start	21,550	29,604	39,354	75,304
New rooms	8,054	9,750	35,950	15,000
Screens - end	29,604	39,354	75,304	90,304
Recurring Revenue	13.35	14.84	18.21	24.76
Other Revenue	1.07	2.17	4.85	7.50

P&L (A$m)	6/16A	6/17A	6/18F	6/19F
Revenue	14.42	17.01	23.07	32.26
COGS	-12.30	-11.61	-14.07	-20.97
Gross Profit	2.12	5.39	9.00	11.29
Margin	*15%*	*32%*	*39%*	*35%*
Corporate Overheads	-3.60	-4.39	-6.50	-7.08
Growth	*5.1%*	*21.9%*	*48.0%*	*9.0%*
EBITDA	-1.48	1.01	2.50	4.21
Margin	*-10%*	*6%*	*11%*	*13%*
Depreciation	-0.30	-1.12	-1.58	-1.65
EBIT	-1.78	-0.12	0.92	2.56
Net Interest	0.00	0.01	-0.05	0.09
PBT	-1.78	-0.11	0.88	2.65
Tax	0.00	0.03	-0.26	-0.80
Tax Rate	0%	30%	30%	30%
Normalised NPAT	-1.78	-0.08	0.61	1.86
EPS - basic	-0.022	-0.001	0.008	0.023
EPS - FD	-0.010	0.000	0.004	0.011

Cashflow Statement (US$m)	6/16A	6/17A	6/18F	6/19F
Net Operating Cash Flow	-0.7	-0.1	1.9	4.0
Investing Cash Flow	0.3	-1.7	-7.2	-1.2
Financing Cash Flow	3.2	0.9	7.7	0.0
Net Change in Cash	2.7	-1.0	2.4	2.8

Balance Sheet (A$m)	6/16A	6/17A	6/18F	6/19F
Cash	*3.2*	*2.2*	*4.6*	*7.5*
Total Current Assets	5.4	5.3	8.7	13.1
Non-Current Assets	6.0	9.2	14.8	14.4
Total Assets	11.4	14.5	23.5	27.4
Current debt	*0.9*	*0.0*	*0.0*	*0.0*
Total Current Liabilities	4.1	3.7	4.5	6.5
Non-Current Debt	*0.0*	*0.0*	*0.0*	*0.0*
Non-Current Liabilities	1.9	4.6	4.6	4.6
Total Liabilities	6.0	8.3	9.1	11.1
Net Assets	5.3	6.1	14.5	16.3
Equity	5.3	6.1	14.5	16.3

Analyst: Aiden Bradley
Phone: +61 8 9268 2876

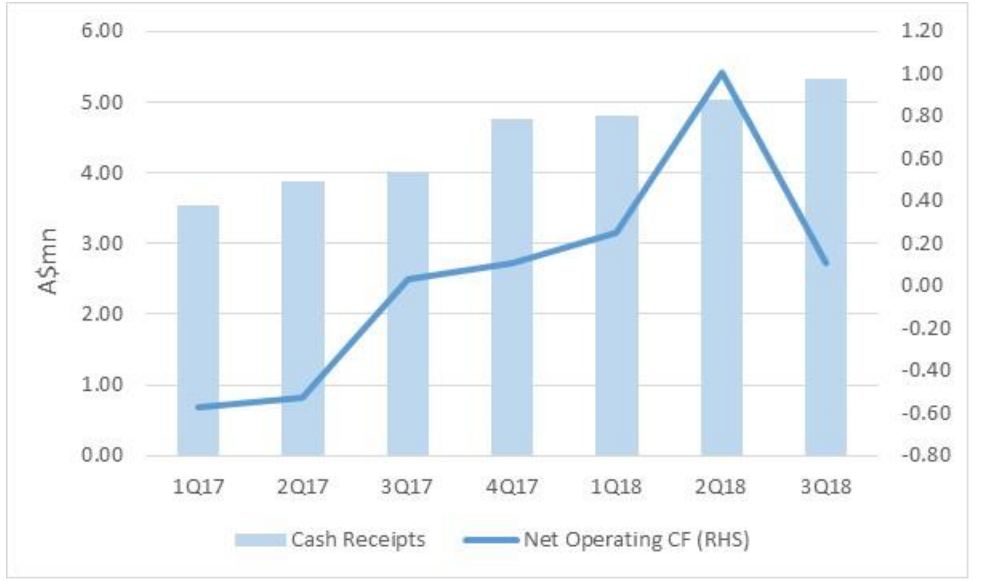
02-May-2018

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

SW1 reported its 3QFY18 result. Cash receipts were $5.325m in the quarter, compared to $5.023m in 2Q18 and $4.017m in the same period last year. Cash receipts for the first nine months of the financial year were $15.155m. This compares to our FY revenue forecast of $27.58m. This implies a substantial further uplift in the 4th quarter.

Fig. 1: Quarterly Revenue and Operating Cash Flow



Source: Company and Hartleys Research

The outlook for the final quarter looks positive with the Company flagging that during the 3rd quarter the Company took the opportunity to order stock in advance for newly secured and anticipated contracts due to be deployed in 4QFY18. Despite this we feel our 4th quarter revenue was set too high and have downgraded our full year revenue forecast to $23.07m.

Fig. 2: Earnings Changes

		FY17 Act	*Change*	FY18 Old	FY18 New	*Change*	FY19 Old	FY19 New	*Change*
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EBITDA	A$m	1.01	*0%*	3.56	2.50	*-30%*	4.29	4.21	*-2%*
NPAT	A$m	-0.08	*0%*	1.36	0.61	*-55%*	1.89	1.86	*-2%*
Capex	A$m	-1.74	*0%*	-7.20	-7.20	*0%*	-1.20	-1.20	*0%*
Change Cash	A$m	-0.97	*0%*	4.16	2.40	*-42%*	1.53	2.81	*83%*

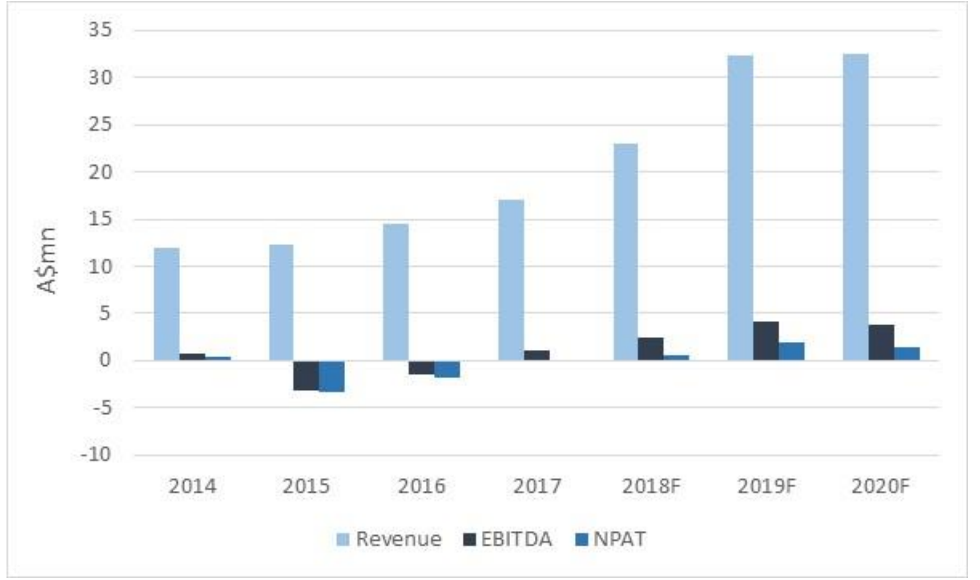
Source: Company and Hartleys Research

While any downgrade is disappointing, given the continued strong growth in room numbers (the Company likely reached our year end number in the 3rd quarter) we view this translation to revenue as simply a timing issue.

Recurring revenue was up 29% yoy in the March quarter, equating to an annualised recurring revenue run-rate of close to $17m (80% from the Mining and Resources sector).

Cash at bank at the end of the quarter was $3.98m. Subsequent to the quarter, SW1 collected $2.297 million in proceeds from option holders, (97% of the 25 cent options which expire on 30 April 2018 converted). These funds and a portion of existing cash will be used to repay its outstanding $2.625m loan by the end of May 2018, at which time the Company will be debt free.

Fig. 3: Revenue, EBITDA and NPAT



Source: Company and Hartleys Research

FY19 and Beyond - High expectations around reseller agreements

The market in late 2017, early 2018 reacted very positively to a number of announcements on high profile reseller agreements, which (as is to be expected) have not yet delivered a disclosed large number of new rooms. We did not expect anything material at least until the second half of 2018.

Key to achieving our FY19 revenue forecast will be the contribution from those 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 close to 70,000. 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.

The two key 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.

INVESTMENT VIEW, VALUATION AND PRICE TARGET

SW1 has seen its share price correct materially in the past six months (from a high of 60c per share on the 20th October 2017). There does not seem to have been any material negative news underpinning this sell off. ASX announcements continue to be positive in tone and content and the first half result was a solid start to FY18 (see our research 'FY18 – A Good Start, A Better Finish' (31st January 2018)).

SW1 does have quite a complex capital structure and a material proportion of the equity capital in the Company will be vesting or coming out of escrow in the coming months. While this in the medium term increases the liquidity for all investors, it may be viewed cautiously by some in the near term. Most importantly, our forecasts, valuation and target price have always assumed full dilution for these shares and options. So as long as the Company can deliver operationally (particularly on their announced reseller agreements in the next six months), then any continued selling related to concerns about the capital structure is likely to be a buying opportunity.

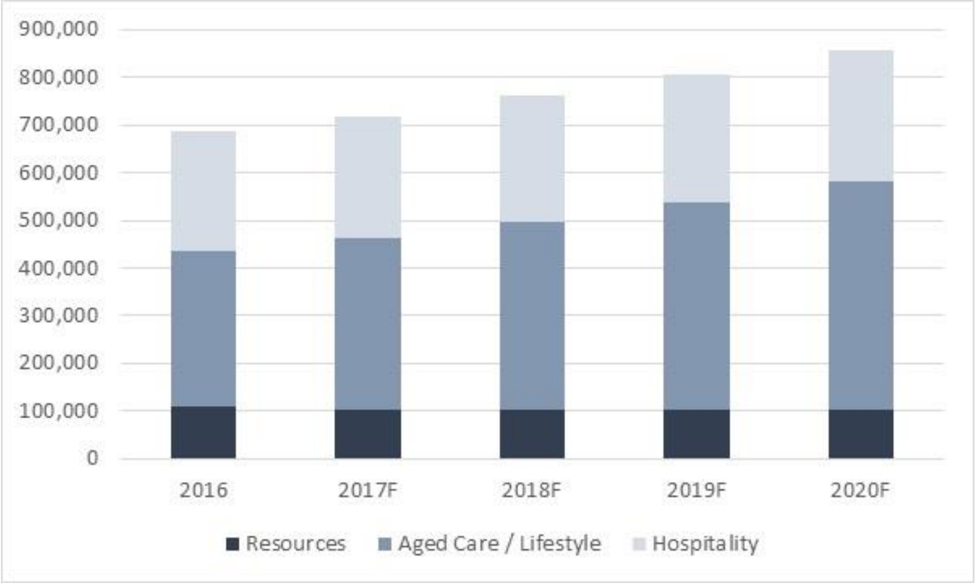
So, while these various 'vesting's' may result in some near-term uncertainty and volatility, we do include all 166m shares in our derivation of fair value. So, on the back of recent share weakness and with no evident change to the fundamental story, we maintain our Speculative Buy rating.

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.

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$0.55 per share (down 4c).

Post the recent correction in the share price, there is now 54% 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%	0.48
Earnings	29x	20%	0.31
DCF		20%	0.37
Synergy/Cost Out			0.13
Valuation			**$0.55**
Upside / downside from current share price			54%

Source: Hartleys Research

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

Post the recent share price correction there is now 54% upside to our 12-month target price of 55c 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

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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