WA Industrial: IT Services

SWIFT NETWORKS GROUP LTD (SW1)

FY18 – Strong Revenue Growth and Record Margins

Swift Networks Group Ltd ('Swift', 'SW1' or the 'Company') have recently released their preliminary FY18 result. Revenue for FY18 was $22.3m (+31% yoy), marginally below Hartleys $23.07m. As at June 2018, SW1's annualised contracted revenue increased 44% yoy to $15.7m (~70% versus 63% in FY17). Recurring revenue was 72% of the total in FY18, versus 80% in FY17. Resellers and partners delivered 43% of all new sales in FY18.

EBITDA of $2.7m (12% margin) was ahead of our forecast of $2.5m (10.8%) and $1m (5.9%) in FY17. This improving profitability was driven by the expansion into higher margin new market verticals (away from Resources) with Group gross margins in FY18 rising to 41.6% from 31.7% in FY17. Cash at the end of the financial year of $3.2m was lower than our estimate of $4.6m, but this is likely just a WC/timing issue given the strong EBITDA number. Overall this is a good result by SW1, with improving levels of profitability due to the changing client mix and scale, and the positive impact of reseller/partner agreements being the key takeaways. We have very marginally downgraded our revenue forecasts for FY18-19 in line with this result, the improving margin has resulted in an equally modest upgrade to EBITDA.

FY18 a strong year, positive FY19 outlook – Speculative Buy

Overall FY18 has turned out to be a very strong year for SW1. With resellers and partners already delivering 43% of all new sales in FY18, the outlook for FY19 is equally as positive. We expect revenue to grow to over $33m over the next two financial years. Margins we expect to continue to improve, although our assumptions could still prove conservative as the client mix continues to shift from Resources and due to the relatively fixed cost base.

We view SW1 as an attractive takeover target for a larger Group focusing on similar sectors and clients. While significant potential also still exists for SW1 to grow itself through further acquisitions, providing additional support for the upside to our 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$0.56 per share (up 1c). 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$m	17.01	*0%*	23.07	22.28	*-3%*	32.26	28.64	*-11%*
COGS	A$m	-11.61	*0%*	-14.07	-13.02	*-7%*	-20.97	-16.72	*-20%*
EBITDA	A$m	1.01	*0%*	2.50	2.67	*7%*	4.21	4.34	*3%*
NPAT	A$m	-0.08	*0%*	0.61	0.69	*13%*	1.86	1.88	*1%*
Capex	A$m	-1.74	*0%*	-7.20	-8.05	*12%*	-1.20	-1.20	*0%*
Change Cash	A$m	-0.97	*0%*	2.40	0.96	*-60%*	2.81	2.74	*-3%*

Source: Company and Hartleys Research

19 Jul 2018	
Share Price:	$0.395
12mth price target:	$0.56

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

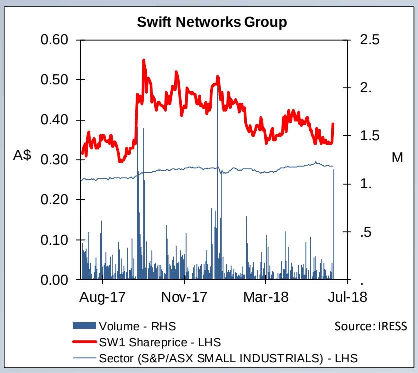
Top Shareholders:	**Shares Held (m)**
Robert Sofoulis	30.2
Wilson Asset Management	7.5

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

Issued Capital:	121.0m
- fully diluted	165.8m
Market Cap:	$47.8m
- fully diluted	$65.5m
Net Cash (end FY18e)	$3.2m

	FY17a	FY18p	FY19e
Screens - end FY	39,354	63,104	86,104
Screen adds	9,750	23,750	23,000
Revenue	17.0	22.3	28.6
EBITDA	1.0	2.7	4.3
EBIT	-0.1	1.0	2.6
NPAT	-0.1	0.7	1.9
EPS	0.000	0.004	0.011
EV/EBITDA	61.9x	23.3x	14.3x
EV/EBIT	-536.5x	60.7x	23.7x

Source: Hartleys Research. * normalised



Authors:
Aiden Bradley
Energy & Industrials Analyst
Ph: +61 8 9268 2876
E: aiden.bradley@hartleys.com.au

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 2 million unlisted options in Swift Networks Group Limited.

SUMMARY MODEL

Swift Networks Group Ltd (SW1)

Company Information		
Date	19 Jul 2018	1 Watts Place
Share Price	$0.395	Bentley
52 Week High-Low	$0.6 - $0.26	W.A, 6102
Market Cap ($m)	$47.8	www.swiftnetworks.com.au
Market Cap - FD ($m)	$65.5	
Enterprise Value ($m)	$44.6	
Enterprise Value - FD ($m)	$62.3	
Ordinary Shares	121.0	
Fully Diluted Shares	165.8	
Net Cash (end FY18p)	3.2	

Valuation

ASX IT Peer Group Multiples (+20%)

	12M forward - Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	21x	40%	0.59
Earnings	34x	20%	0.38
DCF		40%	0.63

Valuation	$0.56
Upside / downside from current share price	43%
P / E (6/18P) at price target	*134.8x*
P / E (6/19F) at price target	*49.8x*
EV / EBITDA (6/18P) at price target	*33.8x*
EV / EBITDA (6/19F) at price target	*20.8x*

Multiples (S/price at $0.40)	6/16A	6/17A	6/18P	6/19F
P / E (reported, basic weighted)	-26.9x	-623.8x	68.8x	25.4x
P / E (normalised, dil. weighted)	-36.8x	-854.4x	94.3x	34.8x
EV/EBITDA multiple	-42.1x	61.9x	23.3x	14.3x
EV/EBIT multiple	-35.0x	-536.5x	60.7x	23.7x

Capital Structure

		m	Expiry	Strike
Current shares on issue		121.0		
Restricted Shares		0.0		
Options		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		165.8		

*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	19.6%
Wilson Asset Management	7,549,449	4.9%

Recommendation: Speculative Buy

Operating Model		6/16A	6/17A	6/18P	6/19F
Resources					
	Screens - start	21,550	29,604	29,854	31,854
	New rooms	8,054	250	2,000	3,000
	Screens - end	29,604	29,854	31,854	34,854
	Revenue	13.35	13.02	12.96	14.01
Aged Care / Lifestyle					
	Screens - start			8,000	12,000
	New rooms		8,000	4,000	8,000
	Screens - end		8,000	12,000	20,000
	Revenue		0.48	1.32	2.88
Hospitality & Other					
	Screens - start			1,500	19,250
	New rooms		1,500	17,750	12,000
	Screens - end		1,500	19,250	31,250
	Revenue		0.09	1.78	4.85
Total					
	Screens - start	21,550	29,604	39,354	63,104
	New rooms	8,054	9,750	23,750	23,000
	Screens - end	29,604	39,354	63,104	86,104
Recurring Revenue		13.35	13.59	16.06	21.74
Other Revenue		1.07	3.41	6.22	6.90

P&L (A$m)	6/16A	6/17A	6/18P	6/19F
Revenue	14.42	17.01	22.28	28.64
COGS	-12.30	-11.61	-13.02	-16.72
Gross Profit	2.12	5.39	9.26	11.91
Margin	*15%*	*32%*	*42%*	*42%*
Corporate Overheads	-3.60	-4.39	-6.58	-7.57
Growth	*5.1%*	*21.9%*	*50.0%*	*15.0%*
EBITDA	-1.48	1.01	2.67	4.34
Margin	*-10%*	*6%*	*12%*	*15%*
Depreciation	-0.30	-1.12	-1.65	-1.72
EBIT	-1.78	-0.12	1.03	2.62
Net Interest	0.00	0.01	-0.03	0.06
PBT	-1.78	-0.11	0.99	2.69
Tax	0.00	0.03	-0.30	-0.81
Tax Rate	0%	30%	30%	30%
Normalised NPAT	-1.78	-0.08	0.69	1.88
EPS - basic	-0.015	-0.001	0.006	0.016
EPS - FD	-0.011	0.000	0.004	0.011

Cashflow Statement (US$m)	6/16A	6/17A	6/18P	6/19F
Net Operating Cash Flow	-0.7	-0.1	3.0	3.9
Investing Cash Flow	0.3	-1.7	-8.1	-1.2
Financing Cash Flow	3.2	0.9	6.0	0.0
Net Change in Cash	2.7	-1.0	1.0	2.7

Balance Sheet (A$m)	6/16A	6/17A	6/18P	6/19F
Cash	*3.2*	*2.2*	*3.2*	*5.9*
Total Current Assets	5.4	5.3	6.7	10.4
Non-Current Assets	6.0	9.2	15.6	15.1
Total Assets	11.4	14.5	22.3	25.5
Current debt	*0.9*	*0.0*	*0.0*	*0.0*
Total Current Liabilities	4.1	3.7	4.8	6.1
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	9.4	10.7
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

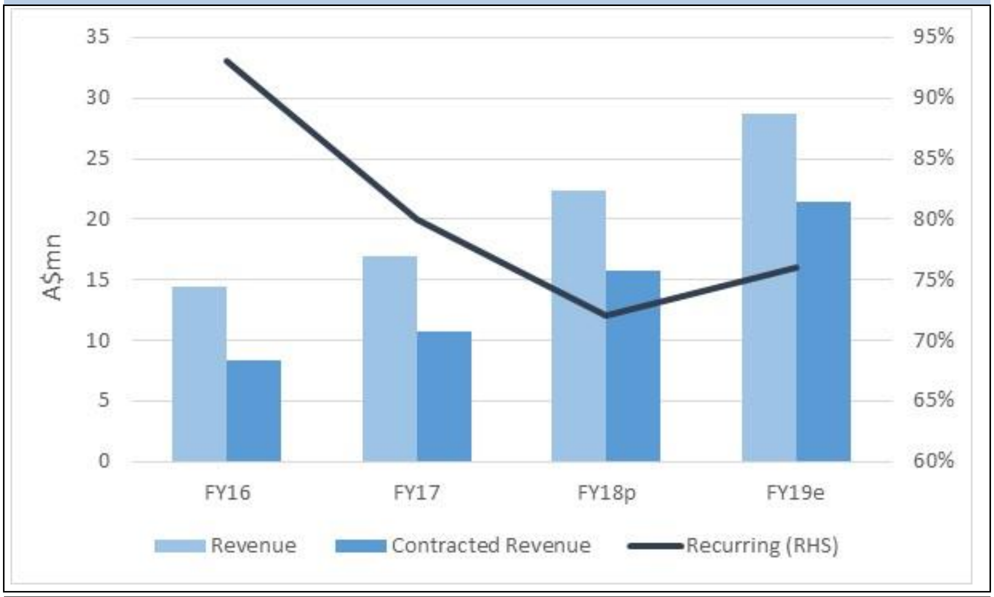
19-July-2018

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

SW1 have released their preliminary FY18 result. Revenue for FY18 was $22.3m (+31%), marginally below Hartleys $23.07m. As at June 2018, SW1's annualised contracted revenue increased 44% yoy to $15.7m (~70%). Resellers and partners delivered 43% of all new sales in FY18.

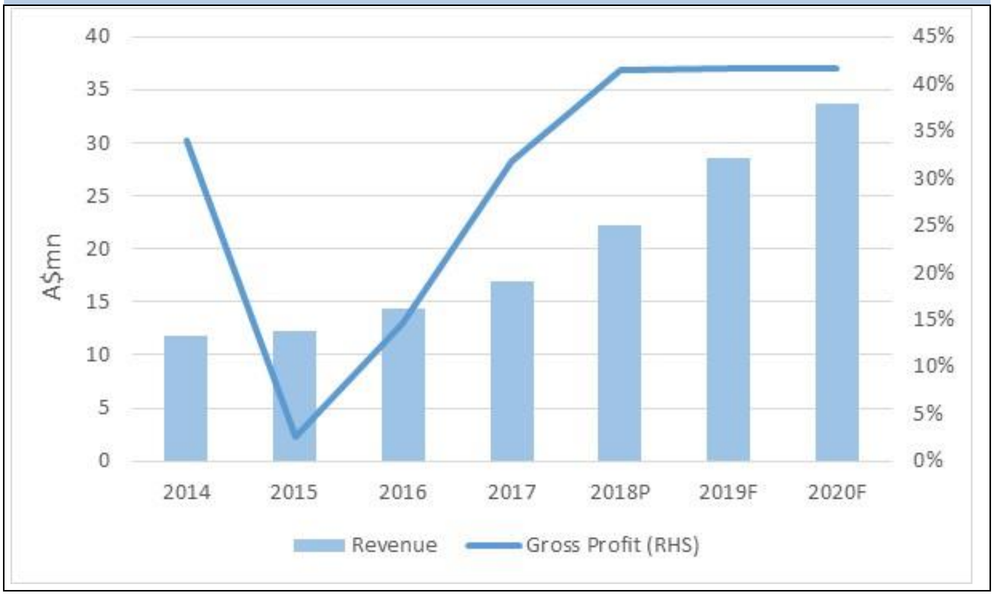
Fig. 1: *Revenue, Contracted and Recurring*



Source: SW1, Hartleys Research

Positively, EBITDA of $2.7m (12% margin) was ahead of our forecast of $2.5m (10.8% margin) and $1m (5.9%) in FY17. This improving profitability was driven by the expansion into higher margin new market verticals (diversifying away from Resources) with Group gross margins in FY18 rising to 41.6% from 31.7% in FY17.

Fig. 2: *Revenue and Gross Profit Margin*



Source: SW1, Hartleys Research

Cash at the end of the financial year of $3.2m was lower than our estimate of $4.6m, but this is likely just a WC/timing issue given the strong EBITDA number.

Overall this is a good result by SW1, with improving levels of profitability due to the changing client mix and scale, and the positive impact of reseller/partner agreements being the key takeaways.

Fig. 3: *Earnings Changes*

		FY17 Act	*Change*	FY18 Old	FY18 New	*Change*	FY19 Old	FY19 New	*Change*
Revenue	A$m	17.01	*0%*	23.07	22.28	*-3%*	32.26	28.64	*-11%*
COGS	A$m	-11.61	*0%*	-14.07	-13.02	*-7%*	-20.97	-16.72	*-20%*
EBITDA	A$m	1.01	*0%*	2.50	2.67	*7%*	4.21	4.34	*3%*
NPAT	A$m	-0.08	*0%*	0.61	0.69	*13%*	1.86	1.88	*1%*
Capex	A$m	-1.74	*0%*	-7.20	-8.05	*12%*	-1.20	-1.20	*0%*
Change Cash	A$m	-0.97	*0%*	2.40	0.96	*-60%*	2.81	2.74	*-3%*

Source: SW1, Hartleys Research

INVESTMENT VIEW, VALUATION AND PRICE TARGET

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.

Overall FY18 has turned out to be a very strong year for SW1. With resellers and partners already delivering 43% of all new sales in FY18, the outlook for FY19 is equally as positive. We expect revenue to grow to over $33m over the next two financial years. Margins we expect to continue to improve, although our assumptions could still prove conservative as the client mix continues to shift from Resources and due to the relatively fixed cost base.

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 itself through further acquisitions, providing additional support for the upside to our 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$0.56 per share (up 1c).

Post the recent correction in the share price, there is still 43% 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 year.

Fig. 4: Valuation Multiples

Valuation

ASX IT Peer Group Multiples (+20%)

	12M forward - Target Multiple	Wgt.%	Tgt Price
EV/EBITDA	21x	40%	0.59
Earnings	34x	20%	0.38
DCF		40%	0.63
Valuation			**$0.56**
Upside / downside from current share price			43%

Source: Hartleys Research

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

Post the recent share price correction there is now 43% upside to our 12-month target price of 56c 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 continue 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, 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

Research

Trent Barnett	Head of Research	+61 8 9268 3052
Mike Millikan	Resources Analyst	+61 8 9268 2805
John Macdonald	Resources Analyst	+61 8 9268 3020
Paul Howard	Resources Analyst	+61 8 9268 3045
Aiden Bradley	Research Analyst	+61 8 9268 2876
Oliver Stevens	Research Analyst	+61 8 9268 2879
Michael Scantlebury	Junior Analyst	+61 8 9268 2837
Janine Bell	Research Assistant	+61 8 9268 2831

Corporate Finance

Dale Bryan	Director & Head of Corp Fin.	+61 8 9268 2829
Richard Simpson	Director	+61 8 9268 2824
Ben Crossing	Director	+61 8 9268 3047
Ben Wale	Director	+61 8 9268 3055
Stephen Kite	Director	+61 8 9268 3050
Scott Weir	Director	+61 8 9268 2821
Scott Stephens	Associate Director	+61 8 9268 2819
Rhys Simpson	Associate Director	+61 8 9268 2851

Registered Office

Level 6, 141 St Georges Tce Postal Address:

Perth WA 6000	GPO Box 2777
Australia	Perth WA 6001
PH:+61 8 9268 2888	FX: +61 8 9268 2800
www.hartleys.com.au	info@hartleys.com.au

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.

Institutional Sales

Carrick Ryan	+61 8 9268 2864
Justin Stewart	+61 8 9268 3062
Simon van den Berg	+61 8 9268 2867
Digby Gilmour	+61 8 9268 2814
Jayme Walsh	+61 8 9268 2828
Veronika Tkacova	+61 8 9268 3053

Wealth Management

Nicola Bond	+61 8 9268 2840
Bradley Booth	+61 8 9268 2873
Adrian Brant	+61 8 9268 3065
Nathan Bray	+61 8 9268 2874
Sven Burrell	+61 8 9268 2847
Simon Casey	+61 8 9268 2875
Tony Chien	+61 8 9268 2850
Tim Cottee	+61 8 9268 3064
David Cross	+61 8 9268 2860
Nicholas Draper	+61 8 9268 2883
John Featherby	+61 8 9268 2811
Ben Fleay	+61 8 9268 2844
James Gatti	+61 8 9268 3025
John Goodlad	+61 8 9268 2890
Andrew Gribble	+61 8 9268 2842
David Hainsworth	+61 8 9268 3040
Murray Jacob	+61 8 9268 2892
Gavin Lehmann	+61 8 9268 2895
Shane Lehmann	+61 8 9268 2897
Steven Loxley	+61 8 9268 2857
Andrew Macnaughtan	+61 8 9268 2898
Scott Metcalf	+61 8 9268 2807
David Michael	+61 8 9268 2835
Jamie Moullin	+61 8 9268 2856
Chris Munro	+61 8 9268 2858
Michael Munro	+61 8 9268 2820
Ian Parker	+61 8 9268 2810
Matthew Parker	+61 8 9268 2826
Charlie Ransom	+61 8 9268 2868
David Smyth	+61 8 9268 2839
Greg Soudure	+61 8 9268 2834
Sonya Soudure	+61 8 9268 2865
Dirk Vanderstruyf	+61 8 9268 2855
Samuel Williams	+61 8 9268 3041