Hartleys

WA Industrial: IT Services

SWIFT NETWORKS GROUP LTD (SW1)

'Adland' - Ready to Launch into the 'Mediasphere'

Swift Networks Group Ltd ('Swift', 'SW1' or the 'Company) have released their full FY18 result. Revenue and EBITDA were previously disclosed on the 17th of July and were roughly in line with our expectations (see 'FY18 – Strong Revenue Growth and Record Margins' (19th July 2018)). In the actual Full Year result, the size of the reported Net Loss after Tax (NLAT) may have been a negative surprise for the market. SW1 reported a NLAT of $7.73m. This included a higher D&A charge than we expected, a $1.7m charge of share-based payments and a $5.7m loss due to the fair value loss on financial liability. We have discussed the latter before, please see our note 'Fully Diluted' (4th April 2018). The size of the 'loss' relates to a material increase in the probability that the share payments are made. Which is a good thing in reality as it means the business is hitting its milestones/targets!

Despite the potential confusion over the large reported net loss, overall this is a good result by SW1, with improving levels of underlying profitability due to the changing client mix and scale, and the positive impact of reseller/partner agreements being the key takeaways. Excluding one-off items, we estimate SW1 recorded a small underlying Net Profit in FY18, which was still below our estimate of $670,000 due to the higher D&A than we expected. Our FY19 estimates therefore remain largely unchanged except at the NPAT level due again to the higher D&A charge.

The outlook for FY19 remains positive. We expect room numbers to increase again from around 65,000 currently up towards 86,000 by year end FY19. FY19 will also see the launch of SW1's advertising offering and SW1 now views itself as a diversified telecommunication, content and 'advertising solutions provider'. This 'expansion' has been the ultimate strategy of the current management from the beginning and the potential to leverage of 65,000 plus rooms in selling advertising is obvious. The Company expects this launch to start contributing meaningful revenue in FY19 and become a major contributor to EBITDA over the coming few years. At this early stage we do not currently include any revenue in our explicit forecasts from advertising, however given its obvious potential it does in our opinion justify the premium multiples that we believe SW1 should trade on.

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, due to the relatively fixed cost base and the potential impact of advertising revenue. Based on our current forecasts and the premium we feel is warranted to the much slower growing ASX IT Services sector we continue to view fair value at **A$0.56 per share** (unchanged). Post the recent correction in the share price, there is now 73% upside to our 12-month target price. We retain our **Speculative Buy Recommendation** with updates on the delivery of rooms from the reseller agreements and the launch of advertising the likely key news in FY19.

SW1.asx
Speculative Buy

	10 Sep 2018
Share Price:	$0.325
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

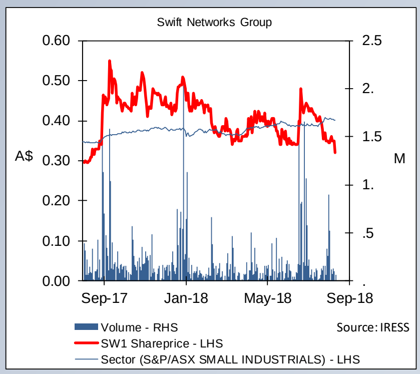
Top Shareholders:	**Shares Held (m)**
Robert Sofoulis	30.2
Wilson Asset Management	6.8

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

Issued Capital:	121.3m
- fully diluted	166.1m
Market Cap:	$39.4m
- fully diluted	$54.0m
Net Cash (end FY18a)	$3.2m

	FY17a	**FY18a**	**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	4.4
EBIT	-0.1	0.1	1.6
NPAT	-0.1	0.0	1.2
EPS	0.000	0.000	0.007
EV/EBITDA	50.5x	18.8x	11.6x
EV/EBIT	-437.3x	446.7x	31.0x

Source: Hartleys Research. * normalised



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SUMMARY MODEL

Swift Networks Group Ltd (SW1)

Recommendation: Speculative Buy

Company Information		
Date	10 Sep 2018	1 Watts Place
Share Price	$0.325	Bentley
52 Week High-Low	$0.6 - $0.285	W.A, 6102
Market Cap ($m)	$39.4	www.swiftnetworks.com.au
Market Cap - FD ($m)	$54.0	
Enterprise Value ($m)	$36.2	
Enterprise Value - FD ($m)	$50.8	
Ordinary Shares	121.3	
Fully Diluted Shares	166.1	
Net Cash (end FY18a)	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%	0.24
DCF		40%	0.69

Valuation	$0.56
Upside / downside from current share price	73%
P / E (6/19F) at price target	*4137.4x*
P / E (6/20F) at price target	*78.4x*
EV / EBITDA (6/19F) at price target	*33.5x*
EV / EBITDA (6/20F) at price target	*20.7x*

Multiples (S/price at $0.33)	6/16A	6/17A	6/18A	6/19F	6/20F
P / E (reported, basic weighted)	-22.1x	-514.5x	1,745.8x	33.1x	20.4x
P / E (normalised, dil. weighted)	-30.3x	-704.3x	2,389.7x	45.3x	27.9x
EV/EBITDA multiple	-34.3x	50.5x	18.8x	11.6x	9.2x
EV/EBIT multiple	-28.5x	-437.3x	446.7x	31.0x	19.3x

Capital Structure		m	Expiry	Strike
Current shares on issue		121.3		
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		166.1		

*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	19.5%
Wilson Asset Management	6,847,462	4.4%

Operating Model	6/16A	6/17A	6/18A	6/19F	6/20F
Resources					
Screens - start	21,550	29,604	29,854	31,854	34,854
New rooms	8,054	250	2,000	3,000	3,000
Screens - end	29,604	29,854	31,854	34,854	37,854
Revenue	13.35	13.02	12.96	14.01	15.27
Aged Care / Lifestyle					
Screens - start			8,000	12,000	20,000
New rooms		8,000	4,000	8,000	8,000
Screens - end		8,000	12,000	20,000	28,000
Revenue		0.48	1.32	2.88	4.32
Hospitality & Other					
Screens - start			1,500	19,250	31,250
New rooms		1,500	17,750	12,000	12,000
Screens - end		1,500	19,250	31,250	43,250
Revenue		0.09	1.78	4.85	7.15
Total					
Screens - start	21,550	29,604	39,354	63,104	86,104
New rooms	8,054	9,750	23,750	23,000	23,000
Screens - end	29,604	39,354	63,104	86,104	109,104
Recurring Revenue	13.35	13.59	16.06	21.74	26.74
Other Revenue	1.07	3.41	6.22	6.90	6.90

P&L (A$m)	6/16A	6/17A	6/18A	6/19F	6/20F
Revenue	14.42	17.01	22.28	28.64	33.64
COGS	-12.30	-11.61	-13.02	-16.72	-19.65
Gross Profit	2.12	5.39	9.26	11.91	13.99
Margin	*15%*	*32%*	*42%*	*42%*	*42%*
Corporate Overheads	-3.60	-4.39	-6.57	-7.55	-8.50
Growth	*5.1%*	*21.9%*	*49.6%*	*15.0%*	*12.5%*
EBITDA	-1.48	1.01	2.69	4.36	5.50
Margin	*-10%*	*6%*	*12%*	*15%*	*16%*
Depreciation	-0.30	-1.12	-2.58	-2.72	-2.86
EBIT	-1.78	-0.12	0.11	1.64	2.64
Net Interest	0.00	0.01	-0.08	0.06	0.13
PBT	-1.78	-0.11	0.03	1.70	2.76
Tax	0.00	0.03	-0.01	-0.51	-0.83
Tax Rate	0%	30%	30%	30%	30%
Normalised NPAT	-1.78	-0.08	0.02	1.19	1.93
EPS - basic	-0.015	-0.001	0.000	0.010	0.016
EPS - FD	-0.011	0.000	0.000	0.007	0.012

Cashflow Statement (US$m)	6/16A	6/17A	6/18A	6/19F	6/20F
Net Operating Cash Flow	-0.7	-0.1	2.6	4.3	5.1
Investing Cash Flow	0.3	-1.7	-8.1	-1.2	-1.2
Financing Cash Flow	3.2	0.9	6.4	0.0	0.0
Net Change in Cash	2.7	-1.0	1.0	3.1	3.9

Balance Sheet (A$m)	6/16A	6/17A	6/18A	6/19F	6/20F
Cash	*3.2*	*2.2*	*3.2*	*6.3*	*10.2*
Total Current Assets	5.4	5.3	8.3	12.7	17.6
Non-Current Assets	6.0	9.2	17.0	15.4	13.8
Total Assets	11.4	14.5	25.3	28.2	31.4
Current debt	*0.9*	*0.0*	*0.0*	*0.0*	*0.0*
Total Current Liabilities	4.1	3.7	15.9	8.3	9.6
Non-Current Debt	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Non-Current Liabilities	1.9	4.6	1.5	1.5	1.5
Total Liabilities	6.0	8.3	17.4	9.8	11.1
Net Assets	5.3	6.1	7.9	18.4	20.3
Equity	5.3	6.1	7.9	18.4	20.3

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Phone: +61 8 9268 2876

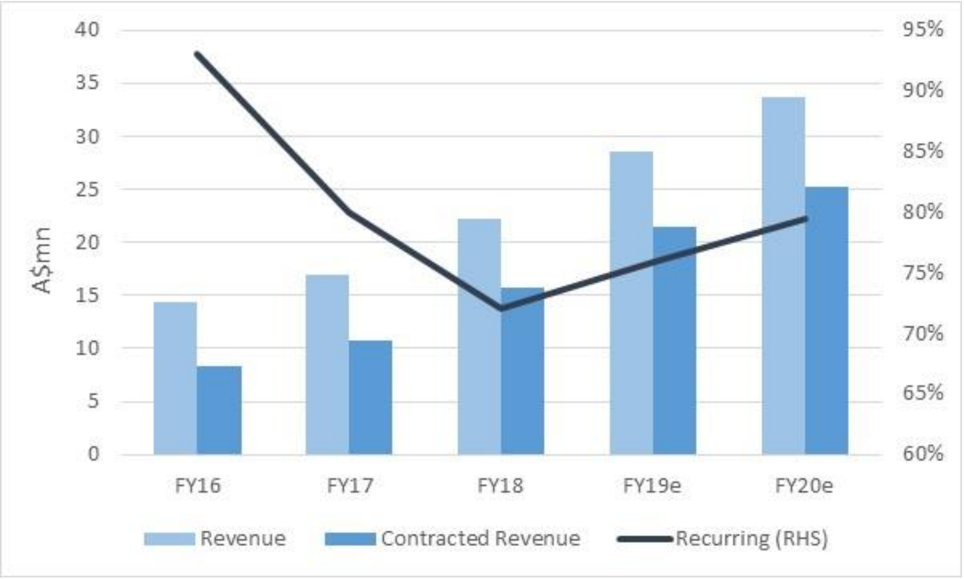
10-September-2018

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

SW1 have released their full FY18 result. Revenue for FY18 (was previously disclosed on the 17th July as a preliminary result) 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

EBITDA of $2.7m (12% margin) was also disclosed on the 17th of July and 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, as the result of marginally higher capital expenditure.

In the actual Full Year result, the size of the reported Net Loss after Tax (NLAT) may have been a negative surprise for the market. SW1 reported a NLAT of $7.73m (versus the Underlying EBITDA previously announced of $2.7m). Figure 3 outlines the reconciliation of these two numbers as provided by SW1.

Fig. 3: Reconciliation of Net Loss and Underlying EBITDA

	A$	Description
Net loss after tax	(7,728,812)	Refer to the Consolidated Statement of Profit or loss and Other Comprehensive Income
Income tax expense	169,253	Refer to Note 5
Interest costs (net)	81,382	Refer to Notes 3 & 4
Depreciation & amortisation expenses	1,066,744	Incurred in the ordinary course of business
Amortisation expenses	1,514,426	Attributable to the amortisation of intangibles recognised as part of the acquisitions made
Fair valuation loss on financial liability	5,683,333	Non-cash year end adjustment to the fair value of financial liabilities in respect of various performance shares (refer to Note 14)
Share based payments	1,715,492	Share based payments issued to the executive management team (refer to Note 18)
Other expenses	192,996	Acquisition related integration and restructuring costs (refer to Note 4)
Underlying EBITDA*	**2,694,814**	

*EBITDA is non IFRS financial information

Source: SW1, Hartleys Research

The higher D&A number was a surprise to us (it now includes $1.5m attributable to the amortisation of intangibles recognised as part of the acquisitions made) and we have adjusted our D&A forecasts accordingly. The $5.7m loss due to the fair value loss on financial liability we have discussed before. Please see our note 'Fully Diluted' (4th April 2018) for further details. The size of this 'loss' relates to a material increase in the probability that the share payments are made. Which is a good thing in reality as it means the business is hitting its milestones/targets!

Fig. 4: Fair Valuation Loss on Financial Liability

Entity	At initial recognition	At 30 June 2017	At 30 June 2018	Fair value at 30 June 2018[1]
Swift Networks Pty Ltd / Wizzie Pty Ltd	Milestone 1 – 20% Milestone 2 – 15%	Milestone 1 – 50% Milestone 2 – 30%	Milestone 1 – 90% Milestone 2 – 75%	$9,350,000
Living Networks	Milestone 1 – 50% Milestone 2 – 50%	Milestone 1 – 50% Milestone 2 – 50%	Milestone 1 – 50% Milestone 2 – 50%	$250,000
Web 2 TV	Milestone 1 – 50% Milestone 2 – 45% Milestone 3 – 40% Milestone 4 – 35% Milestone 5 – 30% Milestone 6 – 25% Milestone 7 – 20% Milestone 8 – 15% Milestone 9 – 10%	Milestone 1 – 75% Milestone 2 – 60% Milestone 3 – 50% Milestone 4 – 40% Milestone 5 – 30% Milestone 6 – 25% Milestone 7 – 20% Milestone 8 – 15% Milestone 9 – 10%	Milestone 1 – 75% Milestone 2 – 60% Milestone 3 – 50% Milestone 4 – 40% Milestone 5 – 30% Milestone 6 – 25% Milestone 7 – 20% Milestone 8 – 15% Milestone 9 – 10%	$687,500

[1] Measured under cash consideration, share price and managements' probability

Source: SW1, Hartleys Research

While these various 'vesting's' may result in some material one-off losses in the P&L and some near-term uncertainty and volatility, as highlighted before we do include all 166m shares (the total likely to be issued) in our derivation of fair value.

Fig. 5: *SW1 Capital Structure*

Capital Structure				
		m	Expiry	Strike
Current shares on issue		121.3		
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		166.1		

*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)

Source: SW1, Hartleys Research

Despite the potential confusion over the large reported net loss, 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. Excluding one-off items, we estimate SW1 recorded a small underlying Net Profit in FY18, which was still below our estimate of $670,000 due to the higher D&A than expected. Our FY19 estimates have remain largely unchanged except at the NPAT level due again to the higher D&A charge.

Fig. 6: *Earnings Changes*

		FY17 Act	FY18 Old	FY18 A	*Change*	FY19 Old	FY19 E	*Change*
Revenue	A$m	17.01	22.28	22.28	*0%*	28.64	28.64	*0%*
COGS	A$m	-11.61	-13.02	-13.02	*0%*	-16.72	-16.72	*0%*
EBITDA	A$m	1.01	2.67	2.69	*1%*	4.34	4.36	*0%*
NPAT	A$m	-0.08	0.69	0.02	*-97%*	1.88	1.19	*-37%*
Capex	A$m	-1.74	-8.05	-8.12	*1%*	-1.20	-1.20	*0%*
Change Cash	A$m	-0.97	0.96	0.96	*0%*	2.74	3.11	*14%*

Source: SW1, Hartleys Research

The outlook for FY19 remains positive. We expect room numbers to increase again from around 65,000 currently up towards 86,000 by year end FY19. This strong growth is again partially based on the continued success of their reseller agreements. Further evidence of the success of this strategy materialised post the release of their full year result. SW1 have expanded their International footprint further, signing a reseller agreement with a Vietnamese systems integrator, Sieu Nhat Thanh Co. Ltd. (http://www.snt.vn/home). Under the agreement, Sieu Nhat Thanh will resell SW1's suite of services on a 'preferred product' status (exclusive basis for an initial 3 years). The deal involves the immediate deployment of SW1's hospitality IPTV and guest connectivity solutions to 500 rooms across 3 hotels in Vietnam.

FY19 will also see the launch of SW1's advertising offering and SW1 now views itself as a diversified telecommunication, content and 'advertising solutions provider'. This 'expansion' has been the ultimate strategy of the current management from the beginning and the potential to leverage of 65,000 plus rooms in selling advertising is obvious. Leveraging of the existing infrastructure will also mean any revenue generated in this business channel will be very high margin. The Company expects this launch to start contributing meaningful revenue in FY19 and become a major contributor to EBITDA over the coming few years. At this early stage we do not currently include any revenue in our explicit forecasts from advertising, however given its obvious potential it does in our opinion justify the premium multiple (+20% to the ASX IT Services Sector) that we believe SW1 should trade on.

INVESTMENT VIEW & VALUATION

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 remains substantial and the launch in FY19 of their advertising platform is another very exciting development. Given this potential blue-sky revenue potential we feel comfortable that SW1 should trade at a 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, due to the relatively fixed cost base and the potential impact of advertising revenue.

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 continue to view fair value at A$0.56 per share (unchanged).

Post the recent correction in the share price, there is now 73% upside to our 12-month target price. We retain our Speculative Buy Recommendation with updates on the delivery of rooms from the reseller agreements and the launch of advertising the likely key news flow in the coming year.

Fig. 7: Valuation Multiples

ASX IT Peer Group Multiples (+20%)	**12M forward Target Multiple**	**Wgt.%**	**Tgt Price**
EV/EBITDA	21x	40%	0.59
Earnings	34x	20%	0.24
DCF		40%	0.69
Valuation			**$0.56**
Upside / downside from current share price			73%

Source: Hartleys Research

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

Post the recent share price correction there is now 73% 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. The launch of their advertising platform is also a potential material contributor to earnings growth in the coming years. 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. The launch of their advertising platform.
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

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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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