Hartleys

SWIFT NETWORKS GROUP LTD (SW1)

Managing to Balance Growth and Profitability

Swift Networks Group Ltd ('Swift', 'SW1' or the 'Company) recently released a preliminary 1HFY19 result. The key positive was the Underlying EBITDA result of $2.76m, this compares to our prior FY forecast of $5.23m. This was achieved despite Revenue being lower than what we expected. Revenue of $12.6m was only up circa $660k versus 2H18. Our prior FY number (excluding a contribution from Medical Media) was $28.6m. The strong EBITDA was therefore underpinned by Gross Margins far exceeding our expectations (54% versus our full year 43% in FY19 and 49% in FY20). So, while revenue growth has slowed, the mix (including diversifying away from Resources) is obviously generating a higher margin. The Gross Margin was boosted by two tech licensing fees, excluding which the Margin may have been closer to 49-50%. While it is great to see the margin improvement, SW1 is still obviously viewed by many as a growth stock, and the lower revenue growth is likely to be behind the muted market reaction to the announcement.

Much of the growth in the traditional SW1 business is now derived from the reseller agreements, with management instead now focused on the high margin growth potential from the developing media offering. Medical Media should contribute to the second half result and the Company continues to expect Advertising/Media to represent close to 1/3 of Group revenue within 24 months, at Gross Margins nearer to 75% versus circa 50% for the traditional SW1 business. Additional revenue growth could materialise from new products (e.g. Lumiair), new content (e.g. eSports), further International penetration (e.g. Vietnam) and potential for further bolt on acquisitions. However, the market will likely be focused on the ability of the new media business (organic and the Medical Media acquisition) to lift growth and this will obviously now be a key focus for those investors over the next year.

We view the Medical Media acquisition as a good strategic move given SW1's growing focus on pursuing the monetisation of its media/advertising potential. 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 updated forecasts including the Medical Media business we continue to view fair value at A$0.52 per share. We retain our Speculative Buy Recommendation with further strong reported results in FY19, upside from the Medical Media acquisition, the continued delivery of rooms from the reseller agreements and the launch of advertising the likely key news flow in the coming year.

Key Chart: Earnings Changes

		FY18 Act	FY19 Old	FY19 E	*Change*	FY20 Old	FY20 E	*Change*
Revenue	A$m	22.28	31.10	28.74	*-8%*	43.26	41.34	*-4%*
COGS	A$m	-13.02	-17.73	-15.23	*-14%*	-22.06	-20.67	*-6%*
EBITDA	A$m	2.69	5.23	5.36	*3%*	9.80	9.60	*-2%*
NPAT	A$m	0.02	1.47	1.57	*6%*	3.61	3.46	*-4%*
Capex	A$m	-8.12	-3.70	-3.70	*0%*	-2.20	-2.20	*0%*
Change Cash	A$m	0.96	1.32	0.76	*-43%*	5.65	5.92	*5%*

Source: Hartleys Research

SW1.asx
Speculative Buy

	6 Feb 2019
Share Price:	$0.26
12mth price target:	$0.52

Brief Business Description:
SW1 is a diversified telecommunications, content and advertising solutions provider. Services include FTA and pay TV, telecom, VOD, integrated advertising and analytics.

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	(Non Executive) - Outgoing
Xavier Kris	CEO/Interim Exec. Chair.
George Nicholls	CFO

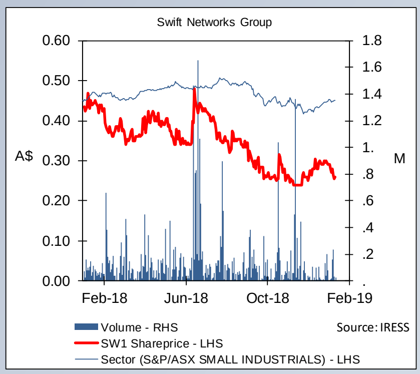
Top Shareholders:	**Shares Held (m)**
Robert Sofoulis	63.5

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

Issued Capital:	136.3m
- fully diluted	251.8m
Market Cap:	$35.4m
- fully diluted	$65.5m
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	28.7
EBITDA	1.0	2.7	5.4
EBIT	-0.1	0.1	2.2
NPAT	-0.1	0.0	1.6
EPS	0.000	0.000	0.006
EV/EBITDA	61.9x	23.1x	11.6x
EV/EBIT	-536.3x	547.8x	28.6x

Source: Hartleys Research. * normalised



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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 unlisted options in Swift Networks Group Limited.

SUMMARY MODEL

Swift Networks Group Ltd (SW1)

Company Information		
Date	6 Feb 2019	1 Watts Place
Share Price	$0.260	Bentley
52 Week High-Low	$0.48 - $0.21	W.A, 6102
Market Cap ($m)	$35.4	www.swiftnetworks.com.au
Market Cap - FD ($m)	$65.5	
Enterprise Value ($m)	$32.2	
Enterprise Value - FD ($m)	$62.3	
Ordinary Shares	136.3	
Fully Diluted Shares	251.8	
Net Cash (end FY18a)	3.2	

Valuation			
ASX IT Peer Group Multiples	**12M forward Target Multiple**	**Wgt.%**	**Tgt Price**
EV/EBITDA	16x	50%	0.50
DCF		50%	0.55
Valuation			**$0.52**
Upside / downside from current share price			102%
P / E (6/19F) at price target			*84.3x*
P / E (6/20F) at price target			*38.2x*
EV / EBITDA (6/19F) at price target			*24.0x*
EV / EBITDA (6/20F) at price target			*13.4x*

Multiples (S/price at $0.26)	6/16A	6/17A	6/18A	6/19F	6/20F
P / E (reported, basic weighted)	-19.9x	-462.6x	1,569.6x	22.6x	10.2x
P / E (normalised, dil. weighted)	-36.8x	-854.2x	2,898.5x	41.8x	18.9x
EV/EBITDA multiple	-42.1x	61.9x	23.1x	11.6x	6.5x
EV/EBIT multiple	-35.0x	-536.3x	547.8x	28.6x	12.8x

Capital Structure		m	Expiry	Strike
Current shares on issue		136.3		
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	73.2		
Full Diluted		251.8		

*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)	Fully Diluted
Carl Clump	Chairman (Non Executive) - Outgoing	1,259,879	1%
Xavier Kris	CEO & Interim Executive Chairman	3,580,833	1%
George Nicholls	CFO	0	0%
Ryan Sofoulis	Executive Director	54,000	0%
Robert Sofoulis	NED	63,500,000	26%
Paul Doropoulos	NED	2,456,437	1%
Darren Smorgon	NED (upon deal closure)	TBC	

Major Shareholders		%
Robert Sofoulis	63,500,000	26.2%

Recommendation: Speculative Buy

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	2.30	3.74
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	3.64	5.81
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	19.95	24.82
Media Revenue	0.00	0.00	0.00	2.47	9.62
Other Revenue	1.07	3.41	6.22	6.33	6.90

P&L (A$m)	6/16A	6/17A	6/18A	6/19F	6/20F
Revenue	14.42	17.01	22.28	28.74	41.34
COGS	-12.30	-11.61	-13.02	-15.23	-20.67
Gross Profit	2.12	5.39	9.26	13.51	20.67
Margin	*15%*	*32%*	*42%*	*47%*	*50%*
Corporate Overheads	-3.60	-4.39	-6.57	-8.14	-11.07
Growth	*5.1%*	*21.9%*	*49.6%*	*24.0%*	*36.0%*
EBITDA	-1.48	1.01	2.69	5.36	9.60
Margin	*-10%*	*6%*	*12%*	*19%*	*23%*
Depreciation	-0.30	-1.12	-2.58	-3.19	-4.73
EBIT	-1.78	-0.12	0.11	2.18	4.86
Net Interest	0.00	0.01	-0.08	0.06	0.08
PBT	-1.78	-0.11	0.03	2.24	4.94
Tax	0.00	0.03	-0.01	-0.67	-1.48
Tax Rate	0%	30%	30%	30%	30%
Normalised NPAT	-1.78	-0.08	0.02	1.57	3.46
EPS - basic	-0.013	-0.001	0.000	0.011	0.025
EPS - FD	-0.007	0.000	0.000	0.006	0.014

Cashflow Statement (US$m)	6/16A	6/17A	6/18A	6/19F	6/20F
Net Operating Cash Flow	-0.7	-0.1	2.6	4.5	8.1
Investing Cash Flow	0.3	-1.7	-8.1	-3.7	-2.2
Financing Cash Flow	3.2	0.9	6.4	0.0	0.0
Net Change in Cash	2.7	-1.0	1.0	0.8	5.9

Balance Sheet (A$m)	6/16A	6/17A	6/18A	6/19F	6/20F
Cash	*3.2*	*2.2*	*3.2*	*4.0*	*9.9*
Total Current Assets	5.4	5.3	8.3	10.4	18.9
Non-Current Assets	6.0	9.2	17.0	30.0	27.4
Total Assets	11.4	14.5	25.3	40.4	46.3
Current debt	*0.9*	*0.0*	*0.0*	*0.0*	*0.0*
Total Current Liabilities	4.1	3.7	15.9	15.6	18.1
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	17.1	19.6
Net Assets	5.3	6.1	7.9	23.3	26.7
Equity	5.3	6.1	7.9	23.3	26.7

Analyst: Aiden Bradley
Phone: +61 8 9268 2876

06-February-2019

Sources: IRESS, Company Information, Hartleys Research

HIGHLIGHTS

Swift Networks Group Ltd ('Swift', 'SW1' or the 'Company) recently released a preliminary 1HFY19 result. The key positive was the Underlying EBITDA result of $2.76m, this compares to our prior FY forecast of $5.23m.

This was achieved despite Revenue being lower than what we expected. Revenue of $12.6m was only up circa $660k versus 2H18. Our prior FY number (excluding a contribution from Medical Media) was $28.6m.

The strong EBITDA was therefore underpinned by Gross Margins far exceeding our expectations (54% versus our full year 43% in FY19 and 49% in FY20). So, while revenue growth has slowed, the mix (including diversifying away from Resources) is obviously generating a higher margin. The Gross Margin was boosted by two tech licensing fees, excluding which the Margin may have been closer to 49-50%.

While it is great to see the margin improvement, SW1 is still obviously viewed by many as a growth stock, and the lower revenue growth is likely to be behind the muted market reaction to the announcement.

Much of the growth in the traditional SW1 business is now derived from the reseller agreements, with management instead now focused on the high margin growth potential from the developing media offering. Medical Media should contribute to the second half result and the Company continues to expect Advertising/Media to represent close to 1/3 of Group revenue within 24 months, at Gross Margins nearer to 75% versus circa 50% for the traditional SW1 business.

Additional revenue growth could materialise from new products (e.g. Lumiair), new content (eSports), further International penetration (e.g. Vietnam) and potential for further bolt on acquisitions.

However, the market will likely be focused on the ability of the new media business (organic and the Medical Media acquisition) to lift growth and this will obviously now be a key focus for those investors over the next year.

INVESTMENT VIEW & VALUATION

Valuation – New Sector Growth key to Upside

The Medical Media acquisition has not only extended SW1's reach into the Medical vertical but also accelerates their move into advertising. There is scope for Medical Media to leverage of SW1's content and technology and for SW1 to leverage of Medical Media's experience with over 2,800 local and national advertisers.

Overall FY18 and 1HFY19 have turned out to be a very strong 18 months for SW1. With resellers and partners already delivering 43% of all new sales in FY18, the outlook for FY19 was equally as positive. We had expected revenue to grow to over $33m over the next two financial years. The Medical Media acquisition is likely to increase this to closer to $41m in FY20, with EBITDA approaching $10m if the transaction delivers as expected.

Fig. 1: *Earnings Changes*

		FY18 Act	FY19 Old	FY19 E	*Change*	FY20 Old	FY20 E	*Change*
Revenue	A$m	22.28	31.10	28.74	*-8%*	43.26	41.34	*-4%*
COGS	A$m	-13.02	-17.73	-15.23	*-14%*	-22.06	-20.67	*-6%*
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Capex	A$m	-8.12	-3.70	-3.70	*0%*	-2.20	-2.20	*0%*
Change Cash	A$m	0.96	1.32	0.76	*-43%*	5.65	5.92	*5%*

Source: Hartleys Research

As highlighted in our other recent research, SW1's share price has been negatively impacted since mid-year 2018 by general weakness in small cap industrial stocks and the release of shares from escrow etc.

We view the Medical Media acquisition as a good strategic move given SW1's growing focus on pursuing the monetisation of its media/advertising potential.

We continue to expect strong organic growth in the core business (despite the slowdown in the growth rate in 1HFY19), while upside from the reseller agreements remains substantial and the launch in FY19 of their advertising platform is another very exciting development.

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 new forecasts including the Medical Media business we continue to view fair value at A$0.52 per share.

We retain our Speculative Buy Recommendation with strong reported results in FY19, upside from the Medical Media acquisition, the continued delivery of rooms from the reseller agreements and the launch of advertising the likely key news flow in the coming year.

Fig. 2: *Valuation*

Valuation			
ASX IT Peer Group Multiples	**12M forward Target Multiple**	**Wgt.%**	**Tgt Price**
EV/EBITDA	16x	50%	0.50
DCF		50%	0.55
Valuation			**$0.52**
Upside / downside from current share price			102%
P / E (6/19F) at price target			*84.3x*
P / E (6/20F) at price target			*38.2x*
EV / EBITDA (6/19F) at price target			*24.0x*
EV / EBITDA (6/20F) at price target			*13.4x*

Source: Hartleys Research

RECOMMENDATION & RISKS

INVESTMENT THESIS & RECOMMENDATION

We retain our Speculative Buy Recommendation. We remain 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, Medical 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 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 and Medical Media 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.

	Medical: Ability to expand the footprint acquired through the acquisition of Medical Media. The launch of their advertising platform and ability to leverage of the Medical Media acquisition.
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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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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