

# Atomos Limited

## Back on track

The 1H21 result illustrated a return to form for AMS. As a global business, the early stages of COVID-19 had a drastic impact. However, by shoring up its supply chain and releasing new products, AMS is now benefitting from shifting trends in how individuals consume video content. The rise of Netflix and other online streaming/video platforms driven by lockdowns means there was surplus demand for original and high-quality content, for which AMS' hardware helped to meet. AMS management has also demonstrated its ability to manage its fixed cost-base, maintaining a rate of ~\$1.6m per month vs ~\$2.3m per month pre-COVID. Management view this rate as the new norm and have called out relatively modest increases going forward. The view that AMS is likely to benefit further from the accelerated shift towards new content creation, combined with the positive gross margin reversion, gives us the confidence to upgrade our recommendation to a BUY and increase our price target to \$1.35 (representing a TSR of 27%).

### 1H21 result

1H21 revenue of \$32.8m showed strong signs of recovery, growing significantly on the 2H20 (+178% hoh). Gross profit margins also saw an improvement on the second half, with gross margins of 44.9% (+4.2%pts on OMLe), largely driven by a reduction in discounting and some new products. The reduced opex and strong GP margin resulted in an EBITDA result of \$2.5m (\$1m ahead of OMLe). Positive cash flow helped to bolster AMS' balance sheet, with the company well placed with ~\$23.3m. Management have called out the potential for M&A opportunities in the near future as a means of deploying the cash.

### Changes to forecasts

AMS management, whilst not providing explicit guidance, did outline that 1H sales momentum is expected to continue into the second half and that it anticipates further margin improvements off the back of new products and revenue streams. Therefore, we have made modest increases to revenue, EBITDA and NPAT off the back of the 1H21 result. See page 3 for more details.

### Key risks

The key risks for AMS include: 1) Supply chain risks, 2) Product obsolescence, 3) Competition, and 4) Global macro events.

| Year-end July (\$)    | FY19A | FY20A  | FY21E | FY22E | FY23E |
|-----------------------|-------|--------|-------|-------|-------|
| Revenue (\$m)         | 53.7  | 44.4   | 65.8  | 80.3  | 96.7  |
| EBITDA (\$m)          | 1.6   | (7.1)  | 4.0   | 7.9   | 12.9  |
| EBIT (\$m)            | 0.2   | (10.9) | 1.0   | 4.7   | 9.6   |
| Reported NPAT (\$m)   | (2.0) | (22.1) | 0.7   | 3.3   | 6.7   |
| Reported EPS (c)      | (1.2) | (10.6) | 0.3   | 1.5   | 2.9   |
| Normalised NPAT (\$m) | (0.7) | (12.0) | 0.7   | 3.3   | 6.7   |
| Normalised EPS (c)    | (0.4) | (5.8)  | 0.3   | 1.5   | 2.9   |
| EPS Growth (%)        | -     | -      | -     | 369.3 | 102.1 |
| Dividend (c)          | -     | -      | -     | -     | -     |
| Net Yield (%)         | -     | -      | -     | -     | -     |
| Franking (%)          | 100   | 100    | 100   | 100   | 100   |
| EV/EBITDA (X)         | -     | -      | -     | 27.3  | 16.5  |
| Normalised P/E (x)    | -     | -      | -     | 72.8  | 36.0  |
| Normalised ROE (%)    | -     | -      | 1.2   | 5.6   | 10.4  |

Source: OML, Iress, Atomos Limited

### Last Price

**A\$1.06**

### Target Price

**A\$1.35** (Previously A\$1.24)

### Recommendation

**Buy** (Previously Speculative Buy)

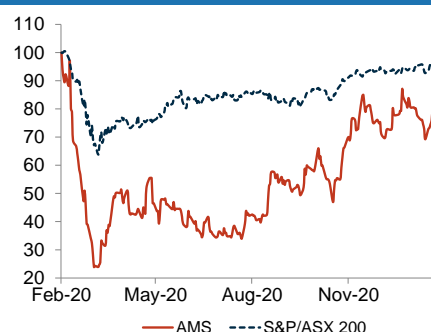
### Risk

**Higher**

### Computer Hardware

|                               |             |
|-------------------------------|-------------|
| ASX Code                      | AMS         |
| 52 Week Range (\$)            | 0.30 - 1.24 |
| Market Cap (\$m)              | 231.6       |
| Shares Outstanding (m)        | 218.5       |
| Av Daily Turnover (\$m)       | 4.7         |
| 3 Month Total Return (%)      | 23.3        |
| 12 Month Total Return (%)     | -14.2       |
| Benchmark 12 Month Return (%) | -3.7        |
| NTA FY21E (¢ per share)       | 16.1        |
| Net Cash FY21E (\$m)          | 18.3        |

### Relative Price Performance



Source: FactSet

### Consensus Earnings

|                 | FY21E | FY22E |
|-----------------|-------|-------|
| NPAT (C) (\$m)  | 1.4   | 4.6   |
| NPAT (OM) (\$m) | 0.7   | 3.3   |
| EPS (C) (c)     | 0.7   | 2.2   |
| EPS (OM) (c)    | 0.3   | 1.5   |

Source: OML, Iress, Atomos Limited

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## 1H21 result overview

- AMS released its 1H21 results with revenue of \$32.8m, ~17% ahead of guidance.
- Gross margin is the key takeaway, up 5.1%pts half-on-half to 44.9% and reverting to historical levels. This helped drive a gross profit beat of 10.9%.
- Operating costs also improved on PCP off the back of reduced occupancy, travel, and staff costs. This meant EBITDA of \$2.5m vs OMLe of \$1.5m.
  - Given the small base, it was ahead vs OMLe by 60.4%.
- Outlook commentary in the result states:
  - Management notes that sales momentum has performed strongly in the half and, whilst cautious given COVID-19, anticipates this momentum to continue into the second half.
  - AMS will continue to invest in new products and paid-for software upgrades. Management expect these to lead to further gross margin upside in the future.
  - Costs are anticipated to grow slightly as AMS brings on additional senior staff and invests in digital marketing. However, management highlighted that they believe the monthly cost-base will not revert to pre-COVID-19 levels.

Figure 1 – Result overview

|                         | FY19a       | 1H20a       | 2H20a        | FY20a        | 1H21a       | %Δ pcg        | 1H21e       | %Δ OMLe        |
|-------------------------|-------------|-------------|--------------|--------------|-------------|---------------|-------------|----------------|
| <b>Sales revenue</b>    | <b>53.7</b> | <b>32.6</b> | <b>11.8</b>  | <b>44.4</b>  | <b>32.8</b> | <b>0.4%</b>   | <b>32.6</b> | <b>0.5%</b>    |
| COGS                    | -29.9       | -18.7       | -8.1         | -26.8        | -18.0       | 3.5%          | -19.3       | -6.7%          |
| <b>Gross profit</b>     | <b>23.8</b> | <b>13.9</b> | <b>3.7</b>   | <b>17.7</b>  | <b>14.7</b> | <b>5.6%</b>   | <b>13.3</b> | <b>10.9%</b>   |
| Total expenses (ex-D&A) | -22.2       | -13.0       | -11.8        | -24.8        | -12.2       | 5.5%          | -11.7       | 4.4%           |
| <b>EBITDA</b>           | <b>1.6</b>  | <b>1.0</b>  | <b>-8.1</b>  | <b>-7.1</b>  | <b>2.5</b>  | <b>151.8%</b> | <b>1.5</b>  | <b>60.4%</b>   |
| D&A                     | -1.5        | -1.6        | -2.2         | -3.8         | -1.5        | 7.8%          | -2.5        | -41.2%         |
| <b>EBIT</b>             | <b>0.2</b>  | <b>-0.6</b> | <b>-10.3</b> | <b>-10.9</b> | <b>1.0</b>  | <b>263.8%</b> | <b>-1.0</b> | <b>-204.9%</b> |
| Net interest            | 0.0         | -0.2        | -0.2         | -0.4         | -0.1        | 28.9%         | 0.0         | 2100.1%        |
| <b>PBT</b>              | <b>0.2</b>  | <b>-0.8</b> | <b>-10.5</b> | <b>-11.3</b> | <b>0.9</b>  | <b>205.1%</b> | <b>-1.0</b> | <b>-189.2%</b> |
| Tax                     | -0.8        | -0.3        | -0.5         | -0.8         | -0.1        | 54.8%         | 0.3         | -142.6%        |
| <b>Normalised NPAT</b>  | <b>-0.7</b> | <b>-1.1</b> | <b>-10.9</b> | <b>-12.0</b> | <b>0.7</b>  | <b>167.6%</b> | <b>-0.7</b> | <b>-209.1%</b> |
| Normalised EPS          | -0.39       | -0.52       | -5.24        | -5.76        | 0.33        | 163.4%        | -0.35       | -193.6%        |
| Gross margin            | 44.3%       | 42.7%       | 31.7%        | 39.8%        | 44.9%       | 2.2%pts       | 40.7%       | 4.2%pts        |
| EBITDA margin           | 3.1%        | 3.0%        | -68.5%       | -16.0%       | 7.6%        | 4.5%pts       | 4.7%        | 2.8%pts        |

Source: OMLe and AMS

## Changes to forecasts

We have made the following changes to our forecasts:

- Adjusted revenue to account for second half momentum.
- Gross margins remain stable in the second half to better reflect the operating conditions.
- Second half EBITDA margins increased slightly to account for additional staff, marketing, and R&D.

**Figure 2 – Changes to forecasts**

|                        | FY21 old    | FY21 new    | %Δ             | FY22 old    | FY22 new    | %Δ            | FY23 old    | FY23 new    | %Δ           |
|------------------------|-------------|-------------|----------------|-------------|-------------|---------------|-------------|-------------|--------------|
| <b>Sales revenue</b>   | <b>58.3</b> | <b>65.8</b> | <b>12.9%</b>   | <b>75.3</b> | <b>80.3</b> | <b>6.7%</b>   | <b>93.1</b> | <b>96.7</b> | <b>3.8%</b>  |
| COGS                   | -35.8       | -36.2       | 1.3%           | -44.6       | -43.8       | -1.8%         | -52.9       | -51.8       | -2.0%        |
| <b>Gross profit</b>    | <b>22.6</b> | <b>29.6</b> | <b>31.2%</b>   | <b>30.6</b> | <b>36.5</b> | <b>19.1%</b>  | <b>40.2</b> | <b>44.9</b> | <b>11.6%</b> |
| Total expenses         | -20.3       | -25.7       | 26.1%          | -24.2       | -28.6       | 18.3%         | -27.8       | -31.9       | 14.9%        |
| <b>EBITDA</b>          | <b>2.2</b>  | <b>4.0</b>  | <b>78.5%</b>   | <b>6.5</b>  | <b>7.9</b>  | <b>22.2%</b>  | <b>12.4</b> | <b>12.9</b> | <b>4.1%</b>  |
| D&A                    | -5.0        | -2.9        | -41.2%         | -5.2        | -3.1        | -39.6%        | -5.4        | -3.3        | -38.1%       |
| <b>EBIT</b>            | <b>-2.8</b> | <b>1.0</b>  | <b>-136.3%</b> | <b>1.3</b>  | <b>4.7</b>  | <b>278.1%</b> | <b>7.0</b>  | <b>9.6</b>  | <b>36.6%</b> |
| Net interest           | 0.0         | 0.0         | -72.1%         | 0.0         | 0.0         | -69.2%        | 0.0         | 0.0         | -38.5%       |
| <b>PBT</b>             | <b>-2.8</b> | <b>1.0</b>  | <b>-136.1%</b> | <b>1.2</b>  | <b>4.7</b>  | <b>283.0%</b> | <b>7.0</b>  | <b>9.6</b>  | <b>36.7%</b> |
| Tax                    | 0.8         | -0.3        | -136.1%        | -0.4        | -1.4        | 283.0%        | -2.1        | -2.9        | 36.7%        |
| <b>Normalised NPAT</b> | <b>-2.0</b> | <b>0.7</b>  | <b>-136.1%</b> | <b>0.9</b>  | <b>3.3</b>  | <b>283.0%</b> | <b>4.9</b>  | <b>6.7</b>  | <b>36.7%</b> |
| Normalised EPS         | -0.9        | 0.3         | -136.1%        | 0.4         | 1.5         | 281.9%        | 2.2         | 2.9         | 36.4%        |
| GP margin              | 38.7%       | 45.0%       | 6.3%pts        | 40.7%       | 45.4%       | 4.7%pts       | 43.2%       | 46.4%       | 3.2%pts      |
| EBITDA margin          | 3.8%        | 6.0%        | 2.2%pts        | 8.6%        | 9.8%        | 1.2%pts       | 13.3%       | 13.4%       | 0.0%pts      |

Source: OML and AMS

## Valuation & Recommendation

Given the long-dated nature of AMS' growth and its working capital consumptive model, we focus on DCF in deriving a valuation for the business. We derive a price target of \$1.35 per share.

**Figure 3 – DCF valuation overview**

| DCF inputs                  |              | DCF outputs                   |             |
|-----------------------------|--------------|-------------------------------|-------------|
| Beta                        | 1.50         | Forecast cash flows (\$m)     | 51          |
| Risk free rate              | 3.3%         | Terminal value (\$m)          | 200         |
| Market risk premium         | 6.0%         | Franking value                | 3           |
| Cost of equity              | 12.3%        | <b>Enterprise value (\$m)</b> | <b>255</b>  |
|                             |              | Add net cash (FY20e) (\$m)    | -19         |
| Debt premium                | 4.0%         | <b>Equity value (\$m)</b>     | <b>273</b>  |
| Cost of debt (after tax)    | 5.1%         | Implied equity value (p.s.)   | 1.20        |
|                             |              | Rolled fwd at Ke              | 12%         |
| D/E                         | 20.0%        | <b>Price target</b>           | <b>1.35</b> |
| <b>WACC</b>                 | <b>10.8%</b> |                               |             |
|                             |              | <b>Implied CAGR (FY22-27)</b> |             |
| <b>Terminal growth rate</b> | <b>3.0%</b>  | Revenue                       | 19.1%       |
|                             |              | EBITDA                        | 41.0%       |
|                             |              | NPAT                          | 53.2%       |
|                             |              | Implied FY23 PE               | 45.8        |
|                             |              | Implied FY24 PE               | 28.5        |

Source: OML

## About Atomos

### About Atomos Limited

Atomos Limited (AMS.ASX) designs and manufactures monitor-recorders, which can be added to existing video equipment to enhance standard definition camera into high-resolution systems. The monitors can be added to phones, tablets or professional video recorders, allowing for a simpler interface for editing and distributing content.

AMS' main product proposition is to converge computer and video technologies, by combining high-quality recording, monitoring, and editing functionality into a low-cost, add-on device for cameras. The portable (in-field) monitor transfers raw images captured by the camera into a proprietary hard drive, which through increased data rates, enhances the quality of the video. The improved user interface of the device allows for more flexible editing and content distribution on the go.

### Key Benefits

- Enhanced video quality by connecting directly to a variety of camera sensors. Improves colour and brightness of low-quality images at an affordable price.
- In field monitors introduce slow motion frame rates to standard cameras and elevates 4K definition to high resolution.
- Jointly developed technologies with large camera manufacturers (e.g. Sony) and post-production software providers (e.g. Apple). This creates a fully integrated vertical in the market, achieving a seamless workflow from capture, through recording and into post-production.
- Increases recording time from minutes to hours using new SSD 2TB hard drive and compressed data capability from codecs such as Apple's ProRes RAW.

### Product Mix

Approximately 87% of revenue from monitor recorders. The lower end of AMS product range, including the smaller "Shinobi" and "Ninja V" monitors, target social media content creators. The number of content creators have increased 23% yoy since 2012 (prospectus). Content on these platforms is distributed through free, ad-click driven platforms like Facebook, Instagram, and YouTube.

Currently Atomos' predominantly targets the professional camera and video equipment market. The end uses of this segment include promotion, events, and corporate video, as well as educational content. In 2018, 81% of US companies used video promotion or training with US\$135B spend in total.

AMS has recently launched its "Neon" range of cinema monitor-recorders targeted at the high-end entertainment industry, an identified growth market. Targeting news/entertainment platforms like Fox, Netflix and Amazon, the Neon range has nearly doubled AMS' product portfolio.

### Background

Founded in 2010 and headquartered in Melbourne, the company has grown internationally with eight offices located in five countries, each servicing a key part of the global market. The company's global sales operations are conducted via the German office in Frankfurt. CEO Jeromy Young has over 20 years of tech management experience, holding previous roles as Business Development Manager at Canopus Japan and Blackmagic Design Pty Ltd. The company has significant IP embedded in their proprietary processes, developed in-house by a team of over 30 engineers.

## Key Drivers

### Key Driver 1 – Growth of Social Video Market

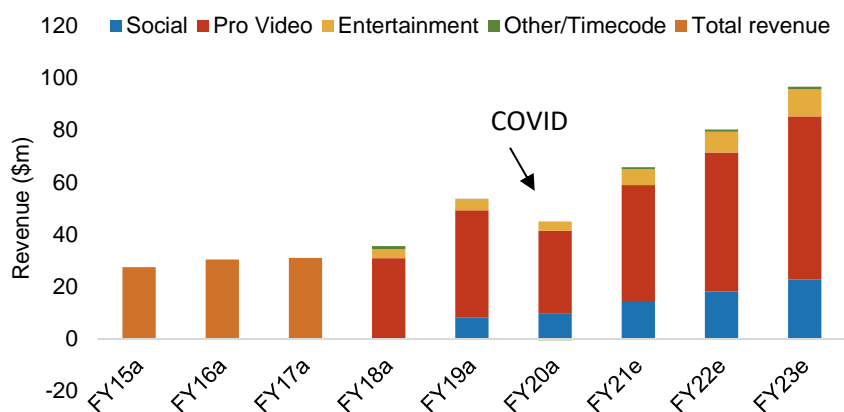
AMS has experienced significant growth in recent years, largely off the back of demand in the social and pro video market segments. The company's focus on capturing market share in the rapidly growing social media market will be accretive, leveraging existing sales channels.

This market, the lower end of Atomos' product range, constitutes social media content creators. The number of content creators have increased 23% yoy since 2012. Content on these platforms is distributed through free, ad-click driven platforms like Facebook, Instagram and YouTube.

While COVID-19 has delayed key product development, reduced filmed content production (and hence demand for AMS products to enhance production), important selling/marketing opportunities at trade shows and disturbed the supply chain, we see long-term trends remaining intact across each vertical, with:

- **Social** content production rising with social media ad spend
- **Pro video** adoption growing with further product development and thanks to ProResRAW capabilities
- **Filmed entertainment** sales benefitting from the growth in neo-studios (Netflix, Amazon Prime) demand for original content

**Figure 4: Revenue Growth by segment**



Source: Company Data and OML estimates

AMS has already established several other key advantages it can use to expand in these markets, which includes:

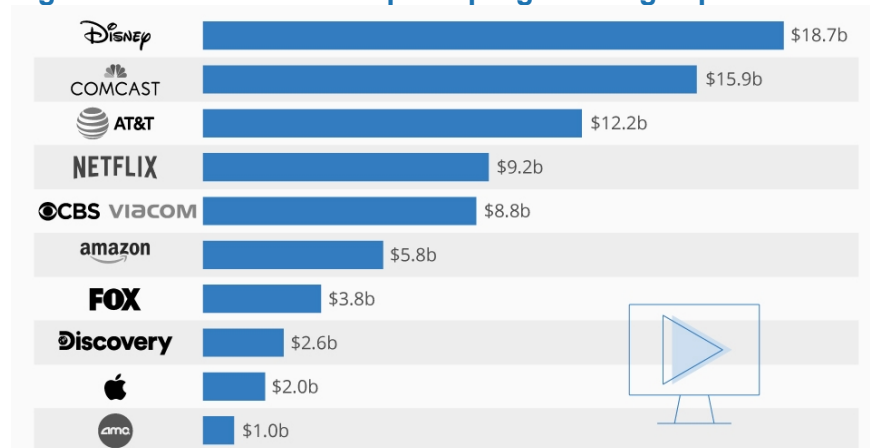
- Using the existing Ninja platform to release upgraded products based on the same core technology (reduced R&D costs).
- Leveraging existing sales channels with distributors that can supply to new and extended markets.
- Developing relationships with new camera manufacturers and other market players to attract new demand (prior partnerships have included Sony, Canon & Nikon).

### Key Driver 2 – Cinema Product Launches

The Neon range of products, launched in September 2019, are 4K HDR field monitor-recorders for studio production. This is targeted at the cinema segment of the video production industry, with its need to produce premium, high-quality entertainment content. The product family offers four monitors differentiated by size (17"-55"), with prices ranging from \$5,500 to \$25,000 per device. While the new product range will cannibalise some of the existing high-end monitors (Sumo range), we believe the Neon family of products will drive strong sales growth.

We anticipate this product offering to be the focal point of growth in the upcoming year and is consistent with the company's strategy to expand into the entertainment and social markets, which is estimated to have a TAM 10x greater than the pro video market historically. Video streaming platforms have grown astronomically in the last decade; Netflix revenue has increased from US\$1.41B in 1Q14 to US\$5.25B during the same period in 2019. Netflix, Amazon and Apple are expected to grow their combined spend for original content from US\$5B in 2017 to >US\$23B in 2022 (AMS Prospectus). Given these hefty budgets, enhanced quality of content is required to remain competitive within the market.

**Figure 5 – Estimated non-sports programming expense 2019**



Source: Statista, Moffett Nathanson, Company Reports

Beyond growing the top line, we think the introduction of new product lines will affect both the gross margin and operating margin of the business. While a gross margin in the mid-40% (ex-COVID) is consistent with companies in the consumer durables sector, we anticipate that the pricing structure of the higher-end Neon products will offer improved gross margin dynamics for the business as these products rise in the mix.

While consumers are fairly price sensitive, enterprises with budgets exceeding \$1m are often less focused on price and more focused on technology offering. As sales grow, we also anticipate better rates with the manufacturer for larger orders, which would also be accretive to gross margins. With a richer product mix, we think operating expenses will need to increase to support the anticipated sales growth. We expect sales and marketing costs to grow as the company penetrates the professional market. Engineering costs will also expand in line with the product line up as AMS broadens its reach throughout the eco-system.

### **Key Driver 3 – Develop Strategic Relationships**

AMS aims to evolve its current strategic relationships with global camera manufacturers and major software video editing providers, in order to achieve end-to-end integrated solutions. AMS monitors assimilate with global camera manufacturers, allowing for cross promotion. Further, by achieving a seamless workflow from capture, through recording and into post-production, software relationships create an efficient process. The key strategic relationships are below:

#### **Apple**

In 2011, CEO Jeremy Young pitched his original Ninja 1 monitor to Steve Jobs. His proposition was recording ProRes directly from the sensor, which launched the strategic relationship with Apple and established credibility for the brand. Last year, AMS was granted a license by Apple for use of its updated recording format, "ProRes RAW"; a codec which creates much smaller video file sizes, while retaining the quality video data rates and editing capabilities. By achieving a seamless workflow from capture, through recording and into post-production, ProRes RAW creates an efficient production process for AMS customers.

#### **Adobe**

The US manufacturer of computer software enables editing of video directly recording on an AMS device, removing the need for transcoding. This enables windows devices the same access to RAW workflows as IOS, using Adobe Premiere Pro CC or Adobe After Effects CC.

#### **Canon and Nikon**

AMS products integrate with numerous camera manufacturers, including Canon and Nikon. By gaining access to proprietary image processing algorithms, AMS monitors can process colour, brightness, and image clean up. Marketing synergies are also established, with the example of Nikon's Z6 & Z7 mirrorless cameras being cross promoted with AMS' Ninja V monitor recorders. This is accretive for AMS, as products are sold with these Japanese cameras, driving monitor sales. Canon and Nikon's market share is 2<sup>nd</sup> (36%) and 3<sup>rd</sup> (24%) in the mirrorless camera market respectively, based on sales figures between Nov 18 and Oct 19.

#### **JVC Kenwood**

In 2017 AMS signed a partnership with JVC Kenwood Corporation (JVC), a global Japanese electronics and camera manufacturer. This agreement specifies JVC may acquire products from AMS, however there is no minimum volumes in the contract. There is also the option, if the requirement arises, for AMS to use JVC production facilities down the track, diversifying production risk for the company.

The two organisations have shared software and hardware technologies including AtomIC (under license), AMS' first custom-built silicon development project, which was licensed to JVC to be used in one or more of their products. These chips provide proprietary low power, high function video capability and are one of AMS' key in-house proprietary technologies.



## Risks

### Higher Input Prices

- AMS cost of revenues will be sensitive to input prices of certain products, including semiconductor chips, LCD panels and memory.
- The memory chip market, mired in a significant downturn throughout 2019, seems to have bottomed out. Inventories are dropping and demand is rising, indicating a brighter year for the sector in 2020.
- The semiconductor market is expected to reach \$573 billion by 2024, with a CAGR of 4.1% from 2019 to 2024. This will likely increase the price of manufacturing for AMS, impacting gross margins in the medium term.

### Increased Competition

There are a range of other companies who produce similar monitor-recorder products in the market. We see competitors as a key risk to medium term growth, but we think this is partially offset by the growing TAM. Amateur content creation is still growing, and with the added product range, AMS can address new markets. Key competitors include, Blackmagic Design, Convergent Design and SmallHD.

AMS faces the risk that:

- Existing competitors could increase their market share through aggressive sales and marketing.
- Customers substitute with these alternative products.
- They may fail to anticipate and respond to changing opportunities or develop new products.
- Customers or strategic partners who purchase from or cross promote, may develop products which compete with AMS.

### Macro Risks to Supply Chain

There are certain inputs for which the AMS has a single or limited source of supply. This inherently increases risk in the production process. Specific macro conditions affecting supply chain, including:

- COVID19, US China trade war, Hong Kong Protests

### Lack of formal written distribution agreements

Given that in the USA a small number of distributors are responsible for 50% of the group's revenue, AMS is materially exposed to this risk. AMS does not have formal written contracts in place with most of its distributors, who order and purchase products on an ad hoc basis with no minimum purchase order obligations. Distributors may decide not to continue buying AMS products, which would have an impact on future revenue. AMS product cannot be bought from any source other than Atomos, however.

### Product Obsolescence

The computer industry has very quick rates of product obsolescence, as new designs continue to eat up existing technology. Further, given the monitor recorder industry in which AMS exists is relatively juvenile, the rate of improvement is high. The typical customer cycle for AMS products is 3-5 years.

Remaining at the forefront of technological advancements in the industry depends heavily on the key strategic relationships AMS has in place; Apple, Sony, Nikon, Adobe etc. Were these relationships to break down or these large corporations take a different approach to the sector, AMS' growth prospects would be materially affected.

## Atomos Limited

| PROFIT & LOSS (A\$m)        | 2019A        | 2020A         | 2021E      | 2022E      | 2023E       |
|-----------------------------|--------------|---------------|------------|------------|-------------|
| Revenue                     | 53.7         | 44.4          | 65.8       | 80.3       | 96.7        |
| Operating costs             | (52.1)       | (51.6)        | (61.9)     | (72.4)     | (83.8)      |
| <b>Operating EBITDA</b>     | <b>1.6</b>   | <b>(7.1)</b>  | <b>4.0</b> | <b>7.9</b> | <b>12.9</b> |
| D&A                         | (1.5)        | (3.8)         | (2.9)      | (3.1)      | (3.3)       |
| <b>EBIT</b>                 | <b>0.2</b>   | <b>(10.9)</b> | <b>1.0</b> | <b>4.7</b> | <b>9.6</b>  |
| Net interest                | (0.0)        | (0.4)         | (0.0)      | (0.0)      | (0.0)       |
| <b>Pre-tax profit</b>       | <b>0.2</b>   | <b>(11.3)</b> | <b>1.0</b> | <b>4.7</b> | <b>9.6</b>  |
| Net tax (expense) / benefit | (0.8)        | (0.8)         | (0.3)      | (1.4)      | (2.9)       |
| <b>Normalised NPAT</b>      | <b>(0.7)</b> | <b>(12.0)</b> | <b>0.7</b> | <b>3.3</b> | <b>6.7</b>  |
| <b>Reported NPAT</b>        | <b>(2.0)</b> | <b>(22.1)</b> | <b>0.7</b> | <b>3.3</b> | <b>6.7</b>  |
| Normalised dil. EPS (cps)   | (0.4)        | (5.8)         | 0.3        | 1.5        | 2.9         |
| Reported EPS (cps)          | (1.2)        | (10.6)        | 0.3        | 1.5        | 2.9         |

|                         |       |       |       |       |       |
|-------------------------|-------|-------|-------|-------|-------|
| Effective tax rate (%)  | 472.6 | (6.7) | 30.0  | 30.0  | 30.0  |
| DPS (cps)               | -     | -     | -     | -     | -     |
| Dividend yield (%)      | -     | -     | -     | -     | -     |
| Payout ratio (%)        | -     | -     | -     | -     | -     |
| Franking (%)            | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Diluted # of shares (m) | 166.5 | 208.9 | 227.5 | 227.8 | 227.8 |

| CASH FLOW (A\$m)             | 2019A        | 2020A         | 2021E        | 2022E        | 2023E        |
|------------------------------|--------------|---------------|--------------|--------------|--------------|
| EBITDA incl. adjustments     | 1.6          | (7.1)         | 4.0          | 7.9          | 12.9         |
| Change in working capital    | (4.8)        | (6.5)         | (2.9)        | (5.1)        | (5.7)        |
| Net Interest (paid)/received | 0.0          | (0.4)         | (0.0)        | (0.0)        | (0.0)        |
| Income tax paid              | (0.2)        | (0.1)         | (0.3)        | (1.4)        | (2.9)        |
| Other operating items        | -            | -             | -            | -            | -            |
| <b>Operating Cash Flow</b>   | <b>(3.3)</b> | <b>(14.1)</b> | <b>0.7</b>   | <b>1.4</b>   | <b>4.4</b>   |
| Capex                        | (3.1)        | (6.4)         | (1.0)        | (3.1)        | (3.3)        |
| Acquisitions                 | -            | (5.6)         | -            | -            | -            |
| Other investing items        | -            | (5.6)         | -            | -            | -            |
| <b>Investing Cash Flow</b>   | <b>(3.1)</b> | <b>(17.6)</b> | <b>(1.0)</b> | <b>(3.1)</b> | <b>(3.3)</b> |
| Inc/(Dec) in borrowings      | 6.6          | (1.4)         | -            | -            | -            |
| Dividends paid               | -            | -             | -            | -            | -            |
| Other financing items        | (2.4)        | (2.2)         | -            | -            | -            |
| <b>Financing Cash Flow</b>   | <b>10.1</b>  | <b>40.4</b>   | <b>-</b>     | <b>-</b>     | <b>-</b>     |
| Net Inc/(Dec) in Cash        | 3.7          | 13.7          | (0.3)        | (1.7)        | 1.1          |

| BALANCE SHEET (A\$m)          | 2019A       | 2020A       | 2021E       | 2022E       | 2023E       |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| Cash                          | 5.1         | 18.8        | 18.5        | 16.8        | 17.9        |
| Receivables                   | 8.0         | 4.7         | 7.9         | 9.6         | 13.5        |
| Inventory                     | 9.6         | 16.8        | 19.9        | 23.7        | 27.0        |
| Other current assets          | 3.0         | 2.6         | 2.6         | 2.6         | 2.6         |
| PP & E                        | 1.7         | 2.7         | 2.8         | 2.8         | 2.9         |
| Intangibles                   | 8.5         | 25.1        | 23.0        | 22.9        | 22.9        |
| Other non-current assets      | -           | 9.0         | 9.0         | 9.0         | 9.0         |
| <b>Total Assets</b>           | <b>35.9</b> | <b>79.6</b> | <b>83.7</b> | <b>87.4</b> | <b>95.7</b> |
| Short term debt               | 1.5         | 0.1         | 0.1         | 0.1         | 0.1         |
| Payables                      | 10.5        | 10.7        | 14.1        | 14.5        | 16.1        |
| Other current liabilities     | 0.6         | 1.7         | 1.7         | 1.7         | 1.7         |
| Long term debt                | -           | -           | -           | -           | -           |
| Other non-current liabilities | 0.0         | 9.6         | 9.6         | 9.6         | 9.6         |
| <b>Total Liabilities</b>      | <b>12.7</b> | <b>22.2</b> | <b>25.6</b> | <b>25.9</b> | <b>27.5</b> |
| <b>Total Equity</b>           | <b>23.2</b> | <b>57.4</b> | <b>58.1</b> | <b>61.4</b> | <b>68.1</b> |
| Net debt (cash)               | (3.6)       | (18.6)      | (18.3)      | (16.6)      | (17.7)      |

## Buy

| DIVISIONS | 2019A | 2020A | 2021E | 2022E | 2023E |
|-----------|-------|-------|-------|-------|-------|
|-----------|-------|-------|-------|-------|-------|

| KEY METRICS (%)       | 2019A | 2020A  | 2021E | 2022E | 2023E |
|-----------------------|-------|--------|-------|-------|-------|
| Revenue growth        | 50.7  | (17.3) | 48.1  | 22.0  | 20.4  |
| EBITDA growth         | 989.4 | -      | -     | 99.5  | 63.9  |
| EBIT growth           | -     | -      | -     | 369.1 | 102.0 |
| Normalised EPS growth | -     | -      | -     | 369.3 | 102.1 |
| EBITDA margin         | 3.1   | -      | 6.0   | 9.8   | 13.4  |
| OCF / EBITDA          | -     | 190.9  | 25.9  | 35.8  | 56.3  |
| EBIT margin           | 0.3   | -      | 1.5   | 5.9   | 9.9   |
| Return on assets      | -     | -      | 0.9   | 3.9   | 7.3   |
| Return on equity      | -     | -      | 1.2   | 5.6   | 10.4  |

| VALUATION RATIOS (x)    | 2019A | 2020A | 2021E    | 2022E | 2023E |
|-------------------------|-------|-------|----------|-------|-------|
| Reported P/E            | -     | -     | 341.5    | 72.8  | 36.0  |
| Normalised P/E          | -     | -     | -        | 72.8  | 36.0  |
| Price To Free Cash Flow | -     | -     | 13,250.0 | 348.3 | 65.4  |
| Price To NTA            | 11.9  | 6.5   | 6.6      | 6.0   | 5.1   |
| EV / EBITDA             | -     | -     | -        | 27.3  | 16.5  |
| EV / EBIT               | 974.3 | -     | 210.5    | 45.3  | 22.3  |

| LEVERAGE                  | 2019A   | 2020A  | 2021E   | 2022E   | 2023E   |
|---------------------------|---------|--------|---------|---------|---------|
| ND / (ND + Equity) (%)    | (18.4)  | (48.0) | (46.1)  | (37.1)  | (35.2)  |
| Net Debt / EBITDA (%)     | (219.6) | 261.8  | (464.0) | (211.0) | (137.1) |
| EBIT Interest Cover (x)   | 176.0   | -      | 355.4   | 889.9   | 1,572.5 |
| EBITDA Interest Cover (x) | 1,645.0 | -      | 1,388.8 | 1,479.1 | 2,120.5 |

| SUBSTANTIAL HOLDERS       | m    | %    |
|---------------------------|------|------|
| Jeromy Young and Family   | 17.8 | 8.2% |
| Ellerston Capital Limited | 16.3 | 7.5% |
| Domazet Ft3 Pty Ltd       | 14.6 | 6.7% |

| VALUATION                    |             |
|------------------------------|-------------|
| Cost of Equity (%)           | 12.3        |
| Cost of debt (after tax) (%) | 7.3         |
| D / EV (%)                   | 20.0        |
| <b>WACC (%)</b>              | <b>10.8</b> |

|  |              |
|--|--------------|
| Forecast cash flow (\$m)                         | 51.2         |
| Terminal value (\$m)                             | 200.1        |
| Franking credit value (\$m)                      | 3.3          |
| Enterprise Value (\$m)                           | 269.9        |
| Less net debt / add net cash & investments (\$m) | (18.6)       |
| <b>Equity NPV (\$m)</b>                          | <b>251.3</b> |
| <b>Equity NPV Per Share (\$)</b>                 | <b>1.20</b>  |

|  |                    |
|--|--------------------|
| Target Price Method                          | Rolled forward DCF |
| Target Price (\$)                            | 1.35               |
| Valuation disc. / (prem.) to share price (%) | 27.2               |

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## Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

|                        |   |
|------------------------|---|
| <b>SPECULATIVE BUY</b> | We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.  |
| <b>BUY</b>             | The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.  |
| <b>ACCUMULATE</b>      | We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.   |
| <b>HOLD</b>            | We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.  |
| <b>LIGHTEN</b>         | We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.  |
| <b>SELL</b>            | We expect the total return to lose 15% or more.   |
| <b>RISK ASSESSMENT</b> | Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historic volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest. |

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