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isentia

COVID-19 uncertainty

ADD (no change)

Current price:	A$0.15
Target price: ▼	A$0.33
Previous target:	A$0.43
Up/downside:	125.6%
Reuters:	ISD.AX
Bloomberg:	ISD AU
Market cap:	US$17.48m
	A$29.00m
Average daily turnover:	US$0.09m
	A$0.14m
Current shares o/s	202.0m
Free float:	83.9%

- ISD has withdrawn FY20 guidance due to escalating uncertainties around the impact of COVID-19. ISD's media monitoring business operates in 11 countries and the impact differs; however, the last month has created significant uncertainty for clients and the business itself.
- The company noted in 1H20 that 90% of revenue was recurring. Despite the strong recurring revenue base it is still subject to contract expiries and end customer, counter party, risk. Like many businesses, ISD is currently assessing the impact and potential longevity of its clients, which are typically enterprise and government.
- We reduce our FY20 and FY21 EBITDA forecasts by 3% and 9% respectively. Despite this ISD still trades, on our forecasts, on undemanding metrics (2x EV/EBITDA and with a >10% Free Cash Flow yield). Add rating retained.

Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-31	-39.6	-29.3
Relative (%)	-3.7	-10.6	-8.2

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Analyst(s) own shares in the following stock(s) mentioned in this report:

– isentia

In its announcement ISD said…

'Isentia is currently experiencing high levels of utilisation of its media monitoring products and services as existing customers try to understand the implications of the pandemic on their brand and corporate reputation. There is also ongoing demand for Insights products as clients commission specific COVID-19 reports. Despite this, with the economic uncertainty clients are facing, Isentia anticipates a net negative impact on revenue and sales pipeline. In response, the company is accelerating cost management programs, the implementation of which have transformed the company's cost base over the past 18 months.' As a consequence FY20 guidance has been withdrawn.

Financial and debt position

From a financial perspective ISD has strong cash conversion, no refinancing required in the next 12 months and 'significant headroom on its debt covenants'. ISD had $31m of net debt in 1H20 vs its bank facility of $49m.This equates to Net Debt of 1.5x annualised EBITDA in 1H20 (the last reported bank covenants was Net Debt of <2.75x). Assuming recurring revenue declines modestly and customers pay their bills, then on our forecasts ISD will generate $4m of free cash flow in 2H20. The company noted 90% recurring revenue at 1H20 but price deflation and some customer losses has seen revenue decline over the last few years. The newish management team has taken a number of steps to resize the business and update the product offering. In addition these technological advancements have allowed ISD to flex its cost base. This is critical in the current environment where revenue uncertainty is high. We expect ISD's new products will help grow revenue in the medium term, however in the short term, all businesses are assessing their end customer risk. This is currently part of a much broader economic outlook that is difficult to assess and the outcome of which remains a key risk across the world.

Investment view - ADD

In the current market investors are seeking equity liquidity which is not something ISD's currently offers. However the company should generate positive free cash flow, its debt position appears comfortable, and it trades on what appears to us to be an unreasonably cheap valuation (assuming our forecasts are even partially correct). We retain our Add, with our blended price target reducing from $0.43 to $0.33 due to our forecast reductions.

Financial Summary	Jun-18A	Jun-19A	June-20F	June-21F	June-22F
Revenue (A$m)	137.1	122.5	109.5	107.7	110.7
Underlying EBITDA (A$m)	33.1	23.1	20.0	21.6	23.1
Normalised NPAT (A$m)	11.5	9.2	6.0	6.8	6.8
Normalised EPS growth	nm	-20%	-35%	12%	-1%
Normalised P/E (x)	2.5	3.2	4.9	4.3	4.4
EV/Underlying EBITDA (x)	3.2	2.5	2.8	2.2	1.6
Free Cash Flow Yield	64%	74%	10%	33%	43%
Price / Book Value	31%	50%	50%	49%	49%
Return on Equity	12%	16%	10%	11%	11%

SOURCE: MORGANS, COMPANY REPORTS

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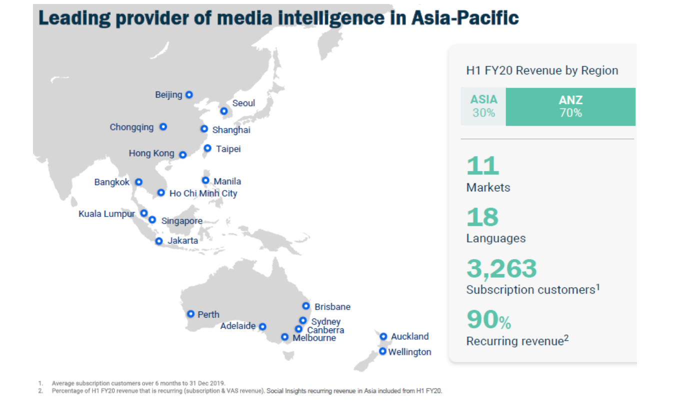
as at March 27, 2020

Market cap (A$m):	29.00	Rating:	ADD
Shares outstanding (m):	202.0	Price (A$):	0.15
Free float (%):	83.9	Target price (A$):	0.33
Website:	isentia.com	Upside/downside to target price (%):	125.6

Company description

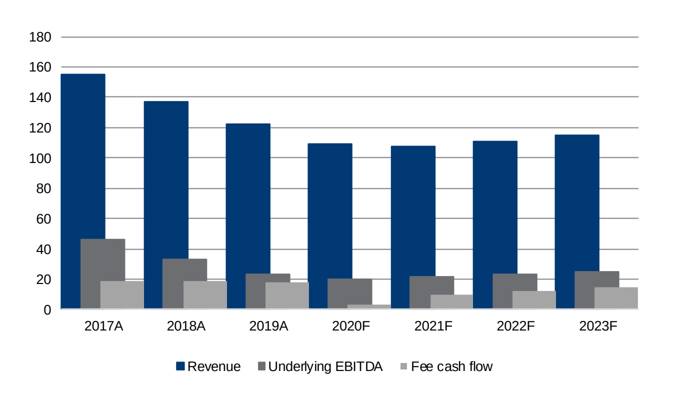
isentia (ISD) is the incumbent and leading provider of media intelligence in Australia with an estimated ~65% market share. ISD is also one of the largest media intelligence providers in Asia. Media intelligence consists of monitoring (reactively monitoring publicity on a brand, matter relating to a public department, or product) and media insights (proactively seeking insights and analytics around key items). Media intelligence is where ISD monitors millions of media sources continuously and reports back to the business (typically the Public Relations or Communications Manager) on what is being said about the business or brand. Monitoring occurs across radio, television, cable television, newspapers and social media.

iSentia's footprint



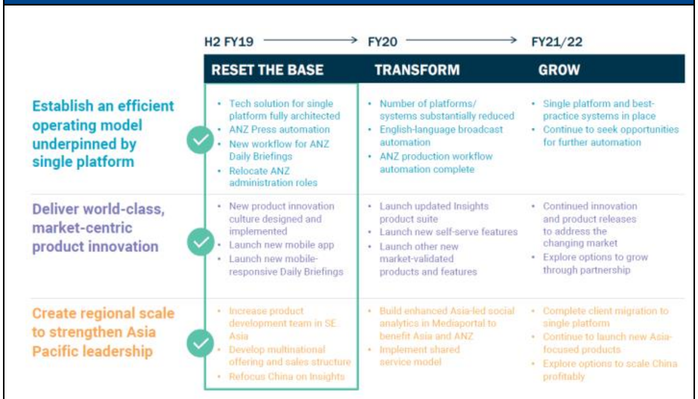
SOURCE: COMPANY

Revenue, Underlying EBITDA and Free Cash Flow (should rebound from FY21)



SOURCE: MORGANS, COMPANY

The turnaround strategy (in words)



SOURCE: MORGANS, COMPANY

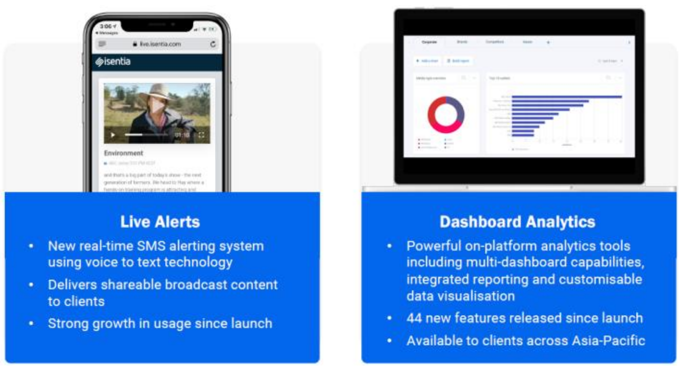
The turnaround strategy (in numbers)

Management have been set 3 year aspiration growth targets (from FY19 to FY22). We explain these below (with a few of our own assumptions on cashflow conversion). Our forecasts sit below ISD's aspiration targets.

	FY19 A	FY20 (Guidance +Morgans E)	FY21 (Morgans E)	FY22 (Morgans E)
ANZ Revenue	88	75	84	93
Asian Revenue	35	35	39	43
Total Revenue	122	110	122	136
Operating costs	99	90	96	101
Underlying EBITDA	23	20	26	35.1
Capital expenditure	-8	-11	-9	-10
Implied free cash flow (EBITDA - capex)	15	10	17	25
Free cash flow to market capitalisation	28%	18%	33%	48%
	FY20 / FY19	**2 year CAGR (FY20 to FY22)**	**3 year CAGR (FY19 to FY22)**	**Managments 3 year CAGR targets (FY19 to FY22)**
ANZ Revenue	-14%	11%	**1.9%**	**1-3%**
Asian Revenue	-1%	12%	**7.5%**	**5-10%**
Total Revenue	-10%	24%	3.6%	na
Operating costs	-10%	12%	0.5%	na
Underlying EBITDA	-13%	32%	**15.0%**	**10-20%**

SOURCE: MORGANS ESTIMATES

ISD's product set - media monitoring (live alerts) and Dashboard analytic (self help)



SOURCE: MORGANS, COMPANY

Outlook

History and turnaround plan: iSentia was once a market darling but has fallen substantially due market share and earnings losses. Two key problems were ISD's fixed price purchasing of media (Copyright) and fixed cost base (mostly manual labour). ISD's costs didn't change so as they lost customer and revenue this came directly off EBITDA. ISD's cost base is now signifiantly more variabilised - Copyright (through an interim legal ruling) and operating costs (with technology like voice-to-text rather than manual entry). Having largely resolved their input costs, the new management team is focussed on refreshing the technology platform, to catch up with competitors are offer faster and more innovative technology solutions. Overseas expansion, particularly into South East Asia, is another pillar of growth for ISD.

FY20 guidance was retracted in March 20 due to COVID-19 uncertainty.

Medium term outlook: Assuming management aspire to achieve their publicly stated targets (as shown above) then EBITDA would need to grow at ~30% pa in both FY21 and FY22. We assume modest growth in our forecasts and our view is that fundamentally ISD is very cheap. The investment market appears to be pricing in further earnings reductions. If management are able to stabilise or grow earnings investors would likely reward this in a meaningful manner.

SOURCE: MORGANS, COMPANY

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Figure 1: Financial summary

Profit and loss	Jun-18A	Jun-19A	June-20F	June-21F	June-22F
Revenue	137.1	122.5	109.5	107.7	110.7
Operating costs	-113.2	-95.4	-88.3	-82.2	-83.7
EBITDA (Underlying)	**33.1**	**23.1**	**20.0**	**21.6**	**23.1**
EBITDA (reported / AASB16)	24.0	27.1	21.2	25.4	26.9
Depreciation & Amortisation	-1.8	-2.0	-18.1	-20.6	-21.1
Impairments	-0.2	-41.0	0.0	0.0	0.0
EBIT	**7.7**	**-28.9**	**3.1**	**4.8**	**5.9**
Net Interest Income	-2.2	-2.2	-2.2	-1.8	-1.4
Pre-tax Profit	5.7	-31.1	0.9	3.1	4.5
Tax	-4.2	-3.2	-0.8	-1.4	-2.0
Reported Profit	**1.3**	**-34.3**	**0.1**	**1.7**	**2.5**
Exceptional items	-10.2	-43.5	-5.9	-5.1	-4.3
Normalised Profit *	**11.5**	**9.2**	**6.0**	**6.8**	**6.8**

* Excludes non-cash amortisation & one-offs

FY20 guidance retracted 27/3/20 due to COVID-19 uncertainty
The rate of year on year revenue decline in FY20 is expected to be similar to FY19
Underlying EBITDA of A$20-23m (excluding AASB16)
Capex of A$10-11m
Significant OPEX & CAPEX investment in building new products and technology
Copyright (CAL) - moves from fixed to volume-based fees & levels playing field

Cash flow statement	Jun-18A	Jun-19A	June-20F	June-21F	June-22F
EBITDA	24.0	27.1	21.2	25.4	26.9
Net interest	-2.2	-2.2	-2.2	-1.8	-1.4
Tax	-3.5	0.0	-2.0	-1.4	-2.0
Changes in working capital	10.0	5.0	-3.2	-3.6	-2.1
Operating cash flow	**28.3**	**29.9**	**13.8**	**18.7**	**21.5**
Capex	-9.6	-8.3	-10.7	-9.2	-8.9
Free Cash Flow	**18.7**	**21.7**	**3.0**	**9.5**	**12.6**
Acquisitions, divestments, capital	-10.9	0.0	-0.7	-0.6	0.0
Investing cash flows	**-20.4**	**-8.3**	**-11.4**	**-9.8**	**-8.9**
Increase / decrease in Equity	0.0	0.0	0.0	0.0	0.0
Increase / decrease in Debt	-12.0	-12.0	-3.8	-6.0	-17.0
Dividends paid	-7.5	0.0	0.0	0.0	-0.6
Other financing cash flows	0.0	0.0	0.0	0.0	0.0
Financing cash flows	**-19.5**	**-12.0**	**-3.8**	**-6.0**	**-17.6**

Balance Sheet	Jun-18A	Jun-19A	June-20F	June-21F	June-22F
Cash And Deposits	11.9	14.7	11.4	14.4	9.4
Debtors	31.2	20.6	18.1	17.9	18.7
Total Current Assets	**47.6**	**36.9**	**31.6**	**34.3**	**30.1**
Fixed Assets	4.6	3.8	6.4	7.6	7.9
Total Non-Current Assets	**163.1**	**104.7**	**112.4**	**100.9**	**88.1**
TOTAL ASSETS	**210.7**	**141.6**	**144.0**	**135.2**	**118.2**
Short Term Debt	4.1	4.3	3.9	3.3	1.6
Creditors	24.2	30.7	27.9	24.1	22.8
Total Current Liabilities	**28.3**	**35.1**	**31.8**	**27.4**	**24.4**
Long Term Debt	55.5	39.7	35.1	29.7	14.4
Total Non -Current liabilities	**87.7**	**48.4**	**53.4**	**48.0**	**32.7**
TOTAL LIABILITIES	**116.0**	**83.4**	**85.2**	**75.4**	**57.1**
Issued capital	403.7	403.7	403.1	404.8	406.6
Retained earnings	-55.3	-95.8	-95.2	-95.2	-95.2
Other reserves and FX	-253.7	-249.7	-249.1	-249.8	-250.4
TOTAL EQUITY	**94.7**	**58.2**	**58.9**	**59.8**	**61.1**

iSentia - valuation detail: ASX:ISD			
Share Price	$0.15	Market Cap	A$29.1m
Price Target	$0.33	TSR	131.0%
Rec	ADD		

	WACC	Valuation
DCF	10.0%	$0.44
EV/EBITDA (NPV of FY22 on 3.6x)		$0.24
Steady state ROE (FY20)		$0.30
Equally weighted valuation		$0.33
Price target		**$0.33**

Key metrics/ multiples	Jun-19A	June-20F	June-21F
Normalised P/E	3.2	4.9	4.3
Norm EPS growth	-20.0%	-35.1%	12.2%
EV / Revenue	0.7	0.8	0.8
EV / EBITDA	2.5	2.8	2.2
Price / Book Value	0.5	0.5	0.5
Price / Net Tangible Assets	-0.7	-0.7	-1.1
Operating cash flow yield	102.6%	47.2%	64.1%
Free cash flow yield	74.3%	10.3%	32.7%
Yield (cash)	0.0%	0.0%	0.0%

Per share data	Jun-19A	June-20F	June-21F
Diluted shares on issue	200	201	203
Reported EPS (A$)	-0.17	0.00	0.01
Normalised EPS (A$)	0.05	0.03	0.03
Dividends per share (A$)	0.00	0.00	0.00
DPS vs. EPS	0.0%	0.0%	0.0%
Dividend vs. FCF	0.0%	0.0%	0.0%

Result quality	Jun-19A	June-20F	June-21F
Cash flow conversion	118.3%	84.9%	85.9%
FCF vs. Normalised NPAT	235.3%	50.2%	140.0%

Gearing	Jun-19A	June-20F	June-21F
Net Debt	29	28	19
Net Debt / Net Debt + Equity	33.5%	31.9%	23.7%
Net Debt / EBITDA (x)	1.1	1.3	0.7
EBITDA interest cover (x)	12.3	9.5	14.3
Invested Capital	83	90	82
Enterprise Value	58	57	48

Growth ratios	Jun-19A	June-20F	June-21F
Revenue	-10.7%	-10.6%	-1.7%
Underlying EBITDA	-30.4%	-13.3%	8.2%
Normalised NPAT	-20.0%	-34.8%	13.3%
Reported EPS	-2772.5%	-100.4%	1248.3%
Normalised EPS	-20.0%	-35.4%	12.2%
Operating cash flow	5.8%	-54.0%	35.9%
Free cash flow	15.7%	-86.1%	216.3%

Margin analysis	Jun-19A	June-20F	June-21F
EBITDA Margin	22.1%	19.3%	23.6%
EBIT margin	-23.6%	2.8%	4.5%
NPAT margin	7.5%	5.5%	6.3%
CASH ROE (norm NPAT)	15.8%	10.2%	11.4%
ROIC	-35.0%	3.5%	5.9%

SOURCE: MORGANS RESEARCH, COMPANY

Forecasts and valuation changes

Following ISD's March 2020 retraction of guidance we have reduced our EBITDA forecasts in FY20 by 3% and FY21 by 9%. Given the retraction of guidance there is no certainty that ISD will hit our forecasts so we highlight this is short term risk to remain aware of. Our valuation reduces 23% to 33cps (from 43cps) on the lower earnings forecasts.

Figure 2: Forecast changes

	New		Old	
Changes to forecast	**FY20**	**FY21**	**FY20**	**FY21**
Revenue	109.5	107.7	109.9	110.4
% change	0%	-3%		
EBITDA (Underlying)	20.0	21.6	20.7	23.8
% change	-3%	-9%		
EBITDA (reported / AASB16)	22.7	25.4	23.4	27.6
% change	-3%	-8%		
Reported Profit	0.1	1.7	1.7	2.9
% change	-93%	-42%		
Cash profit	6.0	6.8	7.6	8.0
% change	-21%	-15%		
Reported EPS	0.06	0.83	0.86	1.43
% change	-93%	-42%		
Free cash Flow	3.01	9.52	4.60	10.31
% change	-35%	-8%		
Valuation and price target	$0.33		$0.43	
% change	-23%			

SOURCES: MORGANS, COMPANY REPORTS

Risks

- **Rebasing earnings** – ISD's EBITDA and cash generation have declined materially over the last few years. We are counting on FY20 being the trough year and earnings improving thereafter. In a competitive environment, there are no guarantees that earnings will improve from here; they could continue to decline. Our valuation is based on growing earnings so a changing trajectory (declining earnings) would lower our valuation materially.
- **Execution** – ISD is a turnaround story. It is rare that turnaround stories go exactly to plan. With this in mind and considering in 1H20 we have already seen revenue slowdowns due to increased competition we prefer to leave room for error. In the tangible world things often take longer and cost more than anticipated and this could prove to be the case with ISD. That said, we argue that investors are not paying for success so failure to achieve stated targets is unlikely to result in a material share price de-rate from current levels.
- **Management** – ISD's revitalised strategy is dependent on key management, retention of those staff, and their ability to lead change in the organisation.
- **Copyright Agency Ltd (CAL)** - ISD had a favourable interim legal ruling with respect to purchasing content from key supplier CAL. The final ruling is expected toward the end of CY20 and is anticipated to be broadly similar to the interim ruling. However, until the final ruling is declared this remains a risk.

Rewards

- **Share price appreciation** – in our view the key reward for ISD shareholders is earnings stabilisation then growth, which should lead to share price appreciation. This view is predicated on management being able to partially deliver its aspiration public growth targets.

- A **takeover target** – ISD was once owned by private equity. Private equity often create value through cash generation and cost reduction. ISD ticks both these boxes so could be an acquisition target for either private equity or a trade buyer looking to bolster its APAC presence.
- **Acquisitions** – Once ISD gets its debt to a comfortable level, which has not yet been defined by the Board, then its substantial free cash generation will be either returned to shareholders via dividends or acquisitions to build scale, most likely in Northern Asia where ISD is currently sub-scale. We assume no acquisitions in our forecast. However, it is worth pointing out that management could achieve its FY22 aspirational EBITDA target through acquisition.
- Our forecasts assume a **return to paying dividends in FY22**. Our assumed dividend policy is that 10% of free cash flow will be distributed to shareholders in the form of dividends. This equates to a ~3% cash yield on today's share price. Given the strong free cash flow of ISD (a ~30% FCF yield on our FY22 forecasts), realistically we would expect the Board to distribute most of this free cash flow to shareholders, if it is not able to find compelling acquisition targets.

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