

Xref Limited

Offshore the X-factor in FY20

Xref released its FY19 results, with growth in credit usage and sales continuing across all markets in FY19. Pleasingly, FY19 credit sales from North America were \$1m (110% on pcp) and EMEA sales were \$900k (up 93% on pcp). APAC, however grew more slowly following turnover in the accounts/sales team, with credit sales up ~30% (vs. ~60% in FY18). Offshore growth will help offset some of this slow-down, but we are keen to see a resumption of +50% growth rates in APAC to justify the cash burn. Expense increases were relatively modest on pcp, up 7%, but we note 1Q20 guidance calls for a 16% lift on 1Q19. We shift our recommendation to Speculative Buy and new target price of 60c (was 90c).

Softer APAC, International remains compelling

The international opportunity remains compelling, with offshore regions now contributing 19% (13% pcp) of credit sales and growing >100% on pcp (~\$1.9m in FY19) in aggregate. Canada and Norway were particularly strong, growing credit sales 110% and 236% on pcp respectively (off low bases). As a further positive signal, credit usage in all regions has grown solidly, showing that clients are engaged with the product. As international growth ramps up, this should help boost growth for the group despite the growth slow-down in APAC.

Forecast changes attributable to weaker credit sales growth

We have downgraded our price target to 60 cents and shift our recommendation to Speculative Buy. This reduction is driven by slowing credit sales growth forecasts in APAC and the continued cash burn. We would need to see the reinvestments in the cost base bear fruit into FY20 to become more excited about the top line and also de-risk the break-even point for the business, which we do not foresee in FY20. Breakeven is likely pushed out further due to lower than expected R&D incentives and upfront payment for RapidID (\$600k).

Reiterating risks

Primary risks revolve around 1) potential for more capital in light of ongoing cash burn, 2) business-as-usual data security requirements, 3) competition from new and existing products, and 4) ongoing technology development and innovation.

Key Financials					
Year-end June (A\$)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (\$m)	4.8	8.0	10.9	14.6	18.7
EBITDA (\$m)	(9.9)	(7.8)	(7.0)	(5.2)	(3.0)
EBIT (\$m)	(10.0)	(7.9)	(7.1)	(5.3)	(3.1)
Reported NPAT (\$m)	(8.9)	(8.1)	(7.1)	(5.4)	(3.2)
Reported EPS (c)	(5.7)	(4.6)	(4.0)	(2.9)	(1.7)
Normalised NPAT (\$m)	(8.2)	(7.5)	(6.7)	(5.0)	(2.8)
Normalised EPS (c)	(5.2)	(4.3)	(3.7)	(2.7)	(1.5)
Dividend (c)	-	-	-	-	-
Net Yield (%)	-	-	-	-	-
Normalised ROE (%)	-	-	3,328.5	109.7	40.0

Ord Minnett acted as broker to the placement in XF1 in October 2018 and received fees for acting in this capacity

Source: OML, Iress, Xref Limited

Last Price

A\$0.39

Target Price

A\$0.60 (Previously A\$0.90)

Recommendation

Speculative Buy (Previously Buy)

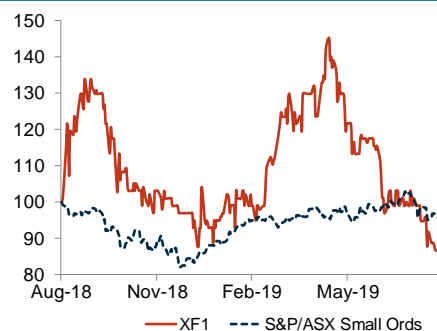
Risk

Higher

Application Software

ASX Code	XF1
52 Week Range (A\$)	0.39 - 0.71
Market Cap (\$m)	65.3
Shares Outstanding (m)	167.3
Av Daily Turnover (\$m)	0.0
3 Month Total Return (%)	-33.9
12 Month Total Return (%)	-19.6
Benchmark 12 Month Return (%)	-2.5
NTA FY20E (¢ per share)	-2.6
Net Cash FY20E (A\$m)	1.7

Relative Price Performance



Source: FactSet

Consensus Earnings

	FY20E	FY21E
NPAT (C) (\$m)	-	-
NPAT (OM) (\$m)	(6.7)	(5.0)
EPS (C) (c)	-	-
EPS (OM) (c)	(3.7)	(2.7)

Source: OML, Iress, Xref Limited

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Result overview

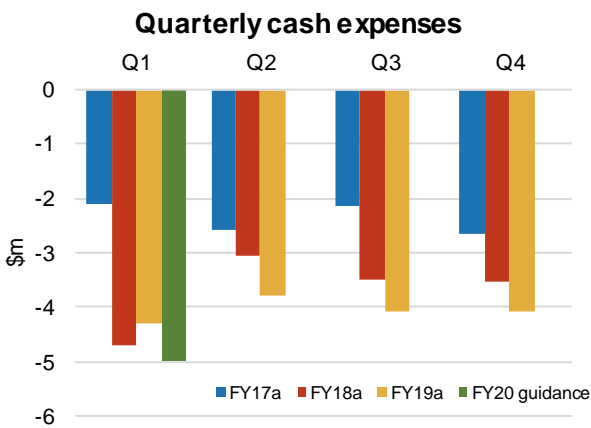
- XF1 produced underlying (exc share based payments) NLAT of \$7.5m in FY19, which was an improvement of 7% on pcp.
- Credit usage (recognised revenue) in FY19 continued to show significant growth from pcp, up 66% to \$8.0m and ahead of OMLe – great to see clients using their credits.
- Credit sales rose by 44% on pcp to \$10m, in line with 4Cs, but behind OMLe of \$11.6m (we had not updated post the Jun quarter). We expect part of this was growth slowdown was owed to turnover in the sales team, which has now been steadied. We reserve judgement on overall credit sales until the Sep quarter as a lead indicator on how this new team is tracking.
- Cash cost growth ~7% on pcp in line with the 4Cs and largely driven by additional hires in 2H19. Guidance on cash costs for 1Q20 was ~\$5m versus pcp at \$4.3m (+16%), largely driven by staff resources.
- Credit sales from North America at \$1m were up 110% on pcp and EMEA sales at \$900k were up 93% on pcp.
 - Total North America and EU sales grew 107% on pcp
 - Australia sales were up 32%
- In aggregate group credit sales were up 42% but should both sets of growth rates be maintained in FY20, we would see an implied \$14.6m of credit sales, or growth of ~45% - noting that international growth is unlikely to be sustained at such high rates.
- We need to see international growth rates continue to ramp up to compensate for the 58% cash EBITDA burn rate in FY19. The “rule of 40” used in growth tech analysis suggests sales should be growing 100% to justify XF1’s current cash burn:revenue margin of 60% (ie 100 - 60 = 40).

Figure 1: Result Overview

	FY18a	FY19a	%Δ
Sales revenue	4.8	8.0	66%
Other revenue	0.0	0.0	na
Cash opex	-14.8	-15.8	-7%
EBITDA	-9.9	-7.8	21%
D&A	-0.1	-0.1	-11%
Normalised EBIT	-10.0	-7.9	21%
Net interest	0.1	0.1	6%
PBT	-9.9	-7.7	22%
Tax	1.7	0.2	-88%
Normalised NPAT	-8.2	-7.5	7%
Share based payments	-0.8	-0.6	19%
Reported NPAT	-8.9	-8.2	8%
Credit sales	7.1	10.0	42%
Credit usage	4.3	7.6	77%
Credit sales EBITDA	-7.7	-5.8	24%
Year-end cash	4.5	8.0	81%

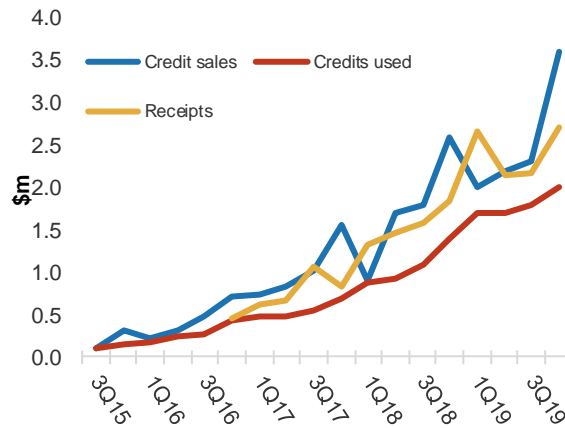
Source: OML and company data

Figure 2: Quarterly cash expenses



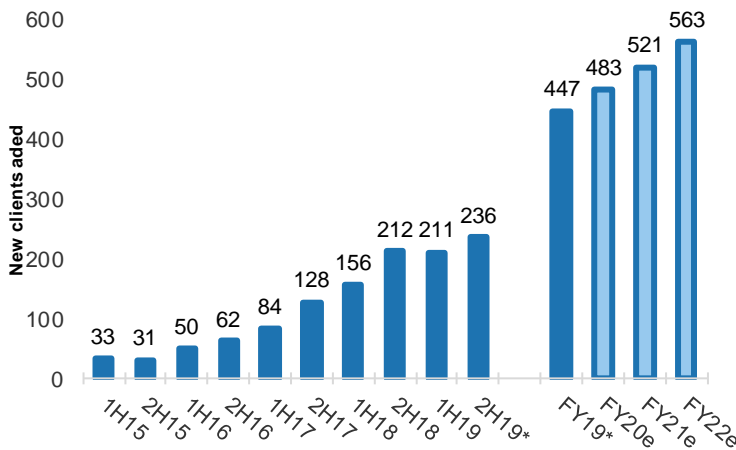
Source: OML and company data

Figure 3: Quarterly metrics



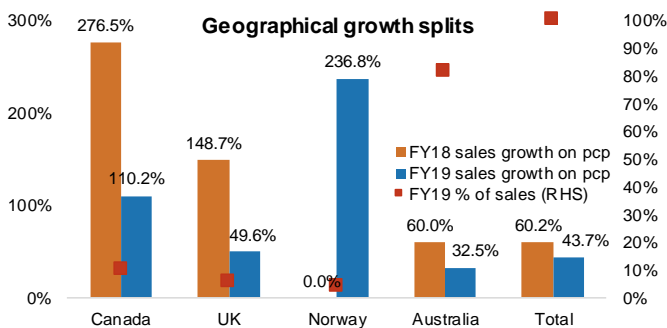
Source: OML and company data

Figure 4: New client wins per half year



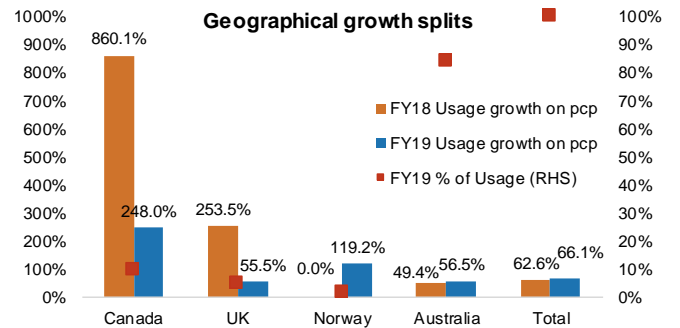
Source: OML and company data *estimated new client wins

Figure 5: Country breakdown – % of credit sales



Source: OML and company data

Figure 6: Country breakdown – % of revenue (usage)



Source: OML and company data

- As per figures 5 and 6 above, all geographies witnessed growth in FY19.
- High global usage and sales is a positive sign, illustrating the Xref is continuing to be received positively in global markets.

Changes to forecasts

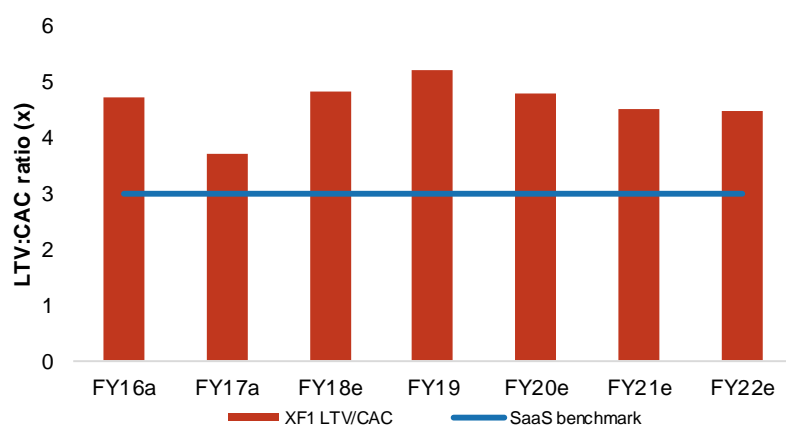
Figure 7: Changes to forecasts

	FY20 old	FY20 new	%Δ	FY21 old	FY21 new	%Δ
Sales revenue	12.1	10.9	-10.4%	17.5	14.6	-16.4%
Other revenue	0.0	0.0	na	0.0	0.0	na
Cash opex	-17.6	-17.9	-1.8%	-19.1	-19.9	-3.9%
EBITDA	-5.4	-7.0	-29.0%	-1.6	-5.2	-223.1%
D&A	-0.1	-0.1	0.0%	-0.1	-0.1	0.0%
Normalised EBIT	-5.5	-7.1	-28.4%	-1.7	-5.3	-210.1%
Net interest	0.2	0.1	na	0.2	0.1	na
PBT	-5.3	-7.0	-30.4%	-1.5	-5.3	-251.3%
Tax	0.9	0.3	-72.2%	0.6	0.3	-58.3%
Normalised NPAT	-4.4	-6.7	-51.2%	-0.9	-5.0	-457.8%
Share based payments	-0.4	-0.4	na	-0.4	-0.4	na
Reported NPAT	-4.8	-7.1	-47.0%	-1.3	-5.4	-316.9%
Credit sales	17.3	14.5	-16.4%	25.0	19.5	-21.9%
Credit sales EBITDA	-0.2	-3.4	-1458.2%	5.9	-0.3	-105.9%
Year-end cash	6.9	1.7	-75.9%	10.4	1.7	-83.6%

Source: OML and company data

- We have revised our credit sales forecasts following this result. Whilst we hold the view that the international business faces considerable upside potential, the APAC credit sales grew 30% in FY19 comparing unfavourably to 60% growth achieved the prior year.
- Our new forecasts imply FY20 and FY21 growth rates of ~45% and 35% respectively for the group.
- **On these numbers, it is also likely that the business will have to raise additional capital in FY21 of ~\$3m. We would need to see considerable ramp up in sales for FY20 and/or a paring back in costs for us to gain comfort that additional capital would not be necessary.**
- The sales rate reduction sees our FY21 cash EBITDA forecast fall by \$6.2m, accounting for this change in view on ongoing capital needs. Lower R&D tax incentives and the \$600k cash paid for RapidID are also drains.
- Based on our current cost assumptions, we continue to maintain a positive outlook on XF1's LTV:CAC ratio remaining above the 3x SAAS benchmark. This implies that the business should continue to spend on acquiring customers, but we would prefer to see sales ramp up to justify the cash burn and de-risk funding needs.

Figure 8: XF1 LTV:CAC ratio



Source: OML and company data

Valuation & Recommendation

- We continue to value Xref using a discounted cash flow model in order to capture the long-dated nature of its profit growth.
- We are relatively conservative in using a weighted average cost of capital of 14% and terminal growth rate of 3.5%.
- We arrive at a DCF valuation of 52 cents per share and roll this forward at our cost of equity (14%) to reach a forward price target of 60 cents per share, offering 54% upside to last trade.

Figure 9: DCF inputs and outputs

DCF inputs		DCF outputs	
Beta	1.50	Forecast cash flows (\$m)	16
Risk free rate	5.0%	Terminal value (\$m)	76
Market risk premium	6.0%	Franking value	0
Cost of equity	14.0%	Enterprise value (\$m)	92
		Add net cash (4Q19) (\$m)	-8
Debt premium	4.0%	Equity value (\$m)	100
Cost of debt (after tax)	6.3%	Implied equity value (p.s.)	0.52
D/E	0.0%	Price target derivation	
WACC	14.0%	DCF valuation (\$ ps)	0.52
		Cost of equity (%)	14.0%
		Rolled-forward valuations (\$ ps)	0.60
Terminal growth rate	3.5%	Less dividend (\$ ps)	0.00
		One-year forward price target (\$ ps)	0.60

Source: OML estimates

Xref Limited

PROFIT & LOSS (A\$m)	2018A	2019A	2020E	2021E	2022E
Revenue	4.8	8.0	10.9	14.6	18.7
Operating costs	(14.8)	(15.8)	(17.9)	(19.9)	(21.7)
Operating EBITDA	(9.9)	(7.8)	(7.0)	(5.2)	(3.0)
D&A	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
EBIT	(10.0)	(7.9)	(7.1)	(5.3)	(3.1)
Net interest	0.1	0.2	0.1	0.1	0.1
Pre-tax profit	(9.9)	(7.7)	(7.0)	(5.3)	(3.0)
Net tax (expense) / benefit	1.7	0.2	0.3	0.3	0.3
Significant items/Adj.	-	-	-	-	-
Associate NPAT	-	-	-	-	-
Normalised NPAT	(8.2)	(7.5)	(6.7)	(5.0)	(2.8)
Reported NPAT	(8.9)	(8.1)	(7.1)	(5.4)	(3.2)
Normalised dil. EPS (cps)	(5.2)	(4.3)	(3.7)	(2.7)	(1.5)
Reported EPS (cps)	(5.7)	(4.6)	(4.0)	(2.9)	(1.7)
Effective tax rate (%)	-	30.0	30.0	30.0	30.0
DPS (cps)	-	-	-	-	-
Dividend yield (%)	-	-	-	-	-
Payout ratio (%)	-	-	-	-	-
Diluted # of shares (m)	155.8	175.9	180.1	185.7	190.4

CASH FLOW (A\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA incl. adjustments	(9.9)	(7.8)	(7.0)	(5.2)	(3.0)
Change in working capital	1.6	0.9	1.1	2.1	2.7
Net Interest (paid)/received	0.1	0.1	0.1	0.1	0.1
Income tax paid	-	-	-	-	-
Other operating items	1.7	1.7	0.2	0.3	-
Operating Cash Flow	(6.5)	(5.0)	(5.6)	(2.8)	(0.3)
Capex	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)
Acquisitions	-	-	(0.6)	-	-
Other investing items	-	(0.0)	-	-	-
Investing Cash Flow	(0.2)	(0.1)	(0.8)	(0.2)	(0.2)
Inc/(Dec) in equity	7.5	7.5	-	3.0	-
Inc/(Dec) in borrowings	-	-	-	-	-
Dividends paid	-	-	-	-	-
Other financing items	(0.5)	1.3	-	-	-
Financing Cash Flow	7.1	8.7	-	3.0	-
FX adjustment	-	-	-	-	-
Net Inc/(Dec) in Cash	0.4	3.6	(6.4)	0.0	(0.5)

BALANCE SHEET (A\$m)	2018A	2019A	2020E	2021E	2022E
Cash	4.5	8.0	1.7	1.7	1.3
Receivables	3.1	2.3	4.9	6.4	8.3
Other current assets	0.2	1.0	1.0	1.0	1.0
PP & E	0.3	0.3	0.4	0.5	0.6
Intangibles	0.1	0.1	0.7	0.7	0.7
Other non-current assets	0.1	0.1	0.1	0.1	0.1
Total Assets	8.4	11.9	8.9	10.5	12.1
Short term debt	-	-	-	-	-
Payables	1.6	1.8	3.8	5.0	6.2
Other current liabilities	4.7	6.8	8.6	11.1	14.2
Other non-current liabilities	-	-	-	-	-
Total Liabilities	6.4	8.7	12.5	16.1	20.4
Total Equity	1.9	3.2	(3.6)	(5.6)	(8.4)
Net debt (cash)	(4.5)	(8.0)	(1.7)	(1.7)	(1.3)

Speculative Buy

DIVISIONS	2018A	2019A	2020E	2021E	2022E
KEY METRICS (%)	2018A	2019A	2020E	2021E	2022E
Revenue growth	62.6	66.1	35.2	34.5	27.9
EBITDA margin	-	-	-	-	-
OCF / EBITDA	84.0	88.4	84.2	59.0	10.3
EBIT margin	-	-	-	-	-
Return on assets	-	-	-	-	-
Return on equity	-	-	188.7	89.9	33.3

VALUATION RATIOS (x)	2018A	2019A	2020E	2021E	2022E
Reported P/E	-	-	-	-	-
Price To Free Cash Flow	-	-	-	-	-
Price To NTA	28.4	20.9	-	-	-
EV / EBIT	-	-	-	-	-

LEVERAGE	2018A	2019A	2020E	2021E	2022E
ND / (ND + Equity) (%)	177.5	164.8	32.0	23.4	13.0
Net Debt / EBITDA (%)	45.0	103.2	24.0	32.6	41.8
EBIT Interest Cover (x)	85.0	43.0	60.4	91.6	54.0
EBITDA Interest Cover (x)	84.3	42.5	59.5	89.9	52.3

SUBSTANTIAL HOLDERS	m	%
Lee-Martin Seymour	30.9	18.4%
Tim Griffiths	30.9	18.4%
IFM	10.9	6.5%

VALUATION	
Cost of Equity (%)	14.0
Cost of debt (after tax) (%)	9.0
D / EV (%)	-
WACC (%)	14.0
Forecast cash flow (\$m)	16.0
Terminal value (\$m)	75.7
Franking credit value (\$m)	-
Enterprise Value (\$m)	99.8
Less net debt / add net cash & investments (\$m)	(8.1)
Equity NPV (\$m)	91.7
Equity NPV Per Share (\$)	0.52

Target Price Method	Rolled fwd DCF
Target Price (\$)	0.60
Valuation disc. / (prem.) to share price (%)	53.8

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SPECULATIVE BUY	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.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	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.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
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