Beer & Co. Equity Research

Wolfstrike Rentals (WSG.ASX) 23 August 2016

De-risking the growth of secure cashflows

Recommendation

STRONG BUY, Medium Risk

Price

1.3c

Valuation

5.1c

Business

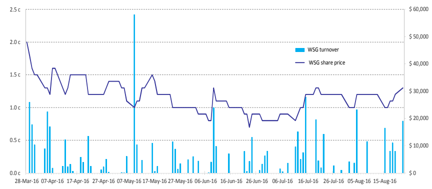
Technology rental to retail & hospitality

- **On 22 August, WSG announced that it had appointed sales agents to grow its rental book and execute client servicing.**
- **WSG increases its focus on rentals.**
- **The change takes out about $2.2m in fixed costs, making them variable costs, so relieving WSG of the balance sheet pressure of growing sales.**
- **WSG reduces debt by about $2m by selling its inventory to its master sales agent.**
- **Beer & Co's valuation of WSG has risen due to this change in near term cashflows and reduction in debt.**

Snapshot

Market Cap	$11.0m
Fully diluted	$12.9m
Net debt (est.) After sale of inventory	$1.9m
Shares on Issue - now	843m
Plus vendor shares to be earned	1,439m
52 Week High	2.0c
52 Week Low	0.8c
1 month / 6 month VWAP	1.1c / 1.1c

WSG : daily share price v. value traded



WSG bundles into a single package the supply, installation, commissioning and integration of a range of technology products to SMEs in the Retail and Hospitality sectors on a rental contract basis, so that the business makes a single monthly payment. These products include Point of Sale equipment, including eftpos and payment terminals.

WSG is growing its business (ie. rent book) rapidly by aggressively increasing its number of customers and, more significantly, by increasing the number of products its rents.

Author : Pieter Bruinstroop
pbruinstroop@beerandco.com.au

WSG establishes an external sales agency to secure growth

On 22 August, WSG announced that it had appointed an external agent to secure rental growth and will be expanding by appointing additional agents.

This followed an internal review which highlighted that much of WSG's current rental book was sourced from its agents, rather than from its own, internal, salesforce.

The agency, EFTPOS Warehouse, is headed by the former sales manager for WSG, and so understands the business intimately.

Out-sourcing de-leverages WSG's business

By using a master agency, WSG has reduced its annual fixed cost by $2.2m and allows a clear focus on growing the rent book. This is balanced by higher commission payments upon sales.

WSG is also selling its product inventory to the master agent, reducing its net debt by $2.2m.

Impact on Beer & Co's modelling

There are 2 impacts on Beer & Co's modelling of WGS :

- On-going fixed costs are reduced; and
- Net debt is reduced.

In Beer & Co's initial valuation we had assumed that 116m 2.0c options, exerciseable by March 2017 were exercised which provided the cash to cover the shortfall from our modelling. This shortfall was due to the fixed costs in building sales, and due to the reduction in fixed costs, this shortfall no longer arises, making WSG's financial position more secure.

Beer & Co's conclusions

Beer & Co's valuation has increased to 5.1c/share.

This transaction significantly de-risks the business. Our valuation will rise, to 5.4c/share, if the 125m 2.0c options are not exercised

Beer & Co affirms WSG as a Strong BUY, Medium Risk, rating.

 See Page 6 for Disclaimer and Disclosures

Operational De-leveraging

WSG out-sources sales

The value of WSG is driven by growth in its rental book.

WSG secured sales through 2 avenues :

- Its own salesforce, which is pad a retainer plus a commission on sales; and
- Agents who are paid purely on a (higher) commission basis.

WSG is moving to out-source all of its sales.

After a business review, WSG determined that a significant portion of its business came from external sales agents and so WSG concluded that it should out-source all of its sales to external agents.

Prior to this, external sales agents were an important source of sales, but not the exclusive source.

This changes WSG's operations to that of a financier, collecting the rental payments and servicing the debt.

It also reduces WSG's staffing to about 5 or 6 people, with a low overhead.

Master Agent Agreement

In its 22 August announcement, WSG stated that it appointed its first master agent.

In this case, the master agent is a new company headed by the sales manager from WSG, employing all of WSG's sales staff.

WSG has entered into a master agent agreement with EFTPOS Warehouse, which is now the former sales manager of WSG, plus his staff.

Financial Impact

By out-sourcing its sales to external agents, WSG estimates that it has reduced its annual fixed costs by $2.2m.

This will be balanced by a higher commission charge.

In addition, the master agent is acquiring WSG's product inventory valued at $2.2m, and the associated debt, reducing WSG's net debt by $2.2m.

Brief Analysis

This transaction significant reduces WSG's operational leverage, but making annual fixed costs of $2.2m into a variable cost.

Each sales contract has secure cashflows.

WSG is growing this set of secure cashflows.

However, in WSG's original operating model, the investment required to secure these cashflows meant that WSG required further capital until it got to the stage where the size of the rent book covered this cost.

In our analysis, Beer & Co assumed that a series of options, exerciseable at 2.0c, would be exercised generating $2.3m in equity.

WSG's financial leverage is reduced by the payment of $2.2m for product inventory.

In Beer & Co's analysis, WSG's need for the cash generated by the exercise of these options is diminished, due to the reduction in fixed costs.

Revised Valuation

Beer & Co's has re-modelled WSG, reducing fixed overhead and increasing commission expenses.

The impact of this is to raise Beer & Co's valuation from 4.7c/share to 5.1c/share.

See Page 6 for Disclaimer and Disclosures

Impact on Beer & Co modelling

Beer & Co initiated research on WSG in July (see Wolfstrike_2016July13).

Beer & Co has revised our modelling to show this lower operating leverage.

In that analysis, Beer & Co showed that we projected WSG to have negative cashflows for a four year period, which become positive, and continue to grow, after the early contracts have been rolled over.

This is shown in Figure 1.

Figure 1 : Beer & Co projected cashflows for WSG, July 2016

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Net New Zealand	$A 0.1m	($A 0.1m)	$A 0.1m	$A 0.6m	$A 1.1m	$A 1.6m	$A 1.8m	$A 1.9m	$A 1.9m
Net Australia	($A 0.2m)	($A 0.7m)	($A 0.4m)	$A 0.3m	$A 0.8m	$A 1.7m	$A 3.0m	$A 3.8m	$A 5.4m
Corporate	($A 0.9m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)
Taxes paid - NZ	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	($A 0.3m)	($A 0.6m)	($A 0.7m)	($A 0.8m)
Taxes paid - Aust	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	($A 0.3m)	($A 1.2m)
Net Cashflow	**($A 1.0m)**	**($A 1.8m)**	**($A 1.3m)**	**($A 0.1m)**	**$A 0.9m**	**$A 2.0m**	**$A 3.2m**	**$A 3.8m**	**$A 4.3m**

Source : Beer & Co initiation research, 13 July 2016

Figure 2 shows the change in Beer & Co's projected cashflows from the change to using external sales agents as opposed to employee sales.

Figure 2 : Beer & Co projected cashflows for WSG, August 2016

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Net New Zealand	($A 0.1m)	$A 0.1m	$A 0.2m	$A 0.8m	$A 1.2m	$A 1.8m	$A 1.9m	$A 2.0m	$A 2.1m
Net Australia	($A 0.1m)	($A 0.3m)	$A 0.0m	$A 0.6m	$A 1.1m	$A 2.0m	$A 3.4m	$A 4.1m	$A 5.8m
Corporate	($A 0.9m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)	($A 1.0m)
Taxes paid - NZ	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	($A 0.5m)	($A 0.7m)	($A 0.8m)	($A 0.9m)
Taxes paid - Aust	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	$A 0.0m	($A 0.0m)	($A 0.9m)	($A 1.3m)
Net Cashflow	**($A 1.1m)**	**($A 1.2m)**	**($A 0.8m)**	**$A 0.4m**	**$A 1.3m**	**$A 2.3m**	**$A 3.6m**	**$A 3.5m**	**$A 4.7m**

Source : Beer & Co estimates

Beer & Co's modelling still shows a projected cash shortfall

Comparing Figure 2 with Figure 1 shows

- Beer & Co still projects negative cashflows for the near term for WSG;
- The near term cashflows are less negative and turn positive more quickly, with the new operating model; and
- In the longer term, the previous model generated higher cashflows.

However, this shortfall is well covered by

- **The equity raised by WSG upon listing; and**
- **The payment received for the inventory sold.**

Figure 2 also shows that the cumulative negative cashflows total $3.1m from June 2015, much of which is covered by the net equity raised at the time of listing in early 2016, of $1.7m.

Concluding Comments

In our earlier work, Beer & Co assumed that 125m 2.0c options would be exercised, as

- our valuation was a significant premium to the exercise prices; and
- there was sufficient time for the share price to rise so that the options would be in the money.

With the operational restructure, Beer & Co's modelling shows that WSG's need for the cash raised by exercise of these options is diminished. Beer & Co's valuation rises to 5.4c/share if the options are not exercised.

Beer & Co.
Equity Research

Conclusions

In addition to lower operational and financial leverage, Beer & Co's valuation has increased from 4.7c to 5.1c/share.

Beer & Co's valuation has increased from 4.7c/share to 5.1c/share, as shown in Figure 3.

Beer & Co affirms our recommendation of STRONG BUY, Medium Risk.

Beer & Co affirms a STRONG BUY, Medium Risk, recommendation.

Figure 3 : Beer & Co's revised valuation of WSG

discount rate = 10.0 %		30 June 2016			22-Aug-16
	risk :	100%	Product	per share	
New Zealand	**100%**	$ 20m	$ 20m	1.3 c	1.3 c
Australia	**100%**	$ 55m	$ 55m	3.5 c	3.6 c
Franking credits	**60%**	$ 19m	$ 11m	0.7 c	0.7 c
Corporate	**100%**	($ 10m)	($ 10m)	(0.6c)	(0.6c)
Equity Raisings	**100%**	$ 2m	$ 2m	0.1 c	0.1 c
TOTAL		**$ 86m**	**$ 79m**	**5.0 c**	**5.1 c**
Shares on issue		842.8m	F P O shares	125.0m	Options
		595.7m	to be issued	125.0m	Ops. Ex'd

Source : Beer & Co estimates

Beer & Co Research

Wolfstrike Group Limited (WSG.ASX) — August 2016

Year ended June		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Section 1 - P&L								
Sales revenue	$A m	8	7	9	14	18	24	28
Interest revenue	$A m	0	0	0	0	0	0	0
Other revenue	$A m	0	0	2	0	0	0	0
Total Revenue	$A m	8	7	11	14	18	24	28
Cash COGS	$A m	(1)	(1)	(1)	(2)	(2)	(2)	(2)
Sales Costs		(1)	(1)	(3)	(2)	(2)	(3)	(3)
Sales Overhead	$A m	(2)	(1)	(2)	(2)	(2)	(3)	(3)
Corporate	$A m	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Other Expenses	$A m	0	0	0	0	0	0	0
Total Operating Expenses	$A m	(4)	(5)	(7)	(7)	(8)	(8)	(9)
EBITDA	$A m	4	3	4	7	11	16	20
Dep'cn & Amort'sn	$A m	(0)	(0)	(1)	(1)	(1)	(1)	(1)
EBIT	$A m	4	2	4	6	10	15	18
Interest Expense	$A m	(1)	(1)	(1)	(1)	(2)	(2)	(2)
Other	$A m	0	0	0	0	0	0	0
Pre-Tax Profit	$A m	3	2	3	5	8	13	16
Tax Expense	$A m	(1)	(0)	(1)	(1)	(2)	(4)	(5)
NPAT	$A m	2	1	2	4	6	9	12
Section 2 - Key Data								
Ordinary shares - year end	m	742.8	842.8	1,256.2	1,563.4	1,563.4	1,563.4	1,563.4
Fully diluted shares on issue	m	1,338.4	1,438.4	1,554.1	1,563.4	1,563.4	1,563.4	1,563.4
Weighted # shares	m	742.8	792.8	1,049.5	1,409.8	1,563.4	1,563.4	1,563.4
Earnings per Share		0.3 c	0.2 c	0.2 c	0.2 c	0.4 c	0.6 c	0.8 c
Dividends Per Share		0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c
Section 3 - Balance Sheet								
Cash	$A m	2	3	0	1	8	21	81
Receivables	$A m	1	0	0	0	3	5	7
Inventory	$A m	2	0	0	0	2	3	4
Other	$A m	0	0	0	0	0	0	0
Current Assets	$A m	5	3	0	1	12	29	92
Receivables	$A m	7	0	0	0	0	0	0
P , P & E	$A m	1	0	0	55	54	61	43
Intangibles	$A m	5	25	30	30	25	19	13
Other	$A m	0	0	0	0	0	0	0
Non-Current Assets	$A m	14	25	30	85	79	80	57
Total Assets	$A m	19	28	30	86	91	109	148
Unearned Income	$A m	1	1	1	1	2	2	2
Payables	$A m	1	0	0	0	0	0	0
Debt	$A m	0	1	2	3	4	5	5
Provisions		0	0	0	0	0	0	0
Other		0	0	0	0	0	0	0
Current Liabilities	$A m	2	2	4	5	6	7	7
Long Term Debt	$A m	7	3	5	6	7	7	8
Other	$A m	0	0	0	0	0	0	0
Non-Current Liabilities	$A m	7	3	5	6	7	7	8
Total Liabilities	$A m	9	5	9	11	13	14	15
NET ASSETS	$A m	**10**	**23**	**21**	**75**	**78**	**95**	**133**
Accumulated Profit (Loss)	$A m	(14)	(12)	(11)	(7)	(1)	8	20
Reserves	$A m	3	2	1	(9)	(13)	(17)	(24)
Contributed Equity	$A m	20	22	25	25	25	25	25
Total Equity	$A m	10	12	15	9	11	16	21

Major shareholders

				fully diluted
Kingbird Limited	David Ritchie	164.3m	19.5 %	11.4 %
Ian Bailey	MD / CEO	63.0m	4.4 %	45.8 %

Key Operating Projections

Year ended June	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Customers	1,544	2,839	3,498	4,098	4,698	5,298	5,898
Contract Size	$ 1,916	$ 2,766	$ 3,123	$ 3,183	$ 3,243	$ 3,303	$ 3,363
Contract Book	$A 3.0m	$A 7.9m	$A 10.9m	$A 13.0m	$A 15.2m	$A 17.5m	$A 19.8m
Customers	0	195	1,110	2,865	4,665	6,465	8,265
Contract Size	$ 0	$ 2,458	$ 2,533	$ 2,653	$ 2,773	$ 2,893	$ 3,013
Contract Book	$A 0.0m	$A 0.5m	$A 2.8m	$A 7.6m	$A 12.9m	$A 18.7m	$A 24.9m
TOTAL BOOK	**$A 3.0m**	**$A 8.3m**	**$A 13.7m**	**$A 20.6m**	**$A 28.2m**	**$A 36.2m**	**$A 44.7m**

Section 4 - Cashflow

		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
New Zealand								
Operations	$A m	(0)	(0)	2	2	3	3	3
Finance	$A m	1	1	(1)	(1)	(1)	(1)	(1)
Overhead	$A m	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Taxes Paid	$A m	0	0	0	0	0	0	(0)
Australia								
Operations	$A m	0	(0)	(2)	(0)	1	3	5
Finance	$A m	0	0	2	2	1	(0)	(1)
Overhead	$A m	0	(0)	(1)	(1)	(2)	(2)	(2)
Taxes Paid	$A m	0	0	0	0	0	0	0
Corporate Overhead	$A m	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Operating Cashflow	$A m	(1)	(1)	(1)	(1)	0	1	2
Change in Equity	$A m	0	2	2	0	0	0	0
Dividends Paid	$A m	0	0	0	0	0	0	0
Other	$A m	0	0	0	0	0	0	0
Financing Cashflow	$A m	0	2	2	0	0	0	0
Free Cashflow	$A m	(1)	(1)	(1)	(1)	0	1	2
Net Cashflow	$A m	(1)	1	1	(1)	0	1	2

Asset based Valuation

discount rate = 10 %		30 June 2016			22-Aug-16
	risk :	100%	Product	per share	
New Zealand	100%	$ 20m	$ 20m	1.3 c	1.3 c
Australia	100%	$ 55m	$ 55m	3.5 c	3.6 c
Franking credits	60%	$ 19m	$ 11m	0.7 c	0.7 c
Corporate	100%	($ 10m)	($ 10m)	(0.6c)	(0.6c)
Equity Raisings	100%	$ 2m	$ 2m	0.1 c	0.1 c
TOTAL		**$ 86m**	**$ 79m**	**5.0 c**	**5.1 c**
		842.8m	F P O shares	125.0m	Options
		595.7m	to be issued	125.0m	Ops. Ex'd

Financial Ratios

Year ended June		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue	$A m	8	7	11	14	18	24	28
EBITDA	$A m	4	3	4	7	11	16	20
EBIT	$A m	4	2	4	6	10	15	18
NPAT (reported)	$A m	2	1	2	4	6	9	12
Adjusted EPS (cps)		0.3 c	0.2 c	0.2 c	0.2 c	0.4 c	0.6 c	0.8 c
EPS Growth (%)			(46%)	27 %	22 %	52 %	60 %	28 %
DPS (c)		0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c	0.0 c
Dividend Yield (%)		0 %	0 %	0 %	0 %	0 %	0 %	0 %
PE adj. (x)	x	4.5	8.3	6.5	5.4	3.5	2.2	1.7
EV / EBITDA (x)	x	1.2	3.5	2.2	1.7	1.6	1.9	4.5
EV / EBIT (x)	x	1.2	3.9	2.5	1.9	1.7	2.0	4.8
Gearing (%)		43 %	12 %	17 %	7 %	8 %	7 %	6 %
Return on Assets		20 %	8 %	12 %	7 %	11 %	13 %	12 %
Return on Equity		22 %	5 %	9 %	5 %	7 %	10 %	9 %
EBITDA Margin (%)		47 %	36 %	45 %	50 %	58 %	66 %	69 %
Interest Cover (x)	x	(4.6)	(3.9)	(3.8)	(4.7)	(6.0)	(8.1)	(9.5)

 See Page 6 for Disclaimer and Disclosures

Beer & Co. Equity Research

Important Information

Confidential
This document is for the confidential use of the recipients only and is not to be reproduced without the authority of Beer & Co Pty Ltd. It has been prepared at the request of WolfStrike Rentals Group Limited ("WolfStrike") and Beer & Co Pty Ltd will receive a fee for its preparation.

Disclaimer
The persons involved in or responsible for the preparation and publication of this report believe that the information herein has been obtained from reliable sources and that any estimates, opinions, conclusions or recommendations are reasonably held at the time of compilation. No warranty is made as to the accuracy of the information in this document and, to the maximum extent permitted by law, Beer & Co Pty Ltd and its related entities, their respective directors and officers disclaim all liability for any loss or damage which may be suffered by any recipient through relying on anything contained or omitted from this document.

General Advice
The content is of a general nature and is based on a consideration of the securities alone, and as such is conditional and must not be relied upon without advice from a securities adviser as to the appropriateness to you given your individual investment objectives, financial situation and particular needs. Whilst this document is based on information and assessments that are current at the date of publication, Beer & Co Pty Ltd has not undertaken detailed due diligence on the information provided and has no obligation to provide revised assessments in the event of changed circumstances.

Disclosure
Beer & Co assisted the Lead Manager to the equity raising in March 2016 by WolfStrike and received fees for this service.

The author of this report participated in the public offer and has a relevant economic interest in WolfStrike.

Beer & Co Pty Ltd seeks to do work with those companies it researches. In the future, Beer & Co Pty Ltd may provide capital raising services or advisory services to WolfStrike on commercial terms. As a result, investors should be aware that Beer & Co Pty Ltd may have a conflict of interest that could affect the objectivity of this report.

Analyst Certification
The analyst responsible for this research report certifies that all of the views expressed reflect his personal views about the securities and the issuer.

Report prepared by : Pieter Bruinstroop pbruinstroop@beerandco.com.au

---

BEER & CO PTY LTD ABN 88 158 837 186,
AUTHORISED REPRESENTATIVE MELBOURNE VENTURE SECURITIES PTY LTD AFSL No. 224 313

Melbourne Office:
Suite 4, Level 2, Bank House
11 - 19 Bank Place,
Melbourne, Vic, Australia 3000
Telephone: (+613) 9600 3599
Facsimile: (+613) 9602 2291
Email: info@beerandco.com.au
Web: www.beerandco.com.au