

YPB Group

Upgrading on guidance

Earnings upgrade

YPB Group (YPB) combines patented anti-counterfeiting technology with security packaging solutions, consulting and forensic services to help businesses protect their brands from the risks of counterfeiting and product diversion. The company recently completed a A\$4.54m share placement and provided guidance to the market for FY17 profit before tax of A\$5m. We have incorporated this guidance and the effect of the share placement into our forecasts, resulting in a 16.2% upgrade to our FY17 PBT. Our DCF valuation of A\$0.44/share is unchanged following the upgrade and after incorporating the additional 18.91m shares on issue.

| Year end | Revenue (A\$m) | PBT* (A\$m) | EPS* (c) | DPS (c) | P/E (x) | Yield (%) |
|----------|----------------|-------------|----------|---------|---------|-----------|
| 12/14 | 0.1 | (2.3) | (2.2) | 0.0 | N/A | N/A |
| 12/15 | 1.7 | (5.7) | (4.7) | 0.0 | N/A | N/A |
| 12/16e | 10.8 | (2.5) | (1.3) | 0.0 | N/A | N/A |
| 12/17e | 26.9 | 5.0 | 2.4 | 0.0 | 10.2 | N/A |

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

FY17 guidance for A\$5m PBT

YPB announced on 19 May that it expects to reach cashflow break-even by end Q117 and deliver profit before tax of A\$5m for the year ending 31 December 2017. This is the first time the company has given guidance for FY17 and follows a spate of successful contracts for the group, the latest being a memorandum of understanding to supply its technology to global packaging group Orora and a A\$1.2m three-year supply contract to Comtech Solutions for New Zealand exports to China. YPB noted that its forecast was achievable across a range of revenue outcomes due to the flexibility of its costs base. A key assumption of the profit guidance is that the company would have sufficient access to capital until it reaches break-even and is self-sustainable.

Share placement raises A\$4.5m

The company has bolstered its cash position with an 18.91m share placement at A\$0.24/share to raise A\$4.54m (before expenses) to accelerate conversion of its business opportunity pipeline into recurring revenues, expand into new markets and enhance its solutions suite through R&D investment. The A\$4.54m share placement, announced on 24 May, was oversubscribed, we understand, by at least A\$500,000, and was supported by both existing and new shareholders, including six new institutional investors.

Valuation: DCF valuation of A\$0.44/share

Our DCF valuation is A\$0.44/share, unchanged after incorporating the profit upgrade and the impact of the share placement. YPB is trading on FY16 sales of 3.1x and FY17 sales of 1.2x, which is at a discount to the 12-month forward EV/sales multiple of 2.9x of its listed peers.

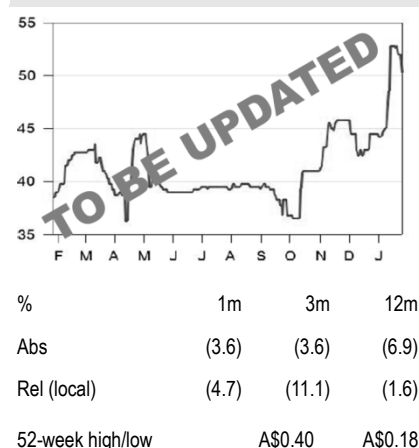
Industrial support services

8 June 2016

Price **A\$0.25**
Market cap **A\$48m**

| | |
|---|--------|
| Net debt (A\$m) at 31 March 2016 (excludes Lanstead receivable) | 1.8 |
| Shares in issue | 191.9m |
| Free float | 65% |
| Code | YPB |
| Primary exchange | ASX |
| Secondary exchange | N/A |

Share price performance



Business description

YPB Group has developed a three-pronged strategy designed to detect and protect brands from counterfeiters. The company owns four Chinese patents over invisible tracers and has secured several contracts for its technology.

Next events

| | |
|-----------------|-----------|
| Interim results | July 2016 |
|-----------------|-----------|

Analysts

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Earnings adjustments

We have adjusted our forecasts to take into account the company's guidance for A\$5.0m profit before tax in FY17. YPB has highlighted in its release to the market on 19 May that business from existing clients and advanced opportunities could potentially convert into FY17 revenue of A\$37.8m. However, it noted that its profit forecast was achievable across a range of revenue outcomes.

We have assumed that YPB adds another A\$2.3m to its forecasted FY16 revenue base and A\$4.7m to its forecasted FY17 revenue base, which in turn is expected to convert to PBT of A\$5m, in line with the company's guidance.

Our EPS forecasts have also been adjusted to take into account the increased shares on issue as a result of the share placement. Exhibit 1 details our earnings adjustments.

| Exhibit 1: Earnings adjustments to FY16 and FY17 | | | | | | |
|---|-----------|-----------|-------|-----------|-----------|-------|
| | FY16e new | FY16e old | % chg | FY17e new | FY17e old | % chg |
| Revenue (A\$m) | 10.8 | 8.5 | 27.9 | 26.9 | 22.2 | 21.3 |
| Gross profit (A\$m) | 5.7 | 4.7 | 22.0 | 14.3 | 12.2 | 16.9 |
| EBITDA (A\$m) | (2.3) | (2.5) | -9.4 | 5.1 | 4.5 | 13.3 |
| PBT normalised (A\$m) | (2.5) | (2.7) | -10.1 | 5.0 | 4.3 | 16.0 |
| NPAT normalised (A\$m) | (2.5) | (2.7) | -10.1 | 5.0 | 4.3 | 16.0 |
| EPS normalised (c) | (1.3) | (1.6) | -19.4 | 2.4 | 2.0 | 19.8 |
| Average number shares (m) | 191.3 | 171.4 | 11.6 | 204.8 | 185.0 | 10.7 |

Source: Edison Investment Research

Valuation

We use the DCF methodology to value YPB Group, arriving at A\$0.44/share based on a WACC of 12.6% and a terminal growth rate of 2%. We also dilute for 40.1m in-the-money options, which have a conversion price of A\$0.20/share and expire on 31 October 2017. Our FY17 forecasts incorporate the cash due from these options. Exhibit 2 sets out our valuation.

| Exhibit 2: DCF valuation | |
|--|-------|
| Present value of cashflows (A\$m) | 46.9 |
| Terminal value (A\$m) | 38.9 |
| Net cash* (A\$m) | 9.3 |
| PV of cash from 31 October 2017 options (A\$m) | 7.1 |
| Net equity value (A\$m) | 102.1 |
| Fully diluted shares on issue (m) | 231.3 |
| Net equity value per share (A\$) | 0.44 |

Source: Edison Investment Research. Note: *Includes the \$5m in staggered payments from Lanstead Capital for its shareholding.

Peer comparison

YPB is trading at an EV/sales discount to its listed peers, which are predominantly large corporations. The peer group is trading on a 12-month forward EV/sales multiple of 2.9x. In comparison, YPB is trading on an FY16 EV/sales multiple of 3.1x and an FY17 EV/sales multiple of 1.2x. Exhibit 3 highlights the peer group.

Exhibit 3: Peer Comparison on 12-month forward earnings

| Company | Country | Currency | Price | Market cap m (local) | Market cap (US\$m) | P/E (x) | EV/sales (x) | EV/ EBITDA (x) | EBITDA margin | Operating margin |
|-----------------------------------|-----------|---------------|--------|-------------------------|-----------------------|-------------|-----------------|----------------------|------------------|---------------------|
| 3M CO | US | US\$ | 169.99 | 103,101 | 103,101 | 19.6 | 3.7 | 12.6 | 29.4% | 24.6% |
| AMCOR LIMITED | Australia | A\$ | 16.35 | 18,936 | 13,564 | 28.7 | 2.3 | 15.8 | 14.8% | 11.2% |
| APPLIED DNA SCIENCES INC | US | US\$ | 2.95 | 71 | 71 | N/A | 4.9 | N/A | 0.0% | N/A |
| AVERY DENNISON CORP | US | US\$ | 74.91 | 6,680 | 6,680 | 18.3 | 1.3 | 9.9 | 12.7% | 9.7% |
| CATALENT INC | US | US\$ | 29.06 | 3,623 | 3,623 | 23.4 | 2.9 | 12.9 | 22.4% | 12.7% |
| DIGIMARC CORP | US | US\$ | 27.17 | 247 | 247 | N/A | 8.2 | N/A | N/A | N/A |
| DUPONT FABROS TECHNOLOGY | US | US\$ | 42.12 | 3,135 | 3,135 | 25.4 | 7.8 | 12.6 | 61.7% | 41.1% |
| ESSENTA PLC | UK | £ | 8.36 | 2,196 | 3,211 | 15.0 | 2.0 | 10.4 | 18.9% | 13.9% |
| HONEYWELL INTERNATIONAL INC | US | US\$ | 114.72 | 87,430 | 87,430 | 16.3 | 2.2 | 10.4 | 21.5% | 18.9% |
| INTEL CORP | US | US\$ | 31.39 | 148,224 | 148,224 | 12.5 | 2.6 | 6.8 | 39.0% | 26.1% |
| THERMO FISHER SCIENTIFIC INC | US | US\$ | 151.16 | 59,483 | 59,483 | 17.5 | 3.8 | 14.9 | 25.6% | 23.5% |
| THIN FILM ELECTRONICS ASA | Norway | NOK | 4.91 | 3,339 | 400 | N/A | 14.0 | N/A | N/A | N/A |
| ZEBRA TECHNOLOGIES CORP-CL A | US | US\$ | 51.76 | 2,704 | 2,704 | 8.9 | 1.4 | 8.0 | 17.6% | 15.5% |
| Anti-counterfeit companies | | Median | | | 431,872 | 16.9 | 2.9 | 11.5 | 18.9% | 13.9% |

Source: Bloomberg. Note: Prices as at 26 May 2016.

Exhibit 4: Financial summary

| | A\$000s | 2014 | 2015 | 2016e | 2017e |
|--|---------|---------|---------|---------|----------|
| Year end 31 December | | IFRS | IFRS | IFRS | IFRS |
| PROFIT & LOSS | | | | | |
| Revenue | | 85 | 1,714 | 10,829 | 26,937 |
| Cost of Sales | | 0 | 0 | (5,107) | (12,660) |
| Gross Profit | | 85 | 1,714 | 5,723 | 14,277 |
| EBITDA | | (1,889) | (4,649) | (2,309) | 5,108 |
| Operating Profit (before amort. and except.) | | (2,204) | (5,551) | (2,335) | 5,034 |
| Intangible Amortisation | | 0 | 0 | (1,727) | (1,526) |
| Exceptionals | | (2,206) | 282 | 0 | 0 |
| Other | | 0 | 0 | 0 | 0 |
| Operating Profit | | (4,410) | (5,269) | (4,062) | 3,508 |
| Net Interest | | (68) | (197) | (127) | (34) |
| Profit Before Tax (norm) | | (2,272) | (5,748) | (2,462) | 4,999 |
| Profit Before Tax (FRS 3) | | (4,478) | (6,030) | (4,189) | 3,473 |
| Tax | | 0 | 0 | 0 | 0 |
| Profit After Tax (norm) | | (2,272) | (5,748) | (2,462) | 4,999 |
| Profit After Tax (FRS 3) | | (4,478) | (6,030) | (4,189) | 3,473 |
| Average Number of Shares Outstanding (m) | | 103.7 | 124.3 | 191.3 | 204.8 |
| EPS - normalised (c) | | (2.2) | (4.7) | (1.3) | 2.4 |
| EPS - (IFRS) (c) | | (4.3) | (4.9) | (2.2) | 1.7 |
| Dividend per share (c) | | 0.0 | 0.0 | 0.0 | 0.0 |
| Gross Margin (%) | | 100.0 | 100.0 | 52.8 | 53.0 |
| EBITDA Margin (%) | | -2222.4 | -271.2 | -21.3 | 19.0 |
| Operating Margin (before GW and except.) (%) | | -2592.9 | -323.9 | -21.6 | 18.7 |
| BALANCE SHEET | | | | | |
| Fixed Assets | | 11,122 | 18,142 | 17,351 | 15,097 |
| Intangible Assets | | 11,096 | 16,176 | 14,449 | 12,923 |
| Tangible Assets | | 26 | 313 | 1,249 | 2,174 |
| Receivable from Lanstead for shares | | 0 | 1,653 | 1,653 | 0 |
| Current Assets | | 2,715 | 7,624 | 11,186 | 27,939 |
| Stocks | | 136 | 179 | 389 | 678 |
| Debtors | | 174 | 4,568 | 1,820 | 4,527 |
| Cash | | 2,405 | 2,877 | 8,977 | 22,734 |
| Other | | 0 | 0 | 0 | 0 |
| Current Liabilities | | (364) | (1,418) | (2,184) | (5,432) |
| Creditors | | (364) | (1,418) | (2,184) | (5,432) |
| Short term borrowings | | 0 | 0 | 0 | 0 |
| Long Term Liabilities | | (2,748) | (3,104) | (3,104) | (3,104) |
| Long term borrowings | | (2,748) | (3,104) | (3,104) | (3,104) |
| Other long term liabilities | | 0 | 0 | 0 | 0 |
| Net Assets | | 10,725 | 21,244 | 23,249 | 34,500 |
| CASH FLOW | | | | | |
| Operating Cash Flow | | (2,075) | (5,767) | 996 | 5,359 |
| Net Interest | | 10 | 76 | (127) | (34) |
| Tax | | 0 | 0 | 0 | 0 |
| Capex | | (17) | (299) | (962) | (999) |
| Acquisitions/disposals | | (163) | (462) | 0 | 0 |
| Financing | | 4,506 | 6,789 | 6,194 | 9,431 |
| Dividends | | 0 | 0 | 0 | 0 |
| Net Cash Flow | | 2,261 | 337 | 6,100 | 13,757 |
| Opening net debt/(cash) | | 125 | 343 | 227 | (5,873) |
| HP finance leases initiated | | 0 | 0 | 0 | 0 |
| Other | | (2,043) | (221) | 0 | 0 |
| Closing net debt/(cash) | | 343 | 227 | (5,873) | (19,630) |

Source: YPB Group accounts, Edison Investment Research. Note: 2017 forecast assumes exercise of 40m in-the-money options.

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