# Track Group

Location tracking and analytics

Initiation of coverage

Tech hardware & equipment

**Track Group is aiming to become a one-stop provider of tracking, monitoring and data analytics services with an initial focus on the global offender management market. The company's revenue is recurring in nature and near-term growth should be supported by the company's contract with Chilean Gendarmerie. The signing of other major national or state-scale contracts should accelerate growth, while the refinancing of debt should also be a key catalyst for upside.**

| Year end | Revenue ($m) | PBT* ($m) | EPS* (c) | DPS (c) | EV/EBITDA (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 09/13 | 15.6 | (0.5) | (8.5) | 0.0 | 34.9 | N/A |
| 09/14 | 12.3 | (7.1) | (71.4) | 0.0 | N/A | N/A |
| 09/15e | 24.6 | (0.7) | (6.7) | 0.0 | 30.7 | N/A |
| 09/16e | 32.8 | 7.5 | 74.0 | 0.0 | 8.1 | N/A |

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

## Tracking-as-a-service

Track Group's core business is based on the manufacture and leasing of devices to federal, state and local law enforcement agencies for the electronic monitoring of offenders. Penetration of electronic tagging in the global offender market is still low. Even in the US, the most advanced market globally, only a small proportion of the c 5m offenders under community supervision are currently electronically monitored. The drivers for increased adoption look very strong – the cost of tagging offenders has been estimated at c one-sixth of the cost of incarceration and jail occupancy rates are at high levels globally. Falling device costs combined with the potential added value of analytic services could accelerate adoption.

## Recurring revenue model, margin expansion drivers

Devices are leased on a per-day, per-active-device basis giving the company a recurring revenue model. Our revenue growth estimates for FY15 (100%) and FY16 (33%) are driven primarily by the Chilean contract, which drives the number of tags in use from 8k exiting FY14 to 15k exiting FY16. Through the acquisition of G2 research, we believe that Track Group is also the only company among its direct peers offering analytics services, which could become a key differentiator. Uptake of analytics should also drive further gross margin expansion, although this is still at an early stage and therefore not yet included in our forecasts.

## Valuation: Geographic and vertical expansion is key

Our reverse DCF suggests that the current valuation prices in a revenue CAGR of 15.5% to c $100m in 2025 with EBITDA margins reaching 25% at this time. To put this into context, we believe this could be achieved through securing three or four significant contracts similar in size to Chile over the next 10 years. The securing of further national/state-wide deals are therefore a key catalyst, in that they could put Track Group ahead of this growth curve and further improve commercial credentials. Our forecasts assume the $30m of debt that matures over the next 12 months will be refinanced.

**5 May 2015**

| | |
|---|---|
| **Price** | **US$9.25** |
| **Market cap** | **US$93m** |

| | |
|---|---|
| Net debt ($m) at 31 December 2014 | 25.1 |
| Shares in issue | 10.1m |
| Free float | 28% |
| Code | SCRA |
| Primary exchange | OTCBB |
| Secondary exchange | N/A |

### Share price performance


| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | (8.9) | (23.0) | (48.1) |
| Rel (local) | (9.6) | (26.3) | (53.1) |
| 52-week high/low | | US$19.45 | US$9.25 |

### Business description

Track Group develops and provides end-to-end B2B and B2G tracking solutions that combine real-time tracking devices and monitoring services with advanced data analytics for the global offender management market. However, healthcare monitoring, asset tracking and data analytics are key opportunities for growth.

### Next event

| | |
|---|---|
| Q215 report | May 2015 |

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***Track Group is a research client of Edison Investment Research Limited***

# Investment summary

## Company description: Electronic monitoring

Track Group offers a patented portfolio of tracking devices, monitoring services and data analytics capabilities to the offender management market and is looking to expand into healthcare, insurance and logistics. In March 2014, it acquired GPS Global, an Israeli start-up with advanced electronic monitoring technology and tracking platform, which was rolled out globally in late 2014. In June 2014 it acquired Emerge Monitoring, which provided a strong customer base and real-time alcohol monitoring technology. In November 2014, Track Group then acquired G2 Research, which has device-agnostic analytics capabilities that could become an important additional revenue stream.

## Financials: High-retention recurring revenue

Electronic monitoring devices are typically leased to customers on a per-day basis. The daily rate ranges from $2 to $15 per day depending on the types of services offered and devices used. The revenue stream is recurring with a current churn rate of less than 8% in terms of the number of devices being returned each year. Historic gross margins have been c 50%, but the new generation of device and the provision of analytics services could increase this significantly. In September 2014 Track Group began installing devices for the Chilean Government that could generate revenues of up to $70m over 41 months which combined with the acquisitions will drive much of the 100% forecast growth in revenues in FY15 and 33% in FY16. The Cash at 31 December 2014 was $5.2m and debt was $30.3m, most of which will need to be refinanced over the coming year.

## Sensitivities: Government budget constraints drive demand

**Funding:** Track Group has $30m of debt that matures over the next year; additional funding will be required for Track Group to continue as a going concern but management is confident that the debt will be refinanced without difficulty. **Major deals**: Signing further significant deals such as the Chilean contract could significantly boost revenue. We understand from management that there are a number of substantial contracts coming up for tender over the next few years, and so if Track Group can win some of these contracts it could prove transformational for the business. **Competition:** electronic monitoring of offenders is a competitive industry and therefore daily monitoring rates could come under pressure. Track Group has tried to mitigate this by investing in innovative and patented technology and maintaining investment in R&D so that it can provide leading technology, but at a competitive price. **Chilean contract:** Track Group has signed a substantial contract with Chile. While the contract is currently being delivered – and there are no indications that it will fall through – contract failure could materially affect the group's results. **Liquidity and large shareholding:** Track Group's free float is 28%, with more than 50% of shares controlled by a single shareholder.

## Valuation: Geographic and vertical expansion key to valuation

If Track Group can follow up the Chilean contract by securing further state or nationwide deals, we believe there is clear potential to drive upside. The opportunity for electronic monitoring of offenders is clearly substantial and there is further potential in other verticals such as healthcare and logistics, although the pace of growth and ultimate potential market size is difficult to quantify. Our reverse DCF suggests that the current valuation prices in a revenue CAGR of 15.5% to c $100m in 2025 with EBITDA margins reaching 25% at this time. At a daily lease rate of $7.50 this would represent c 55k devices in use for 250 days per year, which could be achieved through rolling out and retaining only three or four significant contracts similar in volume size to Chile over the next 10 years. Track Group currently has an installed base of 8,000 tags, and 100,000 offenders are being electronically monitored in the US, with another 100,000 in the UK.

# Company description: Electronic monitoring

Track Group provides a range of tracking and analytics services to a range of verticals, but most revenue currently comes from offender monitoring. Most revenue is from the US, South America, and the Caribbean, where devices and associated services are leased on a per-day basis. It therefore has a high degree of recurring revenue. It is also trying to grow into the analytics space where it can use device-agnostic tracking data to provide insightful analysis to its customers. This is a significant potential value-added growth area.

## Company history

Track Group was formed from the combination of SecureAlert, GPS Global, Emerge Monitoring and G2 Research. SecureAlert was the original listed entity and acquired GPS Global for $7.8m ($7.5m shares, $0.3m cash) in March 2014, Emerge Monitoring for $7.4m cash in June 2014 and G2 Research for C$4.6m (C$2.0m cash, C$2.6m equity earnout) in November 2014. The company was renamed Track Group in October 2014.

## Tracking and analytics service for a wider audience

Electronic monitoring is a competitive area. To differentiate itself Track Group is aiming to provide a package of services from which its customers can select on a platform-as-a-service (PaaS) basis. This includes the basic tracking devices, add-ons including an alcohol monitoring device, monitoring services and/or analytics services. The acquisitions of GPS Global and Emerge Monitoring are key parts of this strategy. The intention is that data collected through monitoring can be monetised through advanced analytics that can be sold as software-as-a-service (SaaS). G2 Research also provides device-agnostic analytics services, which are currently provided to law enforcement and national security agencies on an ad-hoc basis. The analytics services may also be developed to provide advanced warnings of crimes that may be committed by people on tags, based on their location and previous movements. This could be a key selling point for Track Group's devices and could help maintain daily lease rates and win new customers. Lowering the costs of manufacturing through subcontracting to Asian manufacture will help Track Group stay price competitive and improve its margins.

## Management

Guy Dubois (chairman and co-CEO) was appointed director of SecureAlert on 3 December 2012 to oversee a restructuring of the business and the appointment of a new CEO. His appointment was a condition of a loan agreement SecureAlert signed with Sapinda Asia, a key shareholder. Guy is also a director and owner of Tetra House Pte, which provided SecureAlert with a $25m credit facility in January 2014. Before SecureAlert, Guy was CEO of Gategroup AG from September 2008-11. During his tenure he oversaw the listing of the group on the SIX Swiss Exchange and saw the share price increase at over 45% CAGR from CHF15 in May 2009 to CHF45 in April 2011. The $25m facility provided by Guy has since been securitised and sold on to investment trust Conrent Invest SA, which is also an equity investor in Track Group. David Boone is the acting CEO alongside Guy Duboi. He has had a number of senior roles in organisations such as Kraft, PepsiCo, Safeway and Belo Corporation. He also served as CEO of American CareSource Holdings and CFO or Intira Corporation. John Merrill was appointed CFO in April 2014. He has held a number of financial roles in organisations including UHG, Clear Channel, IMG, Sports Authority and CFO of Park City Group (NASDAQ: PCYG) a SaaS provider, and is therefore well placed to bring Track Group to the same standing.

# Product description

## Innovative tracking and alcohol monitoring technology

Exhibit 1 shows the list of products and services that Track Group currently provides. At the moment the products are mainly targeted at offender monitoring, but the intention is they this could be extended into a number of areas including monitoring for hikers and climbers, Alzheimer patients, children, cars/trucks and other physical property monitoring. Track Group intends to expand into these adjacent areas through B2B and B2G arrangement rather than direct to consumer, as it enables faster growth and a more secure revenue stream.

**Exhibit 1: Product and service description**

| Product/service name | Product description |
|---|---|
| Shadow | Shadow is the device that was acquired with GPS Global. Management was attracted to the acquisition of GPS Global because it viewed the technology as the next generation of tracking device, liked its small form factor, the provision of both RF and GPS tracking and the fact that it can be automatically charged by the offender rather than needing to be replaced by the authorities. It requires limited intervention from Track Group's monitoring centre as events are typically dealt with by the law enforcement agency directly. |
| RADAR | RADAR was acquired with Emerge Monitoring and is an innovative and patented system for monitoring the alcohol levels of an offender. It is the most portable device available on the market. It uses biometric factors to identify the person using the device (ie heart rate, breath rate and lip print). It has real time reporting via the mobile network. |
| ReliAlert XC | ReliAlert XC is the original tag developed by SecureAlert. It has patented three-way communication technology, which allows the monitoring centre, offender and law enforcement offices to communicate. Most existing clients will be transitioned to the Shadow, which is lower cost and higher margin and does not require as much manual intervention by a monitoring centre and instead provides direct interaction between the law enforcement agency and the offender. |
| TrackerPAL | TrackerPAL is the tracking platform and gateway technology that allows law enforcement agencies to track the offenders in real time and manage the zones into which they are allowed to travel. It is available on desktop and mobiles and can be used across many different types of devices. TrackerPAL and the device-agnostic analytics could be a key route to Track Group improving growth and margins because it enables the company to penetrate the installed base of other device manufacturers if the law enforcement authorities deem their software to be more advanced. |
| Monitoring centres | Tags can either be monitored directly by the law enforcement agency or Track Group can provide that service. Track Group has a monitoring centre in Utah, US. Monitoring services are provided for an additional daily charge. |
| Device-agnostic analytics | Through the acquisition of G2 Research, Track Group now provides a range of proprietary analytics services for both electronic monitoring devices and any location-based information. This information could include information extracted from mobile phones or any devices that can track location. For the offender monitoring market Track Group is proposing that large-scale data analytics could be used to pre-empt offenders about to commit a crime, which would allow the authorities to intervene before anything actually occurs. The management and monitoring of the movements of offenders, irrespective of the device that is being used to track them, is also a key competitive advantage that few other companies are attempting to provide. |

Source: Edison Investment Research, Track Group

## Improving margins through outsourced manufacture

The legacy SecureAlert devices are manufactured in China and have a relatively high proportion of custom components. The new Shadow devices have a high proportion of pre-built components and the assembly and manufacturing costs are significantly lower. There are six major suppliers of components but currently only one manufacturer, although management is vetting a second service centre/provider to ensure stability of supply. There is generally an eight- to 12-week lead time with devices typically shipped straight to the customer. Management is confident that the quality control and reliability of the devices will be better than historic levels.

# Personal, offender and asset tracking market

Track Group is currently focused on tracking offenders on community supervision orders, particularly in the US (74% FY14 revenue) the Caribbean (23%) and Chile (3%). However, the tracking technology has broader applications that could present additional growth opportunities in the medium to long term.

## Offender monitoring market

There are no reliable global market figures available for the use of electronic monitoring, but several credible sources estimate that approximately 100,000 offenders are monitored each day in the US. To put this into context, the US Bureau of Justice Statistics states that 4.8 million offenders were under community supervision at the end of 2012, 851,000 of whom were on parole. The number of offenders under community supervision in the US fell marginally, by 0.85%, between 2012 and 2013, but only 2.1% of offenders under community supervision in the US are being electronically monitored so there is significant room for growth. There are no reliable statistics for the growth in electronic monitoring, but an estimated 4,914 offenders were being electronically monitored in 2007[1] compared to the current 100,000 estimate by BI, which implies a CAGR of 45%. Other jurisdictions electronically monitor a higher proportion of offenders under community supervision. In the UK, for example, between 2012 and 2013, there were 90,000 cases of individuals being electronically monitored, with approximately 24,000 being tagged at any one time. This is 58% of the c 154,000[2] offenders that were given community sentences in the 12-month period to September 2012. In the US, the Interstate Commission for Adult Offender Supervision (ICAOS) conducted a survey in 2007 on electronic monitoring usage in the US. A summary of the results is shown in Exhibit 2. Although the total number of offenders being electronically monitored will have changed significantly since then, there are no market share statistics available and the ranking of companies is likely to be broadly the same.

**Exhibit 2: Summary of results from ICAOS GPS Survey 2007**

| Supplier | Number of states | Estimated number of offenders monitored at any one time |
|---|---|---|
| Satellite Tracking of People LLC (Securus) | 2 | 1,351 |
| ProTech (3M) | 11 | 1,190 |
| iSecureTrac (Corrisoft) | 5 | 999 |
| BI (The GEO group) | 3 | 362 |
| G4S | 3 | 387 |
| Sentinel Offender Service | 3 | 310 |
| Track Group | 3 | 70 |
| Other/not disclosed | 3 | 245 |
| **Total** | **33** | **4,914** |

Source: ICAOS GPS Update survey April 2007

## Political and social factors are the key drivers

Electronic monitoring reduces the number of offenders in prison and therefore lowers the cost to the state of monitoring and rehabilitating offenders. The US Department of Justice stated in 2011 that the cost of imprisonment to the state was six times higher than that of electronic monitoring. There is also some evidence to suggest that community supervision is also more effective at preventing reoffending. The Ministry of Justice in the UK, using 2011 figures, found that community sentences reduced one-year reoffending rates by 8.3% compared to custodial sentences for similar offenders. A study in Florida, commissioned by the US Department of Justice, also found that the risk of failure of community supervision was reduced by 31% as a result of electronic supervision. Despite this, however, there remain concerns about the safety of electronic monitoring, following instances of technological and administrative failures. This is likely to be holding back adoption in some jurisdictions, but with ongoing budgetary pressures and the large cost savings that can be made by moving towards electronic monitoring, it is likely that the long-term trend will be towards a higher number of more advanced electronic monitoring devices. The key growth driver for Track Group is likely to be more frequent monitoring of offenders on probation and parole, as well as monitoring offenders that would otherwise be sentenced to prison time. Therefore, although the overall prison

[1] ICAOS (Interstate Commission for Adult Offender Supervision) GPS Survey 2007.

[2] Ministry of Justice – Criminal justice statistics quarterly, September 2012.

population and community service sentences have been shrinking in some jurisdictions, the potential market for electronic monitoring could grow significantly.

## Competitors

### One-stop-shop for tracking everything

Track Group intends to build its competitive advantage by becoming a one-stop-shop for all tracking-related services including analytics. Currently the market is fragmented around each of the individual applications and none of Track's direct peers currently offer analytics services. The combination of Track Group's tracking platform, data analytics and globally distributed devices should act as an increasingly strong barrier to competition as more devices are deployed due to the virtuous circle of more data, improved analytics and higher value add. It is important however that its clients can effectively use the data to improve operational efficiencies or gain additional insight, which is currently unproven on a large scale. Exhibit 3 lists Track Group's key competitors in the offender monitoring space. There are a number of other competitors with personal tracking and asset monitoring, but given Track Group's low exposure to those areas at the moment, we have focused on the offender monitoring market.

**Exhibit 3: Key competitors**

| Company name | Description |
|---|---|
| BI Inc (The GEO Group) | BI estimated as at January 2014 there were 100,000 offenders each day being monitored in the US, with 50,000 of them using BI devices. An additional 20,000 are monitored worldwide. BI has a wide range of products including RF, GPS, alcohol monitoring and monitoring centres. They use transdermal alcohol monitoring rather than breathalyser, which means alcohol can be detected using the tag itself (by monitoring alcohol levels in sweat) rather than a separate breathalyser. BI is a fully owned subsidiary of publicly listed GEO Group. |
| 3M Electronic Monitoring | 3M provides an extensive range of electronic monitoring solutions including some that are targeted for use with inmates rather than community supervision. 3M is an $88bn NYSE-listed diversified technology company and therefore has significant resources to spend on the research and development of new monitoring solutions. |
| Satellite Tracking of People (STOP) | STOP was acquired by Securus on 20 December 2013. Securus provides technology and computer systems to 2,300 correctional facilities in the US, Canada and Mexico. |
| G4S | G4S claims to manage12,000 offenders at any one time, although after losing its UK contract this number may have fallen significantly. The G4S system used in the UK was an RF-based home arrest system, which alerted local authorities when an offender went outside the range of the base station. It has since introduced GPS-enabled monitoring in Scotland. |
| Omnilink Systems | Omnilink was founded in 2004 with four employees and has grown to 65 employees today. It provides a wide range of solutions for tracking people and assets, eg people suffering from dementia, children, lone workers, vehicles, goods in transit and construction equipment. It has developed an M2M platform that enables applications to be developed quickly. Omnilink was purchased by Numerex Corp (NASDAQ: NMRX) in May 2014, a leading provider of on-demand and interactive M2M enterprise solutions. |
| iSecureTrac/Corrisoft | Acquired by Corrisoft on 17 December 2013, it provides a similar range of products to Track Group and operates in 41 states in the US and Canada. Corrisoft has developed a range of solutions for various levels of offender risk. All are based around its Air platform, which uses AIR Mobile – a proprietary smartphone that is equipped with GPS, geo-fencing and voice authentication technology – to provide additional resources to help offenders manage their rehabilitation. For high-risk offenders Corrisoft uses STOP's BluTag. |
| Sentinel Offender Services | Sentinel Offender Services provides GPS tracking, alcohol monitoring and various other products similar to Track Group. It claims to monitor up to 2,000 offenders per day. It also provides a range of probation and court services. |
| Buddi | Buddi is a small UK-based private company founded in 2005. It provides combined RF and GPS tracking tags that charge using the body's movement. Its system is used in Sweden, Canada, Ireland and New Zealand. It was awarded the contract for the tags and software to be used in the UK, but negotiations failed and the contract has since been awarded to 3M and Steatite. Despite its small size, Buddi has opened offices in the US and has hired Steve Chapin, who was a founder of ProTech Monitoring, which was sold to 3M in 2010. Therefore, although small in size, Buddi appears to be gaining a strong reputation in the industry and could be disruptive to incumbents. |

Source: Edison Investment Research

## Personal tracking

GPS Global, acquired by SecureAlert in March 2014, is an Israeli company that provides personal locating (as well as offender monitoring) devices that are used to track individuals in the general population. This type of device is marketed at parents who would like to be able to check where their child is, or security guards who could be tracked by a central office to ensure their safety. It is also marketed as a health monitoring device for people with health conditions such as dementia, who could benefit from having a mobile tracking device. Another potential use is for travellers and hikers who are travelling to remote areas and would like the ability to alert people and inform them of their location if they get into trouble. This is a relatively new area for Track Group and is quite a competitive space, with a number of companies providing devices that can track children, dementia patients, pets or cars. To succeed in these areas it is likely that Track Group will need to adapt its current range of products to be more user friendly (eg can be worn on the wrist). The company may also require sales and marketing expenditure to make it stand out from its peers.

### Vehicle and asset tracking

GPS Global also offers a vehicle tracking solution that can transmit audio, video and location over GSM/GPRS. It alerts the fleet/vehicle operator to speeding and can also be configured to send an alert if the driver enters or departs from a pre-defined area. The vehicle and asset tracking market is much bigger than the offender tracking market. ABI Research estimates the number of subscriptions to tracking services will grow from 13.3m in 2012 to 30.4m in 2016. In March 2012, Global Industry Analysts estimated the commercial vehicle telematics market will reach $17.3bn by 2017. The industry is fragmented with numerous players developing proprietary solutions. However, most solutions just provide car and engine management data, but typically do not have the video transmission capabilities of GPS Global's solution. GPS Global is a minority player in the market, although integration within Track Group could help accelerate its growth.

## Sensitivities

- **Funding:** Track group has $30m of debt that matures over the next year; additional funding will be required for it to continue as a going concern.
- **Major deals**: Signing further significant deals such as the Chilean contract could significantly boost revenue. We understand from management that there are a number of substantial contracts coming up for tender over the next few years and so if Track Group can win some of these contracts it could prove transformational for the business.
- **Competition:** offender tracking is a competitive market, with some larger companies than Track Group operating in the space. This could make it difficult for Track Group to gain market share and maintain margins.
- **Chilean contract:** the Chilean contract is expected to be a significant proportion of FY15-16 earnings and therefore failure of this contract or termination after the contracted period could have a material impact on earnings.
- **Liquidity and large shareholding:** Track Group's free float is 28%, with over 50% of shares controlled by a single shareholder. This could lead to volatility in the share price or pricing pressure if the large shareholder decides to sell.

## Financials

### High-retention recurring revenue

Monitoring services are charged on a per-day, per-device basis, with services provided by peers ranging from $1.50 to over $25 a day[3] depending on the devices provided and the services offered. A daily rate of c $1.50 is charged for devices held by clients but not being used. Track Group currently has c 8,000 devices in operation (US 6,000, Chile 1,000, South America, Canada and the Caribbean 0.8k). Active devices are charged at a higher rate ($5+ per device per day) to idle devices ($1.50 per device per day) and management suggests that generally devices are used for 260 days each year. Generally, authorities are not required to use a minimum number of devices,

[3] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Public-Sector/dttl-ps-publicsectordisrupted-08082013.pdf.

but are only provided with the inventory that they are likely to use. Once an authority deploys a certain type of device it is typical that they will keep using that device for three to five years, which results in a stable underlying revenue stream for Track Group. Management reports that typically less than 8% of the existing installed based become inactive each year due to authorities reducing their monitoring schemes or switching providers. Within Track Group, the daily charge will vary depending on which device the customer chooses and whether they sign up for analytics and/or 24/7 monitoring by Track Group's service centre. We expect the average daily rate to be single-digit US$ and fall over time as the device cost falls and the industry becomes more competitive. For the purposes of our model, we assume the average daily rate is $6.30 currently, falling to $5.60 per day by 2016 for the US market. This will be a blended rate across all services and products provided. Exhibit 4 shows our revenue assumptions based on estimates for devices in use and average daily rate charged to customers. Occasionally there are also one-off contracts that do not conform to the normal contract structure because additional services are provided such as advisory work or assistance in constructing effective monitoring centres that the customer will staff. We assume an 8% churn rate (on a device numbers basis) each year.

**Exhibit 4: Revenue assumptions**

| | 2015e | 2016e |
|---|---|---|
| Total number of tags in use at end of period | 10,360 | 11,031 |
| Proportion of tags lost/damaged/sold on | 8% | 8% |
| New tags introduced | 3,000 | 1,500 |
| Average lease revenue per day per tag ($) | 6.30 | 5.60 |
| Alcohol monitoring units in use | | 1,000 |
| Daily rate for alcohol monitoring ($) | | 6.00 |
| Lease days per year | 260.00 | 260.00 |
| One-off contracts with Chile/Mexico/Other ($m) | 6.0 | 12.5 |
| Monitoring services lease revenue ($m) | 17.0 | 17.6 |
| **Total monitoring services revenue ($m)** | **23.0** | **30.1** |
| Product sales($m) | 0.2 | 0.2 |
| Analytics($m) | 1.5 | 2.5 |
| **Total revenue ($m)** | **24.6** | **32.8** |

Source: Edison Investment Research. Note: All figures are Edison estimates.

## Emerge Monitoring provides boost to installed base

The acquisition of Emerge Monitoring for $7.4m cash in June 2014 provided Track Group with its Real-Time Alcohol Detection and Recognition (R.A.D.A.R) system and an installed base of c 2,000 tracking units. Increasing the installed base and the number of authorities with which Track Group is working is an important growth strategy as it allows cross-selling of analytics, tracking and alcohol monitoring across all authorities. Our forecasts do not explicitly factor in any cross-sell, although it does represent a significant opportunity. In our forecasts we have assumed Emerge's installed base is transferred to Track Group bringing the total installed base to c 10,000 units in 2015. We then assume an increase of 700 units in 2016 based on a growth rate (in units) of 6.4%. This does not include any major Chilean-sized contract wins.

## Chilean contract: $70m potential revenue over 41 months

A contract was signed with the Chilean prison service in November 2013 for up to 9,400 devices and up to $70m revenue over 41 months. A $3.4m performance bond was required and posted by Track Group as a condition of the contract and will be returned on successful completion. The $70m maximum potential contract revenue assumes 100% utilisation of the 9,400 tags; we have been conservative in our forecasts and assumed only 1,900 devices are rolled out by the end of FY15, increasing to 4,000 by FY16 as the systems and process become more established.

## Gross margins and operating expenses

The cost of operating devices is calculated on a cost-per-day basis. Track Group's legacy devices are comparatively high cost (c $2-4 per day), but the new GPS Global devices cost around half that, with the opportunity for further reduction as production scales. This is achieved through GPS Global's device using mainly (85% of total) pre-built components. The transition of the installed base from the ReliAlert XC devices to GPS Global devices should therefore provide a substantial boost to gross margins even with a reduction in daily pricing. We model this as an improvement in gross margins for monitoring services to 65% in 2015 followed by a further increase to 70% in FY16. There is typically an eight- to 12-week lead time with the product shipped directly to the customer to minimise the storage and inventory costs. The high-margin analytics software could improve gross margins as it grows to be a greater proportion of total revenue. The main operating costs of the business are currently the monitoring centres, R&D and other staff costs. Sales and marketing are conducted at a senior level so marketing costs should not need to expand considerably. We expect overheads to fall as a result of the restructuring and movement to the new Shadow devices, which in conjunction with automation will require less monitoring centre capacity. Manufacturing is subcontracted to APS Technologies, which is a global contract manufacturer that has clients such as Sony, Dell, Panasonic and Tyco. There is limited capital investment required and low stock levels because stock is built as required by large contracts. Repair and maintenance of devices has historically been a fairly substantial cost, but the new devices and manufacturing process are expected to significantly reduce the repair and maintenance bill. R&D will continue to be an important expenditure as the technology is moving quickly and it is important that Track Group stays ahead of the competition from both a functionality and cost point of view.

## Balance sheet and cash flow

Cash at the end of December 2014 was $5.2m and there was $30.3m of debt. $24.6m of the debt relates to fixed 8% interest unsecured facility that is due to be repaid on 3 January 2016. A further $2.6m relates to a royalty agreement with a third party, in which Track Group agreed to pay $4.5m over two years for a non-exclusive, irrevocable, perpetual and royalty-free licence to use certain patents. An additional $2.7m of related-party notes are payable over 2015. Refinancing these debts is crucial to the success of the business. There is c $5m of contingent consideration payable in cash and shares that may become due depending on the performance of GPS Global and G2 Research, but we have not factored this into our forecasts.

# Valuation

## Significant regional and national contracts key to upside

If Track Group can follow up the Chilean contract by securing further state or nationwide deals, we believe there is clear potential to drive upside. The opportunity for electronic monitoring of offenders is clearly substantial and there is further potential in other verticals such as healthcare and logistics, although the pace of growth and ultimate potential market size is difficult to quantify. Given Track's comparatively early stage of development and the lack of direct peers, we believe that a reverse DCF provides the best gauge as to what the company needs to achieve to both justify its current valuation and drive further upside. Our reverse DCF suggests that the current valuation prices in a revenue CAGR of 15.3% to c $100m in 2025 with EBITDA margins reaching 25% at this time. To put this into context, at a daily lease rate of $7.50 this would represent c 55k devices in use for 250 days per year which could be achieved through rolling-out and retaining only three or four significant contracts similar in volume size to Chile over the next 10 years. We have not incorporated the potential upside from the analytics business because it is too early to quantify the pace of growth. However, if a growth trend is clearly established over the coming quarters it could warrant valuing as a separate component with valuation multiples closer to that of SaaS analytics companies, which typically trade at much higher multiples. Our DCF assumes a WACC of 10%, terminal growth of 3% and the average daily lease rate per device falling from c $10 global average in 2015 to c $7.5 in 2025. There is a high degree of uncertainty in these assumptions and therefore it is useful to look at a range of revenue growth rates and EBITDA margin, as shown in Exhibit 5. Exhibit 6 shows the corresponding revenue and tag count at the same growth rates. Exhibit 7 shows the sensitivity of the DCF valuation to WACC and revenue CAGR from 2015-25.

**Exhibit 5: DCF sensitivity analysis**

| | | Revenue CAGR 2015-25 | | | | |
|---|---|---|---|---|---|---|
| | | 12.3% | 15.3% | 18.7% | 21.8% | 25.0% |
| EBITDA Margin | 25.0% | 7.6 | 9.6 | 12.5 | 15.8 | 19.9 |
| | 30.0% | 9.8 | 12.4 | 16.1 | 20.5 | 25.9 |
| | 35.0% | 12.0 | 15.2 | 19.8 | 25.2 | 31.9 |

Source: Edison Investment Research. Note: Figures in table are DCF valuation per share ($).

**Exhibit 6: Terminal revenue and number of tags in operation by 2025**

| | 12.3% | 15.3% | 18.7% | 21.8% | 25.0% |
|---|---|---|---|---|---|
| Terminal revenue ($'000) | 78,671 | 102,454 | 136,485 | 177,339 | 228,516 |
| Number of tags in operation in 2025 | 41,958 | 54,642 | 72,792 | 94,581 | 121,875 |

Source: Edison Investment Research

**Exhibit 7: WACC sensitivity**

| | | Revenue CAGR 2015-25 | | | | |
|---|---|---|---|---|---|---|
| | | 12.3% | 15.3% | 18.7% | 21.8% | 25.0% |
| WACC | 10.0% | 7.6 | 9.6 | 12.5 | 15.8 | 19.9 |
| | 12.5% | 5.1 | 6.5 | 8.4 | 10.5 | 13.2 |
| | 15.0% | 3.7 | 4.6 | 6.0 | 7.5 | 9.4 |
| | 17.5% | 2.7 | 3.4 | 4.4 | 5.6 | 6.9 |
| | 20.0% | 2.0 | 2.6 | 3.3 | 4.2 | 5.3 |

Source: Edison Investment Research. Note: Figures in table are DCF valuation per share ($).

## Tag numbers in context

Management reports a number of jurisdictions worldwide that are opening up a tender for EM contracts. Two are reported by management to be for c 20-25,000 tags each with a number of other smaller opportunities. Winning significant national contracts such as these could provide an immediate boost to share price. Organic growth in its current geographies is also an important route for growth. This is likely to be primarily driven by Track Group winning market share. Expanding significantly into alternative applications could also result in substantial growth.

## Premium to peers but limited insight from multiples analysis

**Exhibit 8: Peer comparison**

| Company | Market cap ($m) | FY15 EV/S | FY16 EV/S | FY15 EV/ EBITDA | FY16 EV/ EBITDA | FY15 P/E | FY16 P/E |
|---|---|---|---|---|---|---|---|
| **Track Group** | 93 | 4.6x | 3.3x | 30.7x | 8.1x | N/A | 12.4x |
| 3M Co | 100,938 | 3.4x | 3.3x | 12.4x | 11.7x | 20.6x | 18.7x |
| G4S | 6,898 | 0.9x | 0.8x | 11.4x | 10.5x | 22.3x | 19.1x |
| Trakm8 Holdings | 51 | 1.7x | 1.4x | 12.7x | 9.8x | 18.9x | 13.4x |
| **Average** | | **2.0x** | **1.9x** | **12.2x** | **10.7x** | **20.6x** | **17.1x** |

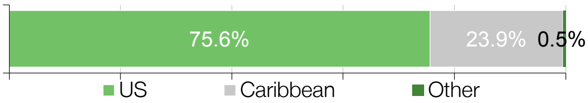
Source: Bloomberg, Edison Investment Research

We have also compared Track Group's valuation multiples against its peers in Exhibit 8. There are limitations in multiples analysis, as a result of the different sizes, target markets and stages of maturity of the businesses listed. 3M and G4S offer a wide range of products and services and therefore tracking is only a small proportion of the total. Trakm8 provides vehicle tracking and telematics, which is an area Track Group may get involved in, but is not the primary target market.

**Exhibit 9: Financial summary**

| | $'000s | 2013 | 2014 | 2015e | 2016e |
|---|---|---|---|---|---|
| 30-September | | US GAAP | US GAAP | US GAAP | US GAAP |
| **PROFIT & LOSS** | | | | | |
| Revenue | | 15,641 | 12,262 | 24,625 | 32,767 |
| Cost of Sales | | (8,030) | (5,499) | (8,405) | (11,376) |
| Gross Profit | | 7,611 | 6,763 | 16,220 | 21,390 |
| EBITDA | | 2,966 | (3,698) | 3,674 | 13,433 |
| Operating Profit (before amort. and except.) | | 552 | (6,156) | 974 | 9,133 |
| Intangible Amortisation | | (1,236) | 0 | 0 | (3,342) |
| Exceptionals | | (1,150) | (1,592) | 0 | 0 |
| Other | | 549 | (22) | 0 | 0 |
| Operating Profit | | (1,286) | (7,770) | 974 | 5,790 |
| Net Interest | | (1,094) | (922) | (1,653) | (1,653) |
| Profit Before Tax (norm) | | (543) | (7,078) | (679) | 7,479 |
| Profit Before Tax (US GAAP) | | (17,916) | (8,692) | (679) | 4,137 |
| Tax | | 0 | 0 | 0 | 0 |
| Profit After Tax (norm) | | (412) | (7,100) | (679) | 7,479 |
| Profit After Tax (US GAAP) | | (17,916) | (8,692) | (679) | 4,137 |
| Average Number of Shares Outstanding (m) | | 4.8 | 10.0 | 10.1 | 10.1 |
| EPS - normalised (c) | | (8.5) | (71.4) | (6.7) | 74.0 |
| EPS - normalised and fully diluted (c) | | (8.5) | (71.4) | (6.7) | 74.0 |
| EPS - (US GAAP) (c) | | (370.8) | (87.4) | (6.7) | 40.9 |
| Dividend per share (c) | | 0.0 | 0.0 | 0.0 | 0.0 |
| Gross Margin (%) | | 48.7 | 55.2 | 65.9 | 65.3 |
| EBITDA Margin (%) | | 19.0 | -30.2 | 14.9 | 41.0 |
| Operating Margin (before GW and except.) (%) | | 3.5 | -50.2 | 4.0 | 27.9 |
| **BALANCE SHEET** | | | | | |
| Fixed Assets | | 17,167 | 37,096 | 37,940 | 35,684 |
| Intangible Assets | | 15,414 | 33,321 | 30,955 | 27,613 |
| Tangible Assets | | 1,754 | 3,775 | 6,985 | 8,072 |
| Investments | | 0 | 0 | 0 | 0 |
| Current Assets | | 9,532 | 17,364 | 13,116 | 19,194 |
| Stocks | | 467 | 1,248 | 1,000 | 1,000 |
| Debtors | | 5,506 | 5,014 | 6,421 | 8,139 |
| Cash | | 3,382 | 11,102 | 5,696 | 10,056 |
| Other | | 176 | 0 | 0 | 0 |
| Current Liabilities | | (2,695) | (9,400) | (10,352) | (10,294) |
| Creditors | | (2,547) | (7,494) | (8,446) | (8,388) |
| Short term borrowings | | (148) | (1,906) | (1,906) | (1,906) |
| Long Term Liabilities | | (41) | (28,568) | (23,618) | (23,618) |
| Long term borrowings | | (41) | (28,568) | (23,618) | (23,618) |
| Other long term liabilities | | 0 | 0 | 0 | 0 |
| Net Assets | | 23,963 | 16,492 | 17,086 | 20,967 |
| **CASH FLOW** | | | | | |
| Operating Cash Flow | | 1,933 | (3,660) | 4,741 | 8,315 |
| Net Interest | | (1,094) | (922) | (1,653) | (1,653) |
| Tax | | 0 | 0 | 0 | (257) |
| Capex | | (560) | (544) | (3,544) | (2,044) |
| Acquisitions/disposals | | 0 | (12,293) | 0 | 0 |
| Financing | | 2,646 | (218) | (4,950) | 0 |
| Dividends | | 0 | 0 | 0 | 0 |
| Net Cash Flow | | 2,924 | (17,637) | (5,406) | 4,360 |
| Opening net debt/(cash) | | 14,716 | (3,194) | 19,373 | 19,829 |
| HP finance leases initiated | | 0 | 0 | 0 | 0 |
| Other | | 14,986 | (4,930) | 4,950 | 0 |
| Closing net debt/(cash) | | (3,194) | 19,373 | 19,829 | 15,469 |

Source: Edison Investment Research, Track Group

| Contact details | Revenue by geography |
|---|---|
| 405 S. Main Street, Suite 700<br>Salt Lake City, UT 84111<br>US<br>+1 866 451 6141<br>www.trackgrp.com |  |

| CAGR metrics | | Profitability metrics | | Balance sheet metrics | | Sensitivities evaluation | |
|---|---|---|---|---|---|---|---|
| EPS 12-16e | N/A | ROCE15e | 2.7% | Gearing 15e | 116.1% | Litigation/regulatory | ◖ |
| EPS 14-16e | N/A | Avg ROCE 12-16e | N/A | Interest cover 15e | 0.6 | Pensions | ○ |
| EBITDA 12-16e | N/A | ROE 15e | N/A | CA/CL 15e | 1.3 | Currency | ◖ |
| EBITDA 14-16e | N/A | Gross margin 15e | 65.9% | Stock days 15e | 14.8 | Stock overhang | ● |
| Sales 12-16e | 25.7% | Operating margin 15e | 4.0% | Debtor days 15e | 95.2 | Interest rates | ● |
| Sales 14-16e | 63.5% | Gr mgn / Op mgn 15e3 | 16.7 | Creditor days 15e | 79.5 | Oil/commodity prices | ○ |

**Management team**

**Chairman and Co-CEO: Guy Dubois**

Guy Dubois was appointed director of SecureAlert on 3 December 2012 to oversee a restructuring of the business and the appointment of a new CEO. Before SecureAlert, he was CEO of Gategroup AG from September 2008-11. Over his tenure he oversaw the listing of the group on the SIX Swiss Exchange and saw the share price increase at over 45% CAGR from CHF15 in May 2009 to CHF45 in April 2011.

**CFO: John Merrill**

John Merrill was appointed CFO in April 2014. He has held a number of senior positions including as CFO of Park City Group (NASDAQ: PCYG) and Prescient Applied Intelligence, a Software-as-a-service provider of supply chain solutions. Between 2010 and 2013 John also worked as an advisor in the healthcare technology industry, where he advised on due diligence and integration of certain acquired companies.

**Co-CEO: David Boone**

David Boone is the acting CEO alongside Guy Dubois. He has had a number of senior roles in organisations such as Kraft General Foods, Sears, PepsiCo, Safeway and Belo Corporation. He also served as CEO of American CareSource Holdings and CFO of Intira Corporation.

| Principal shareholders | (%) |
|---|---|
| Sapinda Asia Limited | 51% |
| Safety Invest | 19% |
| All directors and executive officers | 2% |

**Companies named in this report**

GEO Group (NYSE: GEO), 3M (NYSE: MMM), G4S (LSE:GFS)