

YPB Group

Connecting in the Americas

Company update

Industrial support services

YPB Group has secured a three-year contract to provide its invisible supply chain authentication solution to a major US casual footwear brand, with its tracer technology set to be incorporated in 70% of the brand's entire production. The contract, believed to be with Crocs, is the second major transaction secured by YPB in the Americas this quarter. It follows further support for YPB's product in China with Beijing Sandun Card Technology choosing YPB's anti-counterfeit technology for security passes for the People's Procuratorate of Beijing Municipality. Our DCF valuation is A\$0.44/share, having incorporated the recently completed A\$7.8m capital raise.

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	(5.5)	(4.5)	0.0	N/A	N/A
12/16e	8.5	(2.7)	(1.6)	0.0	N/A	N/A
12/17e	22.2	4.3	2.0	0.0	12.0	N/A

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

New directions and contracts

YPB has cemented new relationships and contracts this quarter which will take the company's anti-counterfeit technology into new regions. In addition to its contracts with Crocs and Sandun Card Technology, YPB has forged an exclusive joint venture with US-based Affyrmx Group focused on the protection of government documents in Latin America. The joint venture agreement, which has a six-year life, has already yielded two revenue producing orders, with YPB to provide high-security vital record documents to the states of Jalisco and Guanajuato, Mexico.

New leadership

YPB has promoted Jens Michel, its global chief operating officer, to chief executive officer, allowing executive chairman and founder John Houston to focus on driving the company's strategy and building investor relationships. Mr Michel joined YPB in September 2015 and has extensive experience across Asia, Australia, New Zealand and Europe including regional leadership in multi-billion dollar technology companies. YPB has also strengthened its board with the appointment of veteran capital markets executive Gerard Eakin as a non-executive director. Current director Dr Geoff Raby has announced he will not stand for re-election at the 2016 annual general meeting but will continue to support YPB as a consultant in China.

Valuation: DCF valuation revised to A\$0.44/share

We have revised our DCF valuation to A\$0.44/share from A\$0.50/share previously, after taking into account the December placement to raise c A\$7.8m at A\$0.26/share and including in-the-money options expiring in October 2017 and the cash forthcoming on these options. We have also made a number of earnings adjustments to our FY16 and FY17 forecasts following the reported FY15 results, reflecting higher than expected opex.

30 March 2016

Price **A\$0.24**

Market cap **A\$41m**

US\$0.76/A\$

Net cash (A\$m) at 31 December 2015 4.8

Shares in issue 171.4m

Free float 27%

Code YPB

Primary exchange ASX

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (14.3) (15.8) (22.6)

Rel (local) (16.5) (11.8) (10.2)

52-week high/low A\$0.40 A\$0.18

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 event

AGM May 2016

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Results summary and earnings adjustments

YPB Group reported a net loss before share-based payments of A\$5.5m for the 12 months to 31 December 2015, which was greater than our forecast for a net loss of \$4m for the period. The chief difference between the reported result and our forecast was the timing of revenue generation and higher opex. The company generated revenue of A\$1.7m for the period, versus our forecast for A\$3.3m as Exhibit 1 highlights.

Exhibit 1: FY15 reported versus Edison's FY15e forecast			
A\$m	FY15e	FY15a	% difference
Revenue	3.3	1.7	(48.6)
Gross profit	2.1	1.7	(19.6)
EBITDA	(2.7)	(4.4)	62.0
EBIT	(3.2)	(5.0)	59.7
PBT normalised	(3.3)	(5.5)	70.4
EPS normalised (c)	(3.2)	(4.5)	41.5

Source: YPB Group, Edison Investment Research

Costs were also higher than we had forecast, in large part due to higher consulting costs (A\$1.4m versus our forecast of A\$0.6m) as YPB tapped into specialists to complete its acquisitions and strategic partnerships. Employee salaries were also higher than we expected (A\$1m versus A\$0.6m) as YPB beefed up its senior management team for the year ahead. Offsetting the higher opex were foreign currency gains of A\$0.7m for the period.

We have adjusted our forecasts for FY16 and FY17, predominantly for higher operating costs and higher depreciation and intangible amortisation, generated by the company's several acquisitions. As Exhibit 2 demonstrates, the higher share count following the A\$7.78m equity raise in December has resulted in a reduced forecasted EPS loss for FY16. Our FY17 EPS forecast has been reduced by 15.1% after taking into account higher opex costs.

Exhibit 2: Earnings adjustments to FY16e and FY17e						
A\$m	FY16e new	FY16e old	% chg	FY17e new	FY17e old	% chg
Revenue	8.5	8.5	0.0	22.2	22.2	0.0
Gross profit	4.7	4.7	0.0	12.2	12.2	0.0
EBITDA	(2.5)	(1.1)	133.6	4.5	4.9	(7.7)
EBIT	(4.3)	(2.4)	81.2	2.9	3.7	(21.6)
PBT normalised	(2.7)	(1.1)	145.0	4.3	4.8	(10.6)
NPAT normalised	(2.7)	(2.4)	15.4	4.3	4.8	(10.6)
EPS normalised (c)	(1.6)	(1.7)	(7.4)	2.0	2.4	(15.1)
Average number of shares (EFPOWA)	171.4	137.6	24.6	185.0	170.4	8.6

Source: Edison Investment Research

As at 31 December, the company had cash on hand of A\$2.9m with another A\$5.0m due from Lanstead Capital over the course of 2016 and 2017 and being held as a current and non-current receivable.

Capital raising

YPB completed a A\$7.78m share placement in December 2015 to fund the A\$1.39m initial cash consideration for the acquisition of Motif Micro as well as for working capital and further investment in growth.

The placement included a A\$5m investment by Lanstead by way of a placement of 19.23m shares at A\$0.26/share, which after an initial A\$0.75m upfront payment (received on 7 January 2016) will be paid in 18 monthly cash instalments, hence the receivable on the balance sheet.

The placement took YPB's shares in issue to 170.4m. YPB also has 40.1m options with a conversion price of A\$0.20, which expire on 31 October 2017.

Valuation

Given its early stage, we use a DCF methodology to derive a valuation. Our DCF valuation, using a WACC of 12.6%, a beta of 1.5x and a terminal growth rate of 2%, is A\$0.44/share (previously A\$0.50/share). Our DCF also incorporates the A\$5m receivable from Lanstead which, together with the A\$2.9m cash on hand at 31 December 2015, offsets the A\$3m loan from executive chairman John Houston. We have also included the 40.1m in-the-money options that are exercisable at 31 October 2017 at A\$0.20/share and the cash that will be generated from these options.

Exhibit 3: DCF valuation

WACC	12.6%
Terminal growth rate	2%
Present value of cash flows, A\$m	81.7
Net cash at 31 December 2015 (includes A\$5m receivable from Lanstead Capital), A\$m	4.8
PV of cash due from 31 October 2017 in-the-money options, A\$m	7.1
Net value for shareholders, A\$m	93.6
Number of shares in issue (including in-the-money share options)	211.5
Fully diluted equity value per share, A\$	0.44

Source: Edison Investment Research

We also consider YPB's peer group, but given that it is not expected to be profitable until FY17, it is not really meaningful to apply the profit-based multiples to our forecasts.

Most of the companies that fall into the peer group are well-established multinationals. Those smaller in size, such as Applied DNA Sciences, Digimarc and Thin Film Electronics, are still not profitable and are trading on forward 12-month EV/Sales multiples of 4-8x.

Exhibit 4: Peer Comparison (using prospective 12-month forward consensus estimates)

Company	Country	Currency	Price	Market cap (local, m)	Market cap (US\$m)	Prospective 12-month forward				
						P/E (x)	EV/sales (x)	EV/EBITDA (x)	EBITDA margin	Operating margin
3M Co	US	US\$	161.81	97,901	97,901	18.5	3.5	12.0	29.5%	24.8%
Amcor Ltd	Australia	A\$	14.12	16,353	12,428	24.7	2.0	13.8	14.9%	11.2%
Applied DNA Sciences Inc	US	US\$	3.05	73	73	N/A	4.2	N/A	0.0%	N/A
Avery Dennison Corp	US	US\$	69.23	6,184	6,184	17.0	1.1	9.1	12.5%	9.5%
Catalent Inc	US	US\$	26.34	3,280	3,280	16.7	2.6	11.4	23.2%	14.5%
Digimarc Corp	US	US\$	27.64	251	251	N/A	7.9	N/A	N/A	N/A
Dupont Fabros Technology	US	US\$	37.64	2,509	2,509	24.3	8.0	13.1	61.4%	41.5%
Essentra Plc	UK	£	8.50	2,229	3,188	15.0	2.0	10.4	19.1%	14.3%
Honeywell International Inc	US	US\$	108.51	82,612	118,136	15.3	2.1	9.5	21.7%	19.1%
Intel Corp	US	US\$	31.43	148,475	212,320	12.0	2.4	6.0	39.7%	27.3%
Scansource Inc	US	US\$	38.62	1,012	1,012	12.7	0.3	7.7	3.6%	0.0%
Thermo Fisher Scientific Inc	US	US\$	139.77	55,386	55,386	16.3	3.6	13.9	25.8%	23.6%
Thin Film Electronics Asa	Norway	NOK	3.58	1,991	239	N/A	7.1	N/A	N/A	N/A
Zebra Technologies Corp	US	US\$	65.83	3,433	3,433	9.7	1.5	8.0	18.4%	16.3%
Anti-counterfeit companies		Median			516,339	15.3	2.5	10.4	18.7%	14.4%

Source: Bloomberg. Note: Prices at 15 March 2016.

If we apply the median forward 12-month EV/sales multiple to YPB's FY17 estimated sales, we arrive at an implied equity value of A\$0.32, fully diluted, as Exhibit 5 demonstrates. This is a ~35% premium to the current share price.

Exhibit 5: Implied EV/sales using peer comparison on FY17 sales (A\$m)

YPB market cap	41.1
Less net cash (includes Lanstead receivable and options due)	11.9
EV	29.2
FY17e sales	22.2
EV/sales (x)	1.3
Applied peer multiple (x)	2.5
Implied EV	55.7
Add net cash (includes Lanstead receivable and options due)	11.9
Implied equity value (A\$m)	67.6
Implied fully diluted equity value per share (A\$)	0.32

Source: Edison Investment Research

Exhibit 6: Financial summary

A\$000s	2014	2015	2016e	2017e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	85	1,714	8,464	22,207
Cost of Sales	0	0	(3,775)	(9,997)
Gross Profit	85	1,714	4,689	12,209
EBITDA	(1,889)	(4,420)	(2,548)	4,508
Operating Profit (before amort. and except.)	(2,204)	(5,322)	(2,574)	4,434
Intangible Amortisation	0	0	(1,727)	(1,526)
Exceptionals	(2,206)	282	0	0
Other	0	0	0	0
Operating Profit	(4,410)	(5,040)	(4,301)	2,908
Net Interest	(68)	(222)	(165)	(125)
Profit Before Tax (norm)	(2,272)	(5,544)	(2,739)	4,309
Profit Before Tax (FRS 3)	(4,478)	(5,826)	(4,466)	2,783
Tax	0	0	0	0
Profit After Tax (norm)	(2,272)	(5,544)	(2,739)	4,309
Profit After Tax (FRS 3)	(4,478)	(5,826)	(4,466)	2,783
Average Number of Shares Outstanding (m)	103.7	124.3	171.4	211.5
EPS - normalised (c)	(2.2)	(4.5)	(1.6)	2.0
EPS - (IFRS) (c)	(4.3)	(4.7)	(2.6)	1.3
Dividend per share (c)	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	55.4	55.0
EBITDA Margin (%)	N/A	N/A	N/A	20.3
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	20.0
BALANCE SHEET				
Fixed Assets	11,122	17,906	17,115	15,097
Intangible Assets	11,096	16,176	14,449	12,923
Tangible Assets	26	313	1,249	2,174
Non-current Debtors	0	1,417	1,417	0
Current Assets	2,715	8,178	6,373	21,960
Stocks	136	398	317	539
Debtors	174	4,905	1,422	3,732
Cash	2,405	2,875	4,634	17,689
Other	0	0	0	0
Current Liabilities	(364)	(1,531)	(1,707)	(4,478)
Creditors	(364)	(1,531)	(1,707)	(4,478)
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	21,449	18,677	29,474
CASH FLOW				
Operating Cash Flow	(2,075)	(5,976)	1,192	4,748
Net Interest	10	(144)	(165)	(125)
Tax	0	0	0	0
Capex	(17)	(329)	(962)	(999)
Acquisitions/disposals	(163)	(414)	0	0
Financing	4,506	7,145	3,583	9,431
Dividends	0	0	0	0
Net Cash Flow	2,261	282	3,648	13,055
Opening net debt/(cash)	125	343	229	(1,530)
HP finance leases initiated	0	0	0	0
Other	(2,043)	(168)	(1,889)	0
Closing net debt/(cash)	343	229	(1,530)	(14,585)

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

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