

Pointer Telocation

Q317 results

Strong foundations for future growth

Pointer Telocation (PNTR) achieved a strong performance in both product and services revenues in the third quarter supported by 16% y-o-y organic subscriber growth and a boost to product margins from increased sales of higher-quality telematics units. PNTR looks set to derive substantial cost synergies in 2018 from the integration of Cielo Telecom's operations in Brazil and we foresee the potential for the new CelloTrack Nano IoT tracker product to emerge as a major profit driver following strong recent interest in the market. We have increased our 2017 and 2018 EBITDA forecasts and reduced our fair discount to peer multiples, resulting in an increase in our peer multiple valuation from \$15.4 to \$19.3 (NIS 67.8) per share, and an 11% increase in our DCF valuation to \$18.1 (NIS 63.6) per share.

| Year end | Revenue (\$m) | PBT* (\$m) | EPS* (c) | DPS (c) | EV/EBITDA (x) | P/E (x) |
|----------|---------------|------------|----------|---------|---------------|---------|
| 12/15 | 60.6 | 6.4 | 67 | 0.0 | 16.8 | 26.7 |
| 12/16 | 64.4 | 6.6 | 62 | 0.0 | 15.2 | 28.8 |
| 12/17e | 79.3 | 10.3 | 96 | 0.0 | 10.7 | 18.6 |
| 12/18e | 88.9 | 12.7 | 116 | 0.0 | 9.0 | 15.4 |
| 12/19e | 96.7 | 13.9 | 125 | 0.0 | 8.3 | 14.2 |

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

Third quarter brings good organic growth & margins

Third quarter results were boosted by faster growth in organic subscriber additions than in previous quarters, which resulted in 16% y-o-y organic subscriber growth and a 26% increase in headline subscribers after acquisitions. Revenues per user remained stable in spite of the addition of lower ARPU ride share customers in the US, while operating leverage and high product margins led to a 65% y-o-y increase in EBITDA.

More benefit from SA acquisition and cost savings

We have increased our full year 2017 and 2018 EBITDA by 4.2% and 9.3%, respectively, for the recent acquisition of 2,400 subscribers in South Africa as well as to reflect the strong trend in organic additions and expected further cost savings in 2018 from the full integration of Cielo Telecom.

Valuation: Increase in peer valuation of share to \$19.3

PNTR's share price has more than doubled this year as the group has gained exposure to the fast-growing driver monitoring market in the US, has seen earnings surge from the Cielo Telecom acquisition in Q416 and has gained a major \$2-3m pa order for its new CelloTrack Nano IoT product. The recent launch of a connected car product is also attracting interest from OEMs and brings exposure to the ADAS revolution. We believe that these strong foundations and the multiple product streams will underpin future top-line growth, while high operational gearing from the SaaS model and synergies from acquisitions should enable further margin gains. In view of this, we have reduced the "fair" peer EV/EBITDA discount assumed in our valuation from 10% to 7%. This together with higher earnings expectations has led to an increase in this valuation from \$15.4 to \$19.3 (NIS 67.8) per share. Helped by increased earnings forecasts, our DCF value has risen 11% to \$18.1 (NIS 63.6) ps.

Tech hardware & equipment

27 November 2017

Price* **\$17.80/NIS 62.45**

Market cap **\$143m/NIS504m**

*Priced as of 23 November 2017

NIS3.5108/US\$

Net debt (\$m) at 30 September 2017 4.6

Shares in issue 8.1m

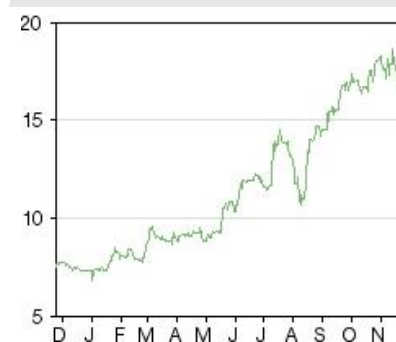
Free float 71.3%

Code PNTR

Primary exchange Nasdaq

Secondary exchange TASE

Share price performance



% 1m 3m 12m

Abs 1.4 28.1 129.7

Rel (local) 0.6 20.9 94.8

52-week high/low US\$18.9 US\$6.8

Business description

Pointer Telocation (PNTR) is a leading provider of MRM services and products to the automotive and insurance industries. Key services are asset tracking, fleet management and monitoring goods in transit/IoT. Its main markets are Israel, Brazil, Argentina, Mexico and Europe.

Next events

FY17 results February 2018

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Quarterly results review

Exhibit 1: Quarterly key data/ratios

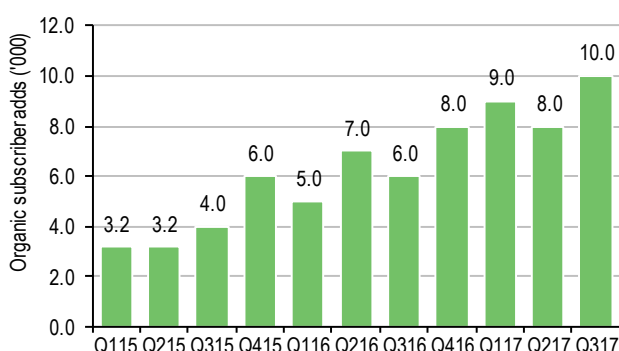
| \$m | Q317 | Q316 | Change y-o-y (%) | 9M17 | 9M16 | Change y-o-y (%) | Q117 | Q217 |
|--|--------------|--------------|---------------------|-------------|--------------|---------------------|--------------|--------------|
| MRM subscribers | 249,000 | 198,000 | 25.8 | 249,000 | 198,000 | 25.8 | 231,000 | 239,000 |
| Net additions | 10,000 | 6,000 | 66.7 | 27,000 | 18,000 | 50.0 | 9,000 | 8,000 |
| of which Subscriber acquisitions | 0 | 0 | N/A | 0 | 0 | N/A | 0 | 0 |
| Avg. service rev. per MRM subscriber (\$/month) | 18.2 | 18.0 | 1.3 | 18.2 | 17.7 | 3.1 | 18.2 | 18.3 |
| Cash flow/balance sheet data | | | | | | | | |
| Operating cash flows | 3.27 | 1.43 | 129.0 | 6.00 | 6.39 | (6.0) | 1.51 | 1.22 |
| Cash conversion (operating CF to EBIT, %) | 112.6 | 102.1 | N/A | 75.1 | 138.0 | N/A | 66.7 | 43.2 |
| Cash flows from investment | (0.85) | (0.69) | 23.2 | (1.90) | (3.07) | (38.0) | (0.75) | (0.31) |
| Purchases of property, plant and equipment | (0.88) | (0.72) | 22.2 | (1.99) | (3.58) | (44.5) | (0.77) | (0.34) |
| Cash & cash equivalents | 7.00 | 14.07 | (50.2) | 7.00 | 14.07 | (50.2) | 5.75 | 5.70 |
| Net debt (\$m) | 4.57 | 2.23 | 105.1 | 4.57 | 2.23 | 105.1 | 8.06 | 7.04 |
| Net debt (cash)/equity (%) | 8.76 | 5.17 | N/A | 8.76 | 5.17 | N/A | 17.20 | 14.11 |
| Current ratio | 1.42 | 1.90 | N/A | 1.42 | 1.90 | N/A | 1.32 | 1.41 |
| Quick ratio | 1.13 | 1.62 | N/A | 1.13 | 1.62 | N/A | 1.05 | 1.12 |

Source: Pointer Telocation, Edison Investment Research

Third quarter results were boosted by an increase in organic mobile resource management (MRM) subscriber additions during the quarter from a quarterly average of 8,500 in H117 to 10,000 in Q3. Stripping out the effect of the 16,000 additions from the Cielo Telecom acquisition in Brazil in Q416 (adding them to the historical base of 198k) gives rise to 16% organic growth in subscriber numbers to 249k. Including these subscribers, customer growth reached 26% y-o-y.

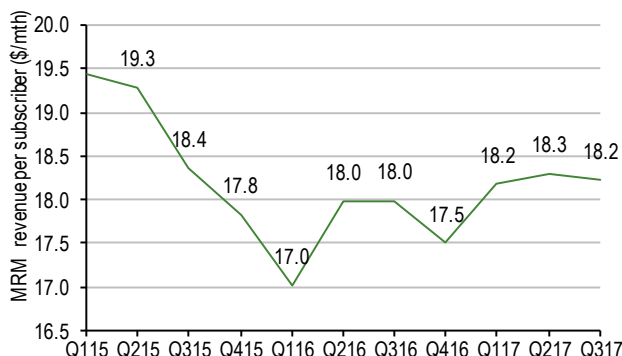
Despite the addition of new lower ARPU (average service revenue per MRM subscriber) ride hail driver monitoring customers in the US, the average service revenue per user (ARPU) of \$18.2 was in line with the previous two quarters (see Exhibit 3), indicating a positive underlying trend in revenues from the core base. This fed through to a 27% y-o-y increase in service revenues to \$13.3m and a 34% increase in gross profit from the services business to \$7.7m. This was on the back of a 3.0 basis point increase in gross margin on service revenues to 57.5%, reflecting the benefit of high operating gearing arising from the group's cloud-based SaaS model.

Exhibit 2: Organic MRM subscriber additions



Source: Pointer Telocation

Exhibit 3: Service revenue per MRM subscriber



Source: Pointer Telocation, Edison Investment Research

Product revenues dipped on seasonal factors versus Q2 but gained 28% y-o-y to \$6.9m with the benefit of increased sales of the higher-quality telematics unit. This also had a positive impact on the gross margin from product sales, rising 3.5 basis points during the quarter to 40.9%, as it enabled the group to avoid the worst effects of severe price competition at the low-quality end of the market.

The group reported strong interest in the CelloTrack Nano and connected car products during the quarter, indicating a likely boost to revenues in 2018. We nevertheless understand that the impact on total product revenues during the quarter was not significant.

Continued focus on cost control led to a 71% increase in normalised operating profit to \$3.1m. This fed through a 97% yoy increase in normalised PBT to \$2.8m, and a 90% y-o-y increase in basic, normalised EPS to \$0.26.

Cash conversion rates also increased sharply during the quarter, helped by lower working capital requirements, reaching 113% in the third quarter after 43% in Q2. Helped by the strong cash generation, net debt levels fell from \$7.0m to \$4.6m over the quarter (see Exhibit 1).

| Exhibit 4: Quarterly earnings summary | | | | | | | | |
|--|---------------|---------------|-----------------------------|----------------|---------------|-----------------------------|---------------|---------------|
| \$m | Q317 | Q316 | Change y-o-y (%) | 9M17 | 9M16 | Change y-o-y (%) | Q117 | Q217 |
| Product revenues | 6.90 | 5.39 | 27.8 | 20.73 | 16.95 | 22.3 | 6.68 | 7.15 |
| Change (%) | 27.8 | 6.0 | N/A | 22.3 | 1.9 | N/A | 21.3 | 18.2 |
| Services revenues | 13.34 | 10.52 | 26.7 | 38.58 | 30.01 | 28.6 | 12.35 | 12.89 |
| Change (%) | 26.7 | 11.1 | N/A | 28.6 | 4.1 | N/A | 32.5 | 26.8 |
| Revenue | 20.23 | 15.92 | 27.1 | 59.30 | 46.96 | 26.3 | 19.03 | 20.04 |
| Change (%) | 27.1 | 9.3 | N/A | 26.3 | 3.3 | N/A | 28.4 | 23.6 |
| Cost of products | (4.08) | (3.30) | 23.5 | (12.83) | (10.48) | 22.4 | (4.28) | (4.48) |
| Gross profit products | 2.82 | 2.09 | 34.6 | 7.9 | 6.5 | 22.0 | 2.41 | 2.67 |
| Gross margin products (%) | 40.9 | 38.8 | N/A | 38.1 | 38.2 | N/A | 36.0 | 37.4 |
| Cost of Services | (5.67) | (4.79) | 18.5 | (16.29) | (13.56) | 20.1 | (5.36) | (5.26) |
| Gross profit Services | 7.66 | 5.73 | 33.7 | 22.3 | 16.4 | 35.5 | 6.99 | 7.64 |
| Gross margin services (%) | 57.5 | 54.5 | N/A | 57.8 | 54.8 | N/A | 56.6 | 59.2 |
| Cost of Sales | (9.75) | (8.09) | 20.5 | (29.13) | (24.04) | 21.1 | (9.64) | (9.74) |
| Gross profit | 10.48 | 7.83 | 33.9 | 30.18 | 22.91 | 31.7 | 9.39 | 10.31 |
| Gross margin (%) | 51.8 | 49.2 | N/A | 50.9 | 48.8 | N/A | 49.4 | 51.4 |
| Research and development | (1.04) | (0.87) | 19.2 | (3.02) | (2.69) | 12.2 | (0.97) | (1.02) |
| % of sales | 5.1 | 5.5 | N/A | 5.1 | 5.7 | N/A | 5.1 | 5.1 |
| Selling and marketing | (3.60) | (3.10) | 16.1 | (10.36) | (8.71) | 18.9 | (3.31) | (3.46) |
| % of sales | 17.8 | 19.5 | N/A | 17.5 | 18.6 | N/A | 17.4 | 17.2 |
| General and administrative | (2.83) | (2.15) | 31.4 | (8.46) | (6.38) | 32.6 | (2.75) | (2.89) |
| % of sales | 14.0 | 13.5 | N/A | 14.3 | 13.6 | N/A | 14.4 | 14.4 |
| EBITDA (norm. /continuing operations) | 3.68 | 2.23 | 65.0 | 10.44 | 6.66 | 56.7 | 3.22 | 3.54 |
| EBITDA margin | 18.2% | 14.0% | N/A | 17.6% | 14.2% | N/A | 16.9% | 17.7% |
| Operating profit normalised | 3.10 | 1.82 | 70.7 | 8.63 | 5.33 | 61.9 | 2.48 | 3.05 |
| Operating margin normalised | 15.3% | 11.4% | N/A | 14.6% | 11.4% | N/A | 13.0% | 15.2% |
| One-off items | 0.00 | (0.20) | (100.0) | 0.00 | (0.20) | (100.0) | 0.00 | 0.00 |
| Operating profit | 2.91 | 1.40 | 107.6 | 8.00 | 4.63 | 72.8 | 2.26 | 2.83 |
| Operating margin (%) | 14.36 | 8.80 | N/A | 13.48 | 9.85 | N/A | 11.85 | 14.14 |
| Net finance costs | (0.29) | (0.38) | (23.9) | (0.71) | (0.62) | 13.8 | (0.16) | (0.26) |
| Other expenses | 0.00 | (0.01) | (150.0) | 0.00 | (0.00) | (200.0) | 0.00 | 0.00 |
| PBT normalised | 2.82 | 1.43 | 97.1 | 7.93 | 4.71 | 68.5 | 2.32 | 2.79 |
| PBT | 2.62 | 1.01 | 158.8 | 7.29 | 4.00 | 82.3 | 2.10 | 2.57 |
| Reported tax | (0.74) | (0.30) | 148.0 | (1.88) | (1.15) | 62.9 | (0.53) | (0.61) |
| Profit after tax reported | 1.88 | 0.71 | 163.3 | 5.42 | 3.00 | 80.3 | 1.57 | 1.97 |
| Profit after tax normalised | 2.08 | 1.07 | 94.3 | 6.05 | 3.52 | 72.2 | 1.79 | 2.18 |
| EPS - basic (\$) | 0.24 | 0.09 | 159.0 | 0.68 | 0.38 | 77.1 | 0.20 | 0.24 |
| EPS - diluted (\$) | 0.23 | 0.09 | 157.8 | 0.67 | 0.38 | 77.5 | 0.20 | 0.24 |
| EPS - basic normalised (\$) | 0.26 | 0.14 | 90.4 | 0.76 | 0.46 | 66.7 | 0.23 | 0.27 |
| EPS - diluted normalised (\$) | 0.25 | 0.13 | 89.5 | 0.75 | 0.45 | 67.0 | 0.22 | 0.27 |
| Source: Pointer Telocation | | | | | | | | |

Changes in forecasts

We have increased our earnings forecasts for the group, as shown in Exhibit 5. The key drivers of the changes are:

- The addition of 2,400 MRM subscribers in early Q417 from an acquisition in South Africa announced on 2 October.
- Positive subscriber and margin growth developments in the third quarter, leading us to increase year end MRM organic subscriber additions by a further 3,600 and to increase total MRM subscriptions in 2018 by 9,000, or 3.1%.
- The impact of ongoing operational gearing on the increase in the subscriber base has led us to increase our gross margin forecast by 0.6% points over the forecast period.
- Management has announced expectations of significant additional costs savings to be derived in 2018 from the full integration of the operations of Cielo Telecom in Brazil, which was acquired in Q416. No more detailed guidance was offered on this topic, but we have assumed savings of \$0.3m from G&A costs 2018 to reflect the scale of the Brazilian operation.

Exhibit 5: Pointer Telocation – change in earnings forecast summary

| \$m | 2016 | 9M17 | 2017 | 2017 | | 2018 | 2018 | | 2019 | 2019 | |
|--------------------------------------|-------------|-------------|-------------|--------|--------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | Old | New | % chg. | Old | New | % chg. | Old | New | % chg. |
| MRM subscribers ('000) | 222 | 249 | 254 | 260 | 2.4 | 287 | 296 | 3.1 | 316 | 326 | 3.1 |
| MRM ARPU (\$/month) | 17.6 | 18.2 | 18.2 | 18.1 | (0.4) | 17.7 | 17.7 | (0.0) | 17.3 | 17.3 | (0.1) |
| Service revenues | 41.6 | 38.6 | 51.9 | 52.4 | 0.9 | 57.6 | 59.2 | 2.7 | 62.6 | 64.5 | 3.0 |
| Product revenues | 22.8 | 20.7 | 26.9 | 26.9 | 0.0 | 28.9 | 29.7 | 2.8 | 31.2 | 32.1 | 2.8 |
| Revenue | 64.4 | 59.3 | 78.8 | 79.3 | 0.6 | 86.5 | 88.9 | 2.7 | 93.9 | 96.7 | 3.0 |
| Revenue growth (%) | 6.3 | 26.3 | 22.5 | 23.2 | N/A | 9.8 | 11.9 | N/A | 8.5 | 8.7 | N/A |
| Gross profit | 31.8 | 30.2 | 39.9 | 40.6 | 1.7 | 44.4 | 46.1 | 3.9 | 48.4 | 50.4 | 4.1 |
| Gross margin (%) | 49.4 | 50.9 | 50.6 | 51.2 | N/A | 51.3 | 51.9 | N/A | 51.5 | 52.1 | N/A |
| Research and development | (3.7) | (3.0) | (4.1) | (4.1) | 0.0 | (4.5) | (4.5) | 0.0 | (4.9) | (4.9) | 0.2 |
| Selling and marketing | (11.8) | (10.4) | (14.0) | (14.0) | 0.6 | (15.3) | (15.7) | 2.7 | (16.6) | (17.1) | 3.0 |
| General and administrative | (9.0) | (8.5) | (11.8) | (11.6) | (1.7) | (13.4) | (13.1) | (2.8) | (15.0) | (14.6) | (2.8) |
| Non-cash adjustments/other | 2.4 | 2.1 | 3.3 | 2.9 | (10.2) | 3.8 | 3.5 | (7.5) | 4.3 | 4.1 | (5.6) |
| EBITDA* | 9.8 | 10.4 | 13.3 | 13.8 | 3.6 | 15.0 | 16.4 | 9.3 | 16.2 | 17.9 | 10.3 |
| EBITDA growth (%) | N/A | N/A | 36.8 | 41.8 | N/A | 12.2 | 18.4 | N/A | 8.5 | 9.4 | N/A |
| EBITDA margin (%) | 15.2 | 17.6 | 16.9 | 17.4 | N/A | 17.3 | 18.4 | N/A | 17.3 | 18.5 | N/A |
| Operating profit normalised | 7.6 | 8.6 | 10.5 | 11.3 | 7.7 | 11.6 | 13.3 | 14.5 | 12.4 | 14.3 | 15.4 |
| Operating profit reported | 6.2 | 8.0 | 9.6 | 10.4 | 8.4 | 10.8 | 12.5 | 15.6 | 11.6 | 13.5 | 16.4 |
| Operating margin norm. (%) | 11.9 | 14.6 | 13.3 | 14.3 | N/A | 13.4 | 14.9 | N/A | 13.2 | 14.8 | N/A |
| Finance costs | (1.0) | (0.7) | (0.9) | (1.0) | 11.1 | (0.5) | (0.6) | 20.1 | (0.2) | (0.3) | 31.2 |
| Profit before tax normalised | 6.6 | 7.9 | 9.6 | 10.3 | 7.4 | 11.1 | 12.7 | 14.2 | 12.1 | 13.9 | 15.1 |
| Profit before tax reported | 5.2 | 7.3 | 8.7 | 9.4 | 8.2 | 10.3 | 11.9 | 15.3 | 11.4 | 13.2 | 16.1 |
| PBT growth (%) | N/A | N/A | 68.1 | 81.8 | N/A | 17.9 | 25.7 | N/A | 10.6 | 11.3 | N/A |
| EPS - diluted normalised (\$) | 0.62 | 0.75 | 0.91 | 0.96 | 5.5 | 1.03 | 1.16 | 12.5 | 1.11 | 1.25 | 13.4 |
| EPS - basic reported (\$) | 0.44 | 0.68 | 0.82 | 0.88 | 6.3 | 0.96 | 1.09 | 13.8 | 1.05 | 1.20 | 14.5 |

Source: Pointer Telocation, Edison Investment Research. Note: *Normalised and before share-based payments.

Valuation review

Exhibit 6: Peer valuation comparison

| \$m | Main focus | Share price (lc) | Market cap (\$m) | Sales FY1 (m) | EBITDA margin 1FY (%) | EV/ sales 1FY (x) | EV/ sales 2FY (x) | EV/ EBITDA 1FY (x) | EV/ EBITDA 2FY (x) | P/E 1FY (x) | P/E 2FY (x) | Last div yield | Net debt (cash)/ equity |
|--|--------------------|------------------|------------------|---------------|-----------------------|-------------------|-------------------|--------------------|--------------------|-------------|-------------|----------------|-------------------------|
| Pointer Telocation | Isr, LA, SA | 17.8 | 143 | 79 | 17.4 | 1.9 | 1.7 | 10.7 | 9.0 | 18.6 | 15.4 | 0.0 | 21.0 |
| CalAmp Corp | NAM | 22.1 | 787 | 362 | 14.7 | 2.2 | 2.1 | 15.1 | 13.2 | 18.9 | 16.5 | 0.0 | 12.2 |
| ID Systems Inc | NAM | 6.8 | 118 | 41 | (0.1) | 2.7 | 1.9 | (2,270) | 15.5 | (250.7) | 18.3 | 0.0 | (42.7) |
| Ituran | Isr, Brzl, Arg | 35.3 | 739 | 237 | 28.8 | 3.0 | 2.8 | 10.4 | 9.2 | 17.2 | 16.4 | 2.4 | (32.6) |
| MiX Telematics Ltd | SA | 160.6 | 277 | 1,676 | 24.7 | 2.1 | 2.0 | 8.7 | 7.5 | 111.4 | 95.0 | N/A | (17.8) |
| Numerex Corp | NAM | 3.7 | 73 | 66 | 9.1 | 1.3 | 1.2 | 13.8 | 7.7 | (9.3) | (185.0) | 0.0 | 19.7 |
| ORBCOMM Inc | US/Europe | 10.3 | 762 | 249 | 19.2 | 3.9 | 3.5 | 20.4 | 15.0 | (12.5) | (80.1) | 0.0 | 74.1 |
| Sierra Wireless Inc | NAM | 20.7 | 667 | 685 | 7.8 | 0.9 | 0.8 | 11.7 | 10.3 | 20.1 | 18.4 | 0.0 | (11.1) |
| Trakm8 Holdings | UK | 1.4 | 65 | 32 | 14.7 | 1.7 | 1.5 | 11.2 | 8.7 | 19.1 | 13.8 | 0.0 | 19.1 |
| QUALCOMM Inc | NAM | 68.1 | 100,435 | 22,920 | 30.0 | 3.7 | 3.5 | 12.2 | 13.3 | 19.0 | 17.8 | 3.2 | (54.3) |
| Quartix Holdings PLC | UK | 3.6 | 228 | 23 | 29.6 | 7.2 | 6.8 | 24.4 | 21.2 | 30.8 | 27.1 | 1.8 | (26.1) |
| Median | | | 277 | 237 | 17.4 | 2.2 | 2.0 | 11.7 | 10.3 | 18.9 | 16.5 | 0.0% | (11.1) |
| Average/Median* - MCAP<\$300m | | | 151 | 310 | 16.1 | 2.0 | 1.8 | 11.0 | 8.9 | 18.8 | 16.8 | 0.0% | 0.7 |
| Average/Median* Ituran/MiX Telematics | | | 508 | 956 | 26.8 | 2.6 | 2.4 | 9.5 | 8.4 | 64.3 | 55.7 | N/A | (25.2) |
| PTNR premium/(discount) to peers | | | | | | (16.2) | (16.5) | (8.4) | (12.1) | (1.7) | (7.1) | N/A | N/A |
| PTNR premium/(discount) to peers MCAP<\$300m | | | | | | (6.9) | (6.3) | (2.5) | 1.8 | (1.4) | (8.7) | N/A | N/A |
| PTNR premium/(discount) to Ituran/MiX Telematics average | | | | | | (27.4) | (30.6) | 12.1 | 8.0 | (71.1) | (72.4) | N/A | N/A |
| PTNR premium/(discount) to Ituran | | | | | | (37.8) | (40.6) | 2.6 | (1.6) | 8.1 | (6.2) | N/A | N/A |

Source: Edison Investment Research, Bloomberg. Note: *Applying median to valuation ratios to eliminate outliers, averages to all else. Priced as at 23 November 2017.

We have updated our peer group valuation for the increases to our earnings forecasts and changes in pricing in the sector as well as our perception of the improvement in earnings quality at the company. The result is an increase our multiple-based valuation from \$15.4 (NIS55.1) to \$19.3 (NIS67.8) per share since our last update ([Right time, right places](#), 11 September 2017).

As mentioned above, we believe that the strong interest being generated by the group's CelloTrack Nano IoT device as well as the Connected Car offering and US Ride Hail driver monitoring devices substantially increase the likelihood of the group benefiting strongly from fast-moving market segments, particularly the current advanced driver-assistance systems (ADAS) and IoT revolution. We also expect the creation of multiple product streams to underpin future top-line growth, while high operational gearing from the SaaS model and synergies from acquisitions should enable further margin gains. We also note that the group is generating strong cash flows, which should either steadily reduce gearing levels to make it more comparable with the sector, where net cash positions are common, or enable more value-accretive acquisitions.

In view of this, we have reduced the discount to peers used in our peer valuation from 10% to 7%. Applying this discount to the EV/EBITDA average sector multiples for FY1 and FY2, together with higher earnings expectations, has led to an increase in our peer based valuation from \$15.4 (NIS55.1) to \$19.3 (NIS67.8) per share.

Exhibit 7: Pointer Telocation DCF model

| \$m | 2016 | 2017e | 2018e | 2019e | 2020e | 2021e | 2022e | 2023e | 2024e | 2025e | 2026e norm. |
|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------------|
| Revenue | 64.4 | 79.3 | 88.9 | 96.7 | 102.0 | 107.5 | 112.6 | 117.6 | 122.9 | 128.5 | 131.7 |
| change y-o-y (%) | 6.3 | 23.2 | 11.9 | 8.7 | 5.6 | 5.3 | 4.7 | 4.5 | 4.5 | 4.6 | 2.5 |
| EBITDA | 9.8 | 13.8 | 16.4 | 17.9 | 19.6 | 21.5 | 23.2 | 24.5 | 25.8 | 27.2 | 27.9 |
| EBITDA margin (%) | 15.2 | 17.4 | 18.4 | 18.5 | 19.2 | 20.0 | 20.6 | 20.8 | 21.0 | 21.2 | 21.2 |
| change y-o-y (%) | 10.9 | 41.8 | 17.7 | 9.4 | 9.4 | 9.8 | 7.8 | 5.7 | 5.5 | 5.2 | 2.5 |
| Change in working capital | 1.1 | (0.5) | (0.3) | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) |
| Working capital/sales (%) | 1.7 | (0.6) | (0.3) | (0.2) | (0.2) | (0.2) | (0.2) | (0.1) | (0.1) | (0.1) | (0.1) |
| Capex, net of PPE sales | (3.5) | (4.4) | (4.9) | (5.3) | (5.7) | (6.1) | (6.5) | (6.8) | (7.2) | (7.6) | (8.0) |
| Capex/sales (%) | (5.4) | (5.5) | (5.5) | (5.5) | (5.6) | (5.7) | (5.8) | (5.8) | (5.9) | (5.9) | (5.9) |
| Tax | (0.1) | (1.4) | (1.5) | (3.4) | (3.8) | (4.2) | (4.5) | (4.7) | (5.0) | (5.2) | (5.0) |
| Acquisitions | (8.6) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Free cash flow | (1.4) | 7.6 | 9.6 | 8.9 | 9.9 | 11.0 | 12.0 | 12.8 | 13.5 | 14.2 | 14.7 |
| Terminal value | | | | | | | | | | | 196.6 |
| Total cash flow | (1.4) | 7.6 | 9.6 | 8.9 | 9.9 | 11.0 | 12.0 | 12.8 | 13.5 | 14.2 | 211.3 |
| Discounted cash flows | 0.0 | 7.6 | 8.7 | 7.3 | 7.4 | 7.5 | 7.4 | 7.1 | 6.9 | 6.5 | 88.4 |
| Sum of discounted CFs | 154.8 | | | | | | | | | | |
| Net debt (cash) | 9.0 | | | | | | | | | | |
| Equity valuation | 145.9 | | | | | | | | | | |
| Number of shares, diluted | 8.1 | | | | | | | | | | |
| Value per share (NIS) | 63.6 | | | | | | | | | | |

Source: Edison Investment Research

As a result of the increase in our earnings expectations, our DCF share value for Pointer Telocation has increased from \$16.3 (NIS58.2) to \$18.1 (NIS63.6) per share. We have left our WACC and terminal value assumptions unchanged.

Exhibit 8: Financial summary

| | \$'m | 2015 | 2016 | 2017e | 2018e | 2019e |
|--|------|---------|---------|---------|---------|---------|
| 31 December | | US GAAP | US GAAP | US GAAP | US GAAP | US GAAP |
| INCOME STATEMENT | | | | | | |
| Revenue | | 60.57 | 64.35 | 79.28 | 88.91 | 96.65 |
| Cost of Sales | | (31.31) | (32.58) | (38.68) | (42.79) | (46.29) |
| Gross Profit | | 29.25 | 31.78 | 40.61 | 46.13 | 50.36 |
| EBITDA | | 8.80 | 9.75 | 13.83 | 16.37 | 17.91 |
| Normalised operating profit | | 7.10 | 7.64 | 11.33 | 13.28 | 14.27 |
| Amortisation of acquired intangibles | | (0.54) | (0.47) | (0.46) | (0.36) | (0.29) |
| Exceptionals | | (0.91) | (0.60) | 0.00 | 0.00 | 0.00 |
| Share-based payments (incl. in COGS) | | (0.31) | (0.32) | (0.43) | (0.43) | (0.44) |
| Reported operating profit | | 5.34 | 6.25 | 10.44 | 12.48 | 13.54 |
| Net Interest | | (0.73) | (1.05) | (1.00) | (0.61) | (0.33) |
| Joint ventures & associates (post tax)/other | | (0.01) | (0.01) | 0.00 | 0.00 | 0.00 |
| Exceptionals | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Profit before tax (norm) | | 6.36 | 6.58 | 10.33 | 12.67 | 13.94 |
| Profit before tax (reported) | | 4.60 | 5.19 | 9.44 | 11.87 | 13.21 |
| Reported tax | | (1.13) | (1.85) | (2.48) | (3.09) | (3.43) |
| Profit after tax (norm) | | 5.23 | 4.93 | 7.84 | 9.58 | 10.50 |
| Profit after tax (reported) | | 3.47 | 3.35 | 6.96 | 8.79 | 9.78 |
| Minority interests | | 0.08 | (0.02) | (0.04) | (0.05) | (0.05) |
| Discontinued operations | | 0.33 | 0.15 | 0.00 | 0.00 | 0.00 |
| Net income (normalised) | | 5.30 | 4.91 | 7.80 | 9.53 | 10.45 |
| Net income (reported) | | 3.87 | 3.48 | 6.92 | 8.74 | 9.72 |
| Basic average number of shares outstanding (m) | | 7.73 | 7.82 | 7.91 | 7.99 | 8.09 |
| EPS – basic normalised (\$) | | 0.69 | 0.63 | 0.99 | 1.19 | 1.29 |
| EPS – diluted normalised (\$) | | 0.67 | 0.62 | 0.96 | 1.16 | 1.25 |
| EPS – basic reported (\$) | | 0.50 | 0.44 | 0.88 | 1.09 | 1.20 |
| Dividend (\$) | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Revenue growth (%) | | N/A | 6.25 | 23.20 | 12.15 | 8.70 |
| Gross margin (%) | | 48.30 | 49.38 | 51.22 | 51.88 | 52.11 |
| EBITDA margin (%) | | 14.52 | 15.16 | 17.44 | 18.41 | 18.53 |
| Normalised operating margin (%) | | 11.71 | 11.87 | 14.29 | 14.93 | 14.76 |
| BALANCE SHEET | | | | | | |
| Fixed assets | | 68.78 | 51.61 | 53.00 | 54.46 | 55.87 |
| Intangible assets | | 31.83 | 40.29 | 39.83 | 39.47 | 39.18 |
| Tangible assets | | 3.28 | 5.61 | 7.47 | 9.28 | 10.98 |
| Investments & other | | 33.67 | 5.71 | 5.71 | 5.71 | 5.71 |
| Current assets | | 34.66 | 25.28 | 28.70 | 36.42 | 47.07 |
| Stocks | | 4.70 | 5.24 | 6.22 | 6.89 | 7.45 |
| Debtors | | 9.49 | 11.46 | 14.12 | 15.84 | 17.22 |
| Cash & cash equivalents | | 7.25 | 6.07 | 5.77 | 11.04 | 19.66 |
| Other | | 13.21 | 2.50 | 2.58 | 2.66 | 2.74 |
| Current liabilities | | (30.45) | (19.83) | (22.11) | (23.47) | (25.26) |
| Creditors | | (9.82) | (13.96) | (16.96) | (18.94) | (20.61) |
| Short-term borrowings | | (4.82) | (4.84) | (3.87) | (3.10) | (3.10) |
| Other | | (15.81) | (1.04) | (1.28) | (1.43) | (1.56) |
| Long-term liabilities | | (17.95) | (14.36) | (8.09) | (4.80) | (4.55) |
| Long-term borrowings | | (8.39) | (10.18) | (4.23) | (1.23) | (1.23) |
| Other long-term liabilities | | (9.57) | (4.18) | (3.86) | (3.57) | (3.31) |
| Net assets | | 55.04 | 42.69 | 51.50 | 62.60 | 73.13 |
| Minority interests | | 1.07 | (0.16) | (0.20) | (0.25) | (0.30) |
| Shareholders' equity | | 56.10 | 42.53 | 51.30 | 62.35 | 72.83 |
| CASH FLOW | | | | | | |
| Operating cash flow before WC and tax | | 8.80 | 9.75 | 13.83 | 16.37 | 17.91 |
| Working capital | | 0.77 | 1.08 | (0.47) | (0.32) | (0.23) |
| Exceptional & other | | 1.99 | (1.62) | 0.00 | 0.00 | 0.00 |
| Tax | | (0.05) | (0.12) | (1.42) | (1.54) | (3.43) |
| Net operating cash flow | | 11.51 | 9.09 | 11.94 | 14.51 | 14.25 |
| Capex | | (3.62) | (4.13) | (4.73) | (5.34) | (5.81) |
| Acquisitions/disposals | | 0.00 | (8.65) | 0.00 | 0.00 | 0.00 |
| Net interest | | (0.89) | 0.00 | (1.00) | (0.61) | (0.33) |
| Equity financing | | 0.02 | 0.10 | 0.00 | 0.00 | 0.00 |
| Dividends | | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other, incl. PPE sales | | 1.26 | 1.05 | 0.42 | 0.47 | 0.52 |
| Net cash flow | | 8.28 | (2.54) | 6.62 | 9.04 | 8.63 |
| Opening net debt/(cash) | | 11.90 | 5.95 | 8.95 | 2.33 | (6.71) |
| FX | | (0.71) | (0.46) | 0.00 | 0.00 | 0.00 |
| Other non-cash movements | | (1.61) | 0.00 | 0.00 | 0.00 | 0.00 |
| Closing net debt/(cash) | | 5.95 | 8.95 | 2.33 | (6.71) | (15.34) |

Source: Pointer Telocation accounts, Edison Investment Research

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