Ad Hoc Note
2 November 2021

Metrofile Holdings Ltd

Good Start on Digital Strategy

Share Code: MFL – Market Cap: R1.3bn – PE: 10.0x – DY: 3.8%

12m Target Price	**497cps**
Share Price	**317cps**
Implied Return	**57%**

Business Support | South Africa

News: Acquisition of Irontree Internet Services CC

- Metrofile has conditionally acquired Irontree Internet Services for a minimum of R80m & a maximum of R140m in cash:
  - 70%-stake for an upfront cash payment of c.R49m & a top-up payment of up to R12.3m if Irontree hits EBITDA of R18.7m for its FY 22E (February) financial year (likely), &
  - 30% to be acquired at a price based on a FY 24E *revenue* target of R100m (i.e. allowing integration of the business in the Group) but limited to the maximum (total) acquisition price of R140m.
- Depending on how you view Irontree's min/max purchase price:
  - It is on an FY 22E EV/EBITDA of c.4.3x ~ 7.5x,
  - An FY 22E Price Earnings of c.6.7x ~ 11.7x, &
  - Appears attractive against our implied DCF of the business.

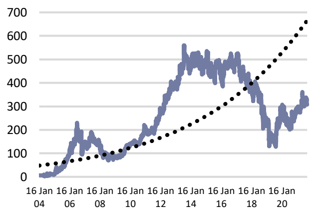
Our Thoughts: Good Start on Digital Strategy

- Irontree is highly cash generative with c.15,000 SME customers & earns c.90% of its revenue from digital backup & hosting services (i.e. recurring revenue) with c.10% of its revenue from digital, security & compliance services.
- The business has grown revenue by c.+15% y/y CAGR over the last 5 years &, assuming this remains unchanged, the Group's FY 24E revenue could be c.R69m (i.e. missing the R100m). Therefore, the R100m revenue target implies confidence that Irontree's addition to Metrofile's group will raise its growth rate (i.e. synergies).
- This is a good first step in Metrofile's Digital Strategy with a well-thought-out, reasonably-priced & comfortably-sized acquisition that should fit neatly into the Group and bolster *both* the Group and the acquired business's growth rates (assumptions in note body).

Forecast, Valuation and Implied Return: Updated

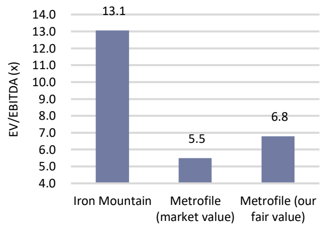
- Irontree lifts Metrofile's FY 22E & FY 23E HEPS to 35.6cps (previously 35.1cps) and 40.2cps (previously 39.5cps) and adds c.+6% to our fair value of 428cps (previously 405cps).
- Rolling this fair value forward, we lift our 12m TP to 497cps (previously 468cps) implying a 57% return from these levels.

Share Price – Metrofile Holdings Ltd



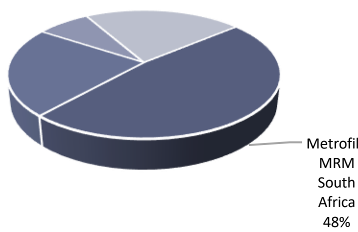
Sources: I-Net Bridge, Blue Gem Research

EV/EBITDA Comparison – IRM vs MFL



Sources: Refinitiv, Blue Gem Research

Domestic Document Storage Market Shares



Sources: Various, Blue Gem Research estimates

Key Forecast (R m)	FY 19A	YoY %	FY 20A	YoY %	FY 21E	YoY %	FY 22E	YoY %	FY 23E	YoY %	FY 24E	YoY %
Revenue	913	*5%*	903	*-1%*	933	*3%*	1,046	*12%*	1,124	*7%*	1,203	*7%*
EBITDA	271	*0%*	302	*11%*	323	*7%*	356	*10%*	397	*11%*	436	*10%*
HEPS (cps)	**19.8**	***-32%***	**24.8**	***25%***	**31.9**	***29%***	**35.6**	***12%***	**40.2**	***13%***	**44.2**	***10%***
Return on Equity (%)	*1.3%*	-	*-3.0%*	-	*24.8%*	-	*24.3%*	-	*24.1%*	-	*23.4%*	-
Price Earnings (x)	*16.0x*	-	*12.8x*	-	*9.9x*	-	*8.9x*	-	*7.9x*	-	*7.2x*	-
DPS (cps)	10.0	*-52%*	13.0	*30%*	15.0	*15%*	17.8	*19%*	20.1	*13%*	22.1	*10%*
Dividend Yield (%)	*3.2%*	-	*4.1%*	-	*4.7%*	-	*5.6%*	-	*6.3%*	-	*7.0%*	-

Sources: Profile Media, Refinitiv, Metrofile Holdings, & Blue Gem Research workings and assumptions

Key Forecast (R m)	FY 19A	YoY %	FY 20A	YoY %	FY 21A	YoY %	FY 22E	YoY %	FY 23E	YoY %	FY 24E	YoY %
Revenue	**913**	***5%***	**903**	***-1%***	**933**	***3%***	**1,046**	***12%***	**1,124**	***7%***	**1,203**	***7%***
MRM South Africa	556	*1%*	543	*-2%*	549	*1%*	564	*3%*	591	*5%*	618	*5%*
MRM Rest of Africa	105	*52%*	106	*1%*	100	*-6%*	106	*7%*	115	*8%*	125	*8%*
MRM Middle East	42	*3%*	55	*31%*	77	*42%*	87	*13%*	97	*12%*	108	*11%*
Products & Services	211	*-1%*	200	*-5%*	207	*4%*	215	*4%*	225	*5%*	236	*5%*
EBITDA	**271**	***0%***	**302**	***11%***	**323**	***7%***	**356**	***10%***	**397**	***11%***	**436**	***10%***
EBITDA Margin (%)	*29.7%*	-	*33.4%*	-	*34.6%*	-	*34.0%*	-	*35.3%*	-	*36.2%*	-
Operating Profit	224	*-3%*	217	*-3%*	241	*11%*	265	*10%*	300	*13%*	326	*9%*
Net finance charges	-69	*50%*	-65	*-6%*	-49	*-24%*	-44	*-11%*	-44	*0%*	-44	*0%*
Net Profit (Parents)	**8**	*-94%*	**-15**	*-296%*	**138**	*>100%*	**154**	*12%*	**174**	*13%*	**192**	*10%*
Weighted Ave. Number of Shares (millions)	*417.8*	*0%*	*431.2*	*3%*	*433.7*	*1%*	*433.7*	*0%*	*433.7*	*0%*	*433.7*	*0%*
EPS (Continuing Operations - cps)	**9.1**	*-71%*	**-3.4**	*-138%*	**31.9**	*>100%*	**35.6**	*12%*	**40.2**	*13%*	**44.2**	*10%*
HEPS (cps)	**19.8**	*-32%*	**24.8**	*25%*	**31.9**	*29%*	**35.6**	*12%*	**40.2**	*13%*	**44.2**	*10%*
Price Earnings Ratio (x)	*16.0x*	-	*12.8x*	-	*9.9x*	-	*8.9x*	-	*7.9x*	-	*7.2x*	-
Dividend Per Share (cps)	**10**	***-52%***	**13**	***30%***	**15**	***15%***	**18**	***19%***	**20**	***13%***	**22**	***10%***
Dividend Yield (%)	*3.2%*	-	*4.1%*	-	*4.7%*	-	*5.6%*	-	*6.3%*	-	*7.0%*	-
Dividend Cover (x)	*2.0x*	-	*1.9x*	-	*2.1x*	-	*2.0x*	-	*2.0x*	-	*2.0x*	-
Property, Plant & Equipment	581	*-1%*	598	*3%*	595	*0%*	511	*-14%*	421	*-18%*	326	*-23%*
Goodwill	439	*-9%*	317	*-28%*	314	*-1%*	331	*5%*	331	*0%*	349	*5%*
Intangible Assets	57	*-4%*	50	*-12%*	44	*-13%*	71	*62%*	64	*-10%*	86	*33%*
Total Assets	1,376	*-6%*	1,378	*0%*	1,353	*-2%*	1,403	*4%*	1,518	*8%*	1,643	*8%*
Shareholder's Equity (Parent)	565	*-7%*	499	*-12%*	559	*12%*	636	*14%*	723	*14%*	819	*13%*
NAV per share (cps)	133	*-7%*	110	*-17%*	129	*17%*	147	*14%*	167	*14%*	189	*13%*
Net Debt	602	*-2%*	527	*-12%*	434	*-18%*	335	*-23%*	145	*-57%*	-16	*-111%*
Net Debt:EBITDA (x)	*2.2*	-	*1.7*	-	*1.3*	-	*0.9*	-	*0.4*	-	*-0.0*	-
Net Debt:Equity (%)	*1.1*	-	*1.1*	-	*0.8*	-	*0.5*	-	*0.2*	-	*-0.0*	-
Free Cash Flow / EBITDA Conversion (%)	194	*72%*	79	*26%*	184	*57%*	175	*49%*	201	*51%*	224	*51%*
Free Cash Flow Yield (%)	***9.8%***	-	***4.1%***	-	***10.1%***	-	***10.2%***	-	***13.1%***	-	***16.3%***	-
Return on Equity (%)	***1.3%***	-	***-3.0%***	-	***24.8%***	-	***24.3%***	-	***24.1%***	-	***23.4%***	-
Return on Assets (%)	***0.5%***	-	***-1.1%***	-	***10.2%***	-	***11.0%***	-	***11.5%***	-	***11.7%***	-
Price Earnings Ratio (x)	*16.0x*	-	*12.8x*	-	*9.9x*	-	*8.9x*	-	*7.9x*	-	*7.2x*	-
Price-to-Book (x)	*2.4x*	-	*2.9x*	-	*2.5x*	-	*2.2x*	-	*1.9x*	-	*1.7x*	-
Current Ratio	*1.4x*	-	*1.4x*	-	*1.3x*	-	*2.1x*	-	*3.1x*	-	*4.0x*	-

Sources: Metrofile Holdings various reports, Refinitiv, Iress, Profile Media, & Blue Gem Research workings & assumptions

Assumptions & Workings for Consolidating Irontree Internet Services

We have made the following simplifying assumptions for forecasting and consolidating Irontree Internet Services into Metrofile's financials, forecasts & valuation:

- **Irontree assumptions**:
    - All conditions are met and the acquisition becomes unconditional,
    - Irontree achieves its FY 22E warranties of adjusted EBITDA of R12,3m,
    - Historical revenue growth of c.+15% y/y rises to c.+30% y/y to achieve the targeted FY 24E revenue of R100m before declining on a straight-line basis to a Terminal Year growth rate of +6.3% y/y in FY 31E,
    - Fixed and variable cost base tracks returns to scale path for a business of this type,
    - Net working capital tracks c.2 months' worth of revenue (i.e. 60 days),
    - The business is ungeared with no net cash, &
    - Its effective tax rate approximates the South African corporate tax rate of 27%.
- **Consolidation assumptions**:
    - The full purchase price of R140m is ultimately paid with 1/3rd being allocated to goodwill (not amortised) and 2/3rd allocated to customer contracts (amortized on a straight-line basis over 5 years to zero on the balance sheet).
    - Irontree's February year-end sees 2 months of FY 22E consolidated into Metrofile's December year-end for FY 22E and 10 months of Irontree's FY 23E period consolidated into this period. Likewise for all future financial years.

Reminder: Metrofile's Digital Strategy

Metrofile's previously communicated digital strategy includes an element of creating a hedge against any decline in the Group's traditional physical business by digitalisation trends (Figure 1).

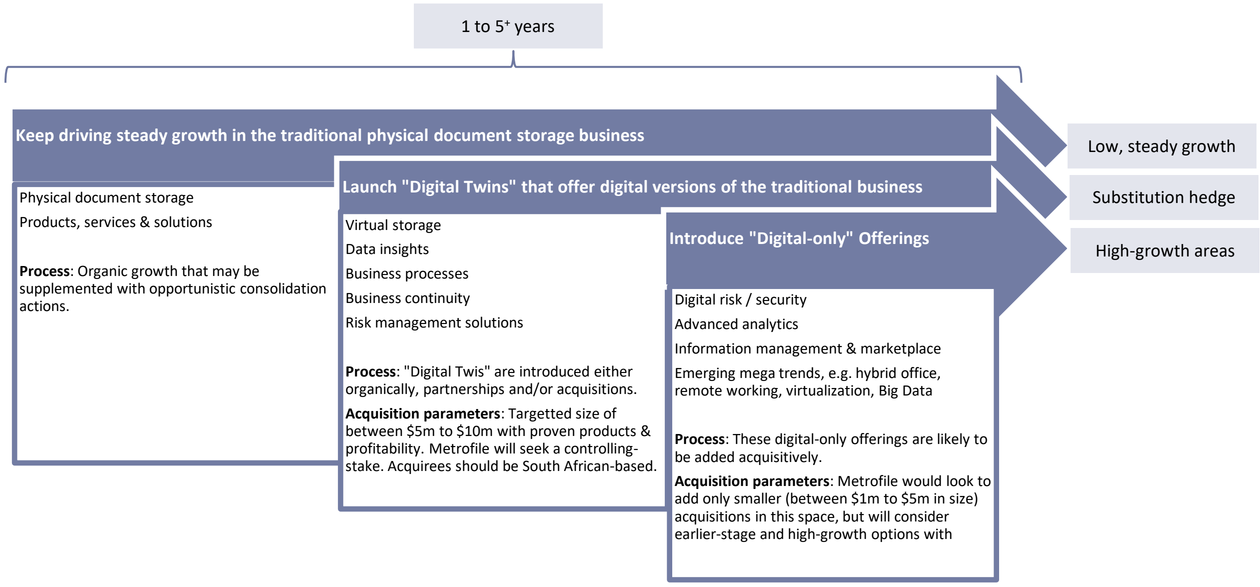
Albeit the digital strategy also goes *beyond* these Digital Twins. Indeed, the strategy seeks to leverage the Group's reach, profile & client-base by growing out entirely *new* (digital) offerings as well.

In this sense, Irontree's broader offering fits neatly into expanding Metrofile's reach into the ICT cloud space.

Metrofile's digital strategy can be summarized as attempting to achieve two things:

- **Introduce "Digital Twins" – 1 to 3^{+} years**: Digitizing its core business services in parallel to running its traditional physical storage operations (not cannibalizing, but rather *supplementing* its physical storage and document management offerings to clients via bundling), &
- **Build, Buy &/or Partner-with "Digital-only" Offerings – 1^{+} to 5^{+} years**: The Group aims to build out digital-only offerings *around* its existing business & client base. These offerings will seek to leverage existing client needs and Metrofile's trusted position in handling, storing, retrieving, analysing, &, generally, being involved in sensitive client data and processes. While being complementary to the Group's existing services, these digital-only businesses will be offering services that the Group did not offer before (e.g. hosting, ICT security & cloud computing, which Irontree currently offers).

Figure 1: Illustration of Metrofile's Digital Strategy



Sources: Metrofile management discussion & Blue Gem Research's interpretation

We do have a range of observations on management's digital strategy:

- **Futureproof/hedges prospects**: Our assumptions around the traditional physical storage market indicate a long runway for future profitability but we may be wrong and paper-based storage needs may decline faster than expected. Management's steady and focussed foray into the Digital Twins hedges the Group's prospects against any possible decline as existing clients can be naturally converted into using the Group's Digital Twin offering and, thus, ensuring sustainability in revenues.
- **Boosts forward growth potential**: The world's steady push into digital spaces creates a natural tailwind that implies that the Digital-only drive may introduce significantly higher growth rates into the Group's various revenues streams (indeed, we can see that Irontree's addition to the Group does appear to lift the Group's forward average growth rate).
- **Creates an embedded "digital option" in the share**: Due to the above upsides—which are admittedly hard to quantify and even harder to value—Metrofile's share price can be considered to hold an embedded option on the outcome and success of the above iterated digital strategy.

Key risk to our valuation

A summary of the key risks to our view and valuation of Metrofile:

- **Downside risks:**
  - Sovereign and macro risks, including South African, African & Middle Eastern economic/political deterioration and COVID-19 prospects,
  - A faster macro transition to digital and/or a higher decline in the physical document storage market than we have predicted,
  - Any growth or pricing assumptions missing to the downside, &
  - Poor execution on or weak traction gained with Metrofile Holdings' digital strategy.
- **Upside risks:**
  - Sovereign and macro risks, including South African, African & Middle Eastern economic/political improving and COVID-19 receding quicker than expected,
  - A slower macro transition to digital and/or a lower decline in the physical document storage market than we have predicted,
  - Any growth or pricing assumptions missing to the upside,

- Excellent execution on or strong traction gained with Metrofile Holdings' digital strategy, &
- Any delisting/takeover bid materializing for Metrofile.

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** Market prices have all been taken at Close on 29 October 2021.*

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