**Results Note**
**3 October 2022**

# Metrofile Holdings Ltd

## Headwinds Obscure Good Digital Growth

**Share Code: MFL – Market Cap: R1.4bn – PE: 10.6x – DY: 5.4%**

| | |
|---|---|
| **12m Target Price** | **473cps** |
| **Share Price** | **325cps** |
| **Implied Return** | **46%** |

**Business Support | South Africa**

### FY 22 Results: Tougher H2:22 than expected

- Revenue rose +5% y/y, EBITDA +1.0% y/y and HEPS slipped to 30.7cps (FY 21: 31.8cps) as floods, disruptions, inflationary pressures and longer customer lead times combined to make for a weaker H2:22 than we had expected.
- Despite this, cash generation was strong (R324m EBITDA converted into R327m of cash flow), debt levels are comfortable, and management hiked the dividend by +20%.
- Finally, management have asserted that share buy-backs will be initiated, which should be quite accretive at this share price.

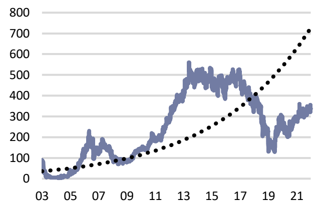
### Our Thoughts: Core remains strong, digital growing quickly

- The tumultuous environment obscured the progress made in retaining the Group's core (net boxes *grew* +2.8% y/y) & growing its digital services (now making up 21% of Group revenue and *grew* +35% y/y). On the latter point, digital services are growing even quicker than reported because scanning revenues were in fact down -9% over this period; IronTree was slightly ahead of targets, & DataStor & eTracker (Metrofile Vysion) grew +40% y/y in this period.
- **Annexure A** shows the Group's digital strategy (past, present & future) and it is very much worth studying as roadmap.

### Forecast, Valuation and Implied Return: Undemanding multiples

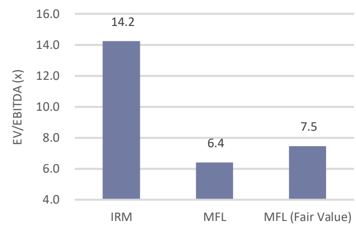
- We see Metrofile's fair value as 404cps (previously: 405cps), or c.24% higher than its current share price. Higher interest rates and our inclusion of IFRS 16 leases into net debt (taking c.34cps of fair value out of SOTP) were the major headwinds that kept our fair value flat over this period.
- Importantly, our fair value implies an EV/EBITDA of 7.5x & a PE of 12.7x, which compares attractively to Iron Mountain's EV/EBITDA of 14.2x & PE of 37.7x.
- Rolling our fair value forward, we arrive at a 12m TP of 473cps (previously: 472cps), implying an attractive +46% return (including dividends) from these levels.

**Share Price – Metrofile Holdings Ltd**



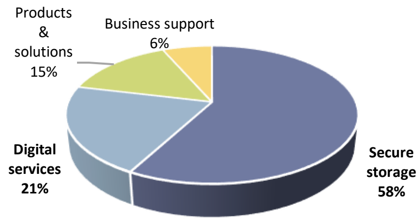

*Sources: I-Net Bridge, Blue Gem Research*

**EV/EBITDA Comparison – IRM vs MFL**




*Sources: Refinitiv, Blue Gem Research*

**Group Revenue Split – Types of Business**




*Sources: Various, Blue Gem Research estimates*

| Key Forecast (R m) | FY 20A | YoY % | FY 21A | YoY % | H1:22A | FY 22A | YoY % | FY 23E | YoY % | FY 24E | YoY % |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 903 | *-1%* | 933 | *3%* | 474 | 980 | *5%* | 1,126 | *15%* | 1,219 | *8%* |
| EBITDA | 302 | *11%* | 323 | *7%* | 157 | 325 | *1%* | 364 | *12%* | 403 | *11%* |
| **HEPS (cps)** | **24.8cps** | ***25%*** | **31.9cps** | ***29%*** | **14.9cps** | **30.8cps** | ***-3%*** | **34.6cps** | ***12%*** | **42.3cps** | ***22%*** |
| *Return on Equity (%)* | *-3.0%* | - | *24.8%* | - | *24.6%* | *23.9%* | - | *24.1%* | - | *26.2%* | - |
| Price Earnings Ratio (x) | 13.1x | - | 10.2x | - | 10.2x | 10.6x | - | 9.4x | - | 7.7x | - |
| DPS (cps) | 13.0cps | *30%* | 15.0cps | *15%* | 9.0cps | 18.0cps | *20%* | 21.0cps | *17%* | 25.0cps | *19%* |
| *Dividend Yield (%)* | *4.0%* | - | *4.6%* | - | *5.2%* | *5.5%* | - | *6.5%* | - | *7.7%* | - |

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

| Key Forecast (R m) | FY 20A | YoY % | FY 21A | YoY % | FY 22A | YoY % | FY 23E | YoY % | FY 24E | YoY % |
|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | **903** | ***-1%*** | **933** | ***3%*** | **980** | ***5%*** | **1,126** | ***15%*** | **1,219** | ***8%*** |
| MRM South Africa | 543 | *-2%* | 549 | *1%* | 539 | *-2%* | 601 | *12%* | 631 | *5%* |
| MRM Rest of Africa | 106 | *1%* | 100 | *-6%* | 91 | *-9%* | 99 | *9%* | 108 | *9%* |
| MRM Middle East | 55 | *31%* | 77 | *42%* | 86 | *10%* | 88 | *2%* | 98 | *12%* |
| Products & Services (including IronTree)* | 200 | *-5%* | 207 | *4%* | 264 | *27%* | 338 | *28%* | 382 | *13%* |
| **IronTree (included above in Products & Services for forecasts)* | *-* | *0%* | *-* | *0%* | *37* | *>100%* | *82* | *122%* | *106* | *30%* |
| **EBITDA** | **302** | ***11%*** | **323** | ***7%*** | **325** | ***1%*** | **364** | ***12%*** | **403** | ***11%*** |
| *EBITDA Margin (%)* | *33.4%* | *-* | *34.6%* | *-* | *33.2%* | *-* | *32.3%* | *-* | *33.1%* | *-* |
| Operating Profit | 217 | *-3%* | 241 | *11%* | 240 | *0%* | 272 | *13%* | 305 | *12%* |
| Net finance charges | -65 | *-6%* | -49 | *-24%* | -49 | *-1%* | -53 | *9%* | -51 | *-5%* |
| **Net Profit (Parents)** | **-15** | *-296%* | **138** | *>100%* | **134** | *-3%* | **150** | *12%* | **183** | *22%* |
| *Weighted Ave. Number of Shares (millions)*** | *431.2* | *3%* | *433.7* | *1%* | *433.7* | *0%* | *433.7* | *0%* | *433.7* | *0%* |
| **EPS (Continuing Operations - cps)** | **-3.4cps** | *-138%* | **31.9cps** | *>100%* | **30.8cps** | *-3%* | **34.6cps** | *12%* | **42.3cps** | *22%* |
| **HEPS (cps)** | **24.8cps** | *25%* | **31.9cps** | *29%* | **30.8cps** | *-3%* | **34.6cps** | *12%* | **42.3cps** | *22%* |
| ***Price Earnings Ratio (x)*** | ***13.1x*** | **-** | ***10.2x*** | **-** | ***10.6x*** | **-** | ***9.4x*** | **-** | ***7.7x*** | **-** |
| **Dividend Per Share (cps)** | **13cps** | ***30%*** | **15cps** | ***15%*** | **18cps** | ***20%*** | **21cps** | ***17%*** | **25cps** | ***19%*** |
| ***Dividend Yield (%)*** | ***4.0%*** | **-** | ***4.6%*** | **-** | ***5.5%*** | **-** | ***6.5%*** | **-** | ***7.7%*** | **-** |
| *Dividend Cover (x)* | *1.9x* | *-* | *2.1x* | *-* | *1.7x* | *-* | *1.6x* | *-* | *1.7x* | *-* |
| Property, Plant & Equipment | 598 | *3%* | 595 | *0%* | 610 | *2%* | 579 | *-5%* | 541 | *-7%* |
| Goodwill | 317 | *-28%* | 314 | *-1%* | 372 | *19%* | 372 | *0%* | 410 | *10%* |
| Intangible Assets | 50 | *-12%* | 44 | *-13%* | 68 | *55%* | 60 | *-11%* | 89 | *48%* |
| Total Assets | 1,378 | *0%* | 1,353 | *-2%* | 1,492 | *10%* | 1,546 | *4%* | 1,559 | *1%* |
| Shareholder's Equity (Parent) | 499 | *-12%* | 559 | *12%* | 560 | *0%* | 622 | *11%* | 698 | *12%* |
| NAV per share (cps) | 110cps | *-17%* | 129cps | *17%* | 129cps | *0%* | 143cps | *11%* | 161cps | *12%* |
| Net Debt | 527 | *-12%* | 434 | *-18%* | 446 | *3%* | 339 | *-24%* | 372 | *10%* |
| *Net Debt:EBITDA (x)* | *1.7x* | *-* | *1.3x* | *-* | *1.4x* | *-* | *0.9x* | *-* | *0.9x* | *-* |
| *Net Debt:Equity (%)* | *1.1* | *-* | *0.8* | *-* | *0.8* | *-* | *0.5* | *-* | *0.5* | *-* |
| ***Free Cash Flow Yield (%)*** | ***4.1%*** | **-** | ***10.0%*** | **-** | ***10.7%*** | **-** | ***12.7%*** | **-** | ***14.2%*** | **-** |
| ***Return on Equity (%)*** | ***-3.0%*** | **-** | ***24.8%*** | **-** | ***23.9%*** | **-** | ***24.1%*** | **-** | ***26.2%*** | **-** |
| ***Return on Assets (%)*** | ***-1.1%*** | **-** | ***10.2%*** | **-** | ***9.0%*** | **-** | ***9.7%*** | **-** | ***11.8%*** | **-** |
| *Price Earnings Ratio (x)* | *13.1x* | *-* | *10.2x* | *-* | *10.6x* | *-* | *9.4x* | *-* | *7.7x* | *-* |
| *Price-to-Book (x)* | *2.9x* | *-* | *2.5x* | *-* | *2.5x* | *-* | *2.3x* | *-* | *2.0x* | *-* |
| *Current Ratio* | *1.4x* | *-* | *1.3x* | *-* | *1.3x* | *-* | *1.9x* | *-* | *1.7x* | *-* |

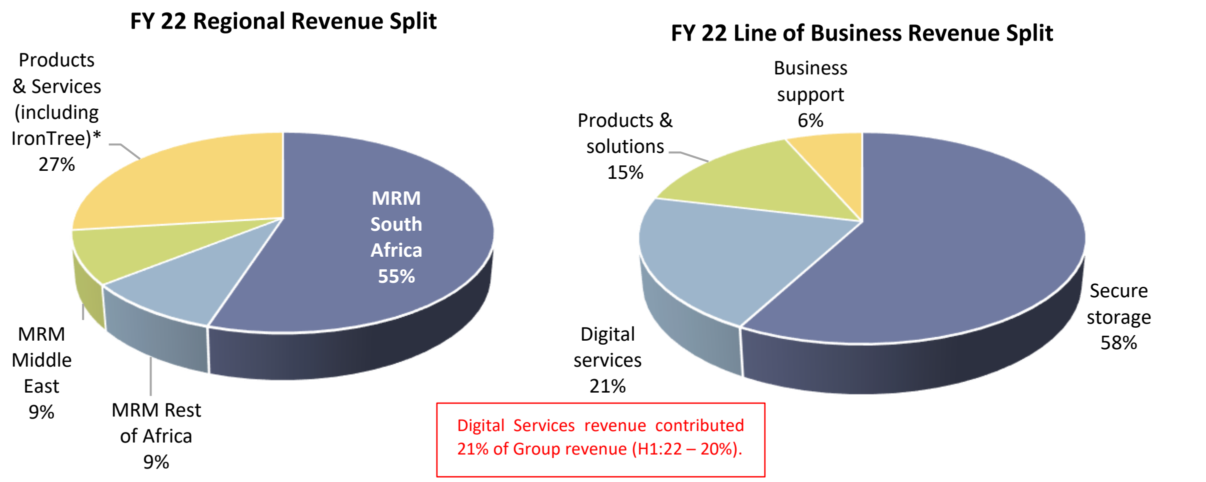
*Sources: Metrofile Holdings various reports, Refinitiv, Iress, Profile Media, & Blue Gem Research workings & assumptions; * IronTree is consolidated into the Group's Products & Services segment. We have shown it separately here for information purposes; ** We do not forecast any share buy-backs, though we note that management have specifically highlighted this as part of their capital allocation strategy, and we expect this to be forthcoming & earnings enhancing at the current share price.*

## Summary of FY 22 Results

The tumultuous H1:22 environment continued into H2:22 for Metrofile Holdings (code: MFL), obscuring the progress made in retaining the Group's core (net boxes grew +2.8% y/y) and growing its digital services (now making up 21% of Group revenue and grew +35% y/y). It is notable that the Group's FY 22 period included domestic riots, the implementation of the POPIA, domestic elections, Kenyan regulatory pressures, COVID & supply chains disruptions, & a flood in KwaZulu-Natal:

- Revenue rose +5% y/y (+1% excluding IronTree's seven months of consolidation) to R980m (FY 21: R933m), missing our forecasts by 1.8% as H2's anticipated catch-up disappointed for several reasons, including longer customers lead times, disruptions in South Africa and Kenya continuing and a lower activity level (which generates good margin service revenue) on existing boxes. These negatives were partially offset by good growth in net boxes (11.2m grew to 11.5m boxes across the Group) and continuing ratchetting up in its digital revenues (+35% growth).
- The small revenue miss cascaded down the income statement to see EBITDA growing only +1.0% y/y and HEPS slipping -3% to 30.7cps (FY 21: 31.8cps) missing our forecasts by c.4%. We view this miss as environmental as neither we nor management could have anticipated floods and other disruptions during the period while box-related services should play catch-up in FY 23/24E.
- Cash generation remained superb (R324m EBITDA converted into R327m of operational cash flow), debt levels (even after IronTree's potential FY 24E earn-out is paid in full) are well below covenants, management hiked the dividend by +20% to 18cps (FY 21: 15cps) on a higher payout ratio that they believe is sustainable while share buy-backs will be initiated.

**Figure 1: Metrofile Holdings Regional & Segmental Revenue**




*Sources: Metrofile Holdings various reports & Blue Gem Research workings and assumptions; *Includes IronTree for 7 months in FY 22*

- Despite the difficult H2, several not-obvious positives exist that are yet to be reflected in the Group's numbers and should impact on FY 23E and onwards:
  - Group-wide and on average, box pricing is managing to keep up with inflation,
  - Digital services are growing even *quicker* than reported because scanning revenues were in fact *down* -9% over this period; IronTree was slightly ahead of expected growth targets and DataStor and eTracker (part of Metrofile Vysion) grew +40% y/y in this period,
  - The MRM Middle East segment has become the Group's second largest contributor and both it and the MRM Rest of Africa are looking to expand into new geographies in coming years,
  - FY 22's (long lead-time) pipeline has started converting into sales in the FY 23E year (the Group are a month & a half into the new year) and MRM South Africa has some *large* potential public sector opportunities that—if they secure them—will be material (we do not account for any of these in our forecasts and valuation).

- Finally, we have included in '**Annexure A**' a wonderful illustration of how Metrofile's digital strategy is progressing and how it ties into the existing businesses, brands, services and solutions *and* where it will still evolve. This slide was copied with Metrofile's management permission and is worth viewing alongside Figure 1's current revenue and segmental split.

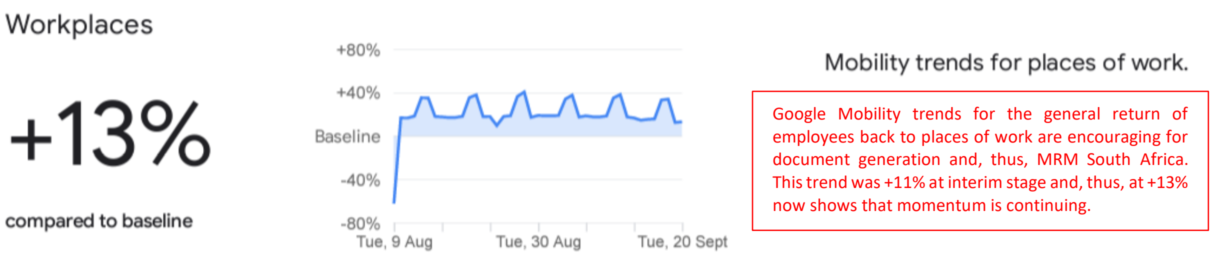
## MRM South Africa

| **Forecast & DCF (Rm's):** | **FY 19** | **FY 20** | **FY 21** | **FY 22A** | **FY 23E** | **FY 24E** | **FY 25E** | **FY 26E** | **FY 27E** | **FY 28E** | **FY 29E** | **FY 30E** | **FY 31E** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Net Box Growth (y/y %)* | *3.8%* | *0.9%* | *6.3%* | *2.1%* | *3.3%* | *2.5%* | *1.8%* | *1.0%* | *0.3%* | *-0.5%* | *-1.2%* | *-2.0%* | *-2.7%* |
| *Non-storage Revenue (%)* | *20.0%* | *20.0%* | *20.0%* | *20.0%* | *22.3%* | *22.6%* | *23.0%* | *23.5%* | *24.1%* | *24.9%* | *25.8%* | *26.9%* | *28.2%* |
| *EBITDA Margin (%)* | *42.0%* | *46.8%* | *46.2%* | *46.3%* | *43.5%* | *43.4%* | *43.1%* | *42.4%* | *41.4%* | *40.0%* | *38.3%* | *36.2%* | *33.6%* |
| **Revenue** | **556** | **543** | **549** | **539** | **601** | **631** | **659** | **684** | **705** | **724** | **738** | **750** | **757** |
| *Growth (y/y %)* | *1.1%* | *-2.3%* | *1.1%* | *-1.8%* | *11.6%* | *5.0%* | *4.4%* | *3.8%* | *3.2%* | *2.6%* | *2.0%* | *1.5%* | *1.0%* |
| EBITDA | 234 | 254 | 254 | 250 | 261 | 274 | 284 | 290 | 292 | 290 | 283 | 271 | 255 |
| Working Capital | 3 | -2 | 3 | -0 | -3 | -3 | -3 | -2 | -2 | -1 | 0 | -0 | 1 |
| Capex | -33 | -39 | -42 | -17 | -24 | -20 | -15 | -9 | -3 | -58 | -57 | -57 | -56 |
| Tax | -55 | -56 | -58 | -53 | -56 | -59 | -62 | -63 | -63 | -63 | -61 | -58 | -54 |
| **Free Cash Flow (FCF)** | **148** | **157** | **157** | **179** | **179** | **192** | **204** | **216** | **224** | **169** | **165** | **156** | **146** |
| *Discount Factor* | | | | | *0.89* | *0.80* | *0.71* | *0.64* | *0.57* | *0.51* | *0.46* | *0.41* | *0.36* |
| **Discounted FCF** | | | | | **160** | **153** | **146** | **138** | **128** | **86** | **75** | **64** | **490** |
| **Enterprise Value (EV)** | | | | | | | | | | | | | **R1,439m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | | ***5.8x*** |

*Sources: Metrofile Holdings, Iress, Profile Media & Blue Gem Research workings & assumptions*

- MRM South Africa remained under pressure in H2 and revenue and EBITDA were flat (-2% and -1% respectively) thus managing to maintain 46% margins (FY 21: 46%). These figures are in line with our forecasts (we expected flat revenue and EBITDA), though on the low-end of that expectation.
- New box growth of +2% (our forecast: +2.4%) was enjoyed (+8% inflows less -6% outflows) but paper *services* declined as activity levels in the domestic economy remained low. There is an expectation that these will be somewhat recovered in FY 23E as office workers steadily return to the office and, thus, documents and resulting service revenue is triggered. Google Mobility data (Figure 2) taken post-year-end tends to agree with this view of a steady return to the office and, thus, a normalization of document generation, box flows and paper services activity.

**Figure 2: Google Mobility Trends for South Africa (24 September 2022)**




*Source: Google (https://www.google.com/covid19/mobility/)*

- In adjusting our MRM South Africa segmental forecasts, we have left our net box flow assumptions largely unchanged, adjusted the inflationary price increase slightly upwards, see the FY 23E box *activity* (driving service revenue) as playing strong catch-up on the weak FY 22 period and, finally, worked in some margin pressure as short-term inflationary increases in the cost-base are above our longer-term inflationary assumptions.
- While we do not forecast interims, we expect H1:23E to be softer than our full-year forecast as some cost-base expansion needs to annualize while it is only likely to drive growth in top-line into H2:23E.
- Finally, note that management have specifically stated that there are currently some *large* opportunities in the public sector space. We have not modelled any of these into our forecasts, though if any close in favour of Metrofile, we may need to update our forecasts to reflect this.

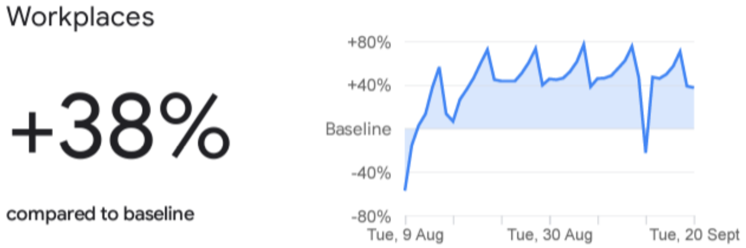
## MRM Rest of Africa

| Forecast & DCF (Rm's): | FY 20 | FY 21 | FY 22A | FY 23E | FY 24E | FY 25E | FY 26E | FY 27E | FY 28E | FY 29E | FY 30E | FY 31E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Net Box Growth (y/y %)* | *9.2%* | *3.8%* | *5.5%* | *7.0%* | *6.5%* | *6.0%* | *5.5%* | *5.0%* | *4.5%* | *4.0%* | *3.5%* | *3.0%* |
| *Non-storage Revenue Contribution (%)* | *20.0%* | *20.0%* | *12.0%* | *11.8%* | *11.6%* | *11.4%* | *11.2%* | *11.0%* | *10.9%* | *10.8%* | *10.8%* | *10.7%* |
| *EBITDA Margin (%)* | *45.4%* | *57.0%* | *47.7%* | *44.6%* | *45.4%* | *46.0%* | *46.3%* | *46.4%* | *46.2%* | *45.8%* | *45.2%* | *44.3%* |
| **Revenue** | **106** | **100** | **91** | **99** | **108** | **117** | **127** | **137** | **146** | **156** | **166** | **175** |
| *Growth (y/y %)* | *1.4%* | *-6.0%* | *-9%* | *8.6%* | *9.1%* | *8.6%* | *8.2%* | *7.7%* | *7.2%* | *6.7%* | *6.2%* | *5.7%* |
| EBITDA | 48 | 57 | 43 | 44 | 49 | 54 | 59 | 63 | 68 | 72 | 75 | 78 |
| Working Capital | -1 | 1 | 1 | -0 | -1 | -1 | -1 | -1 | -1 | -0 | -1 | -0 |
| Capex | -88 | -5 | -11 | -11 | -12 | -12 | -13 | -13 | -14 | -14 | -13 | -13 |
| Tax | -9 | -10 | -8 | -8 | -9 | -11 | -12 | -13 | -14 | -15 | -16 | -16 |
| **Free Cash Flow (FCF)** | **-50** | **42** | **25** | **25** | **27** | **30** | **33** | **36** | **39** | **43** | **45** | **48** |
| *Discount Factor* | | | | *0.81* | *0.65* | *0.53* | *0.43* | *0.34* | *0.28* | *0.23* | *0.18* | *0.15* |
| **Discounted FCF** | | | | **20** | **18** | **16** | **14** | **12** | **11** | **10** | **8** | **98** |
| **Enterprise Value (EV)** | | | | | | | | | | | | **R206m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | ***4.8x*** |

*Sources: Metrofile Holdings, Iress, Profile Media & Blue Gem Research workings & assumptions*

- MRM Rest of Africa disappointed as Kenya continued to struggle under poor financial services sector conditions. Management in this region has been changed, the business model adjusted to the new environment and the first month and a half of trading has tracked above the prior comparable period.
- Revenue slipped -9% to R91m (FY 21: R99m) below our expectation of R92m as EBITDA fell -24% to R43m (FY 21: 57m) missing our R47m target.
- Net boxes grew +6% (despite Kenya) beating our expectations with inflows of +7% and outflows only reflect a -1% over the period.

**Figure 3: Google Mobility Trends for Kenya (24 September 2022)**




The Kenyan office environment is recovering well from its pre-COVID baseline. The pressure on the operations remains from the structural changes that have occurred in the banking and financial services sector, though the activity and the high margins on boxes remains there.

*Source: Google (https://www.google.com/covid19/mobility/)*

- Our Rest of Africa forecasts have been adjusted to the weaker Kenyan environment, though we see this normalizing across the year and the operation recovering steadily into FY 24E.
- Growth is being explored in other regions too, though this is harder to model and provides upside risk to our topline forecasts here. Much like MRM South Africa, though, we see inflationary pressure on the cost-base that, in the short-term, could create some margin pressure.

## MRM Middle East

| Forecast & DCF (Rm's): | FY 21 | FY 22A | FY 23E | FY 24E | FY 25E | FY 26E | FY 27E | FY 28E | FY 29E | FY 30E | FY 31E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *Net Box Growth (y/y %)* | *46.1%* | *7.9%* | *15.0%* | *14.7%* | *14.5%* | *14.2%* | *13.8%* | *13.5%* | *13.1%* | *12.7%* | *12.3%* |
| *Non-storage Revenue Contribution (%)* | *36.0%* | *73.0%* | *69.9%* | *68.3%* | *66.8%* | *65.2%* | *63.7%* | *62.3%* | *60.9%* | *59.6%* | *58.3%* |
| *EBITDA Margin (%)* | *18.8%* | *22.1%* | *18.3%* | *23.3%* | *28.1%* | *32.6%* | *36.8%* | *40.8%* | *44.4%* | *47.9%* | *51.1%* |
| **Revenue** | **77** | **86** | **88** | **98** | **110** | **123** | **138** | **154** | **173** | **193** | **216** |
| *Growth (y/y %)* | *41.7%* | *10.4%* | *2.5%* | *11.9%* | *12.0%* | *12.0%* | *12.0%* | *12.0%* | *12.0%* | *11.9%* | *11.8%* |
| EBITDA | 15 | 19 | 16 | 23 | 31 | 40 | 51 | 63 | 77 | 93 | 110 |
| Working Capital | -2 | -1 | 0 | -1 | -1 | -1 | -1 | -1 | -1 | -2 | -2 |
| Capex | 10 | -11 | -6 | -8 | -9 | -11 | -12 | -14 | -17 | -19 | -22 |
| Tax | - | - | - | - | - | - | - | - | - | - | - |
| **Free Cash Flow (FCF)** | **22** | **7** | **10** | **14** | **21** | **28** | **37** | **47** | **59** | **72** | **87** |
| *Discount Factor* | | | *0.81* | *0.65* | *0.53* | *0.43* | *0.34* | *0.28* | *0.23* | *0.18* | *0.15* |
| **Discounted FCF** | | | **8** | **9** | **11** | **12** | **13** | **13** | **13** | **13** | **265** |
| **Enterprise Value (EV)** | | | | | | | | | | | **R357m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | ***18.9x*** |

*Sources: Metrofile Holdings, Iress, Profile Media & Blue Gem Research workings & assumptions*

- Contrary to the MRM Rest of Africa segment, MRM Middle East continued its stellar year with revenues +10% and EBITDA growing +30%, both ahead of our expectations of +5% growth to both metrics.
- It is worth noting that some of this revenue growth was one-off and will not be repeated in FY 23E, though management are careful to guide that organic growth in this operation is (and post-period has remained) strong and they expect this organic growth to fill the one-off FY 22 revenue gap in FY 23E.
- Net box growth of +8% was strong (ahead of our +5.2% expectation) with inflows of +10% and outflows of only -2%. Space expansion is being explored in this region but we have not modelled anything material in either our capex or earnings until otherwise communicated by management.
- Despite this box growth, MRM Middle East's revenue continues to be dominated by digital services (72% of FY 22 segmental revenue). This mix is expected to remain, and management is mulling some geographic expansion in the region too, though—given the previous management's challenges with this—any development here will be done carefully.
- We have kept most of our assumptions unchanged here, though taper some growth in FY 23E (due to the FY22 one-off revenue not recurring) that is offset by organic growth and sees a flatter topline in FY 23E. We expect this to continue into FY 24E, but the base-effect is gone, and normal growth should be reflected then. Finally, we have tweaked the inflationary expectations here upwards too.

## Product & Services

**Products & Services (*including* IronTree Internet Services*)**

| Forecast & DCF (Rm's): | FY 20 | FY 21 | FY 22A | FY 23E | FY 24E | FY 25E | FY 26E | FY 27E | FY 28E | FY 29E | FY 30E | FY 31E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Non-storage Revenue Contribution (%)* | *94.0%* | *94.0%* | *95.0%* | *96.1%* | *96.5%* | *96.8%* | *97.1%* | *97.4%* | *97.6%* | *97.8%* | *98.0%* | *98.1%* |
| *EBITDA Margin (%)* | *12.6%* | *16.1%* | *17.9%* | *25.1%* | *27.0%* | *28.3%* | *28.8%* | *29.4%* | *28.8%* | *26.9%* | *27.8%* | *27.5%* |
| **Revenue*** | **200** | **207** | **264** | **338** | **382** | **429** | **479** | **535** | **590** | **640** | **695** | **741** |
| ***IronTree Revenue (inc. above)*** | **-** | **-** | ***37*** | ***82*** | ***106*** | ***133*** | ***160*** | ***192*** | ***220*** | ***242*** | ***267*** | ***283*** |
| *Growth (y/y %)* | *-5.4%* | *3.8%* | *27.4%* | *28.0%* | *13.0%* | *12.5%* | *11.5%* | *11.8%* | *10.3%* | *8.6%* | *8.6%* | *6.6%* |
| EBITDA | 25 | 33 | 47 | 85 | 103 | 121 | 138 | 157 | 170 | 172 | 194 | 204 |
| Working Capital | 1 | 3 | -8 | -7 | -6 | -6 | -6 | -6 | -6 | -4 | -6 | -4 |
| Capex | -11 | -34 | -18 | -20 | -22 | -24 | -26 | -29 | -32 | | -38 | -42 |
| Tax | -2 | -5 | -8 | -17 | -21 | -25 | -28 | -32 | -34 | -33 | -36 | -37 |
| **Free Cash Flow (FCF)** | **13** | **-2** | **14** | **41** | **55** | **67** | **78** | **90** | **99** | **135** | **113** | **121** |
| *Discount Factor* | | | | *0.89* | *0.80* | *0.71* | *0.64* | *0.57* | *0.51* | *0.46* | *0.41* | *0.36* |
| **Discounted FCF** | | | | **36** | **44** | **48** | **50** | **51** | **50** | **62** | **46** | **834** |
| **Enterprise Value (EV)** | | | | | | | | | | | | **R1,220m**** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | ***25.8x*** |

*Sources: Metrofile Holdings, Iress, Profile Media & Blue Gem Research workings & assumptions; *IronTree revenue shown separately for illustrative purposes, but it is consolidated into the segment for forecast and valuation purposes; ** EV includes both existing businesses and 100% of IronTree EV, where IronTree minorities are taken out of the Group Sum-of-the-Parts (Table 5)*

- Products & Services (now including IronTree, which contributed for 7 months in FY 22 and added R36.8m and R8.2m revenue and profit respectively) had a challenging trading period, missing our overall expectations.
- While Metrofile Vysion (business process automation) had strong growth (DataStor and eTracker grew +40% y/y), Cleardata saw increased destructions and IronTree performed slightly ahead of its expected growth, Tidy Files weak H1 continued into H2 with loadshedding and competitor pricing pressures hampering revenue and margins.
- We have maintained our view that Tidy Files will recover in FY 23E but have slightly lifted our digital growth assumptions (both from Metrofile Vysion outperforming and IronTree beating our expectations).
- Importantly, SME success is starting to scale, cross-selling is occurring, and the Group's key Acronis relationship (partner for the cloud offering) is looking to expand beyond South Africa.

## Macro Environment

### Global Environment:

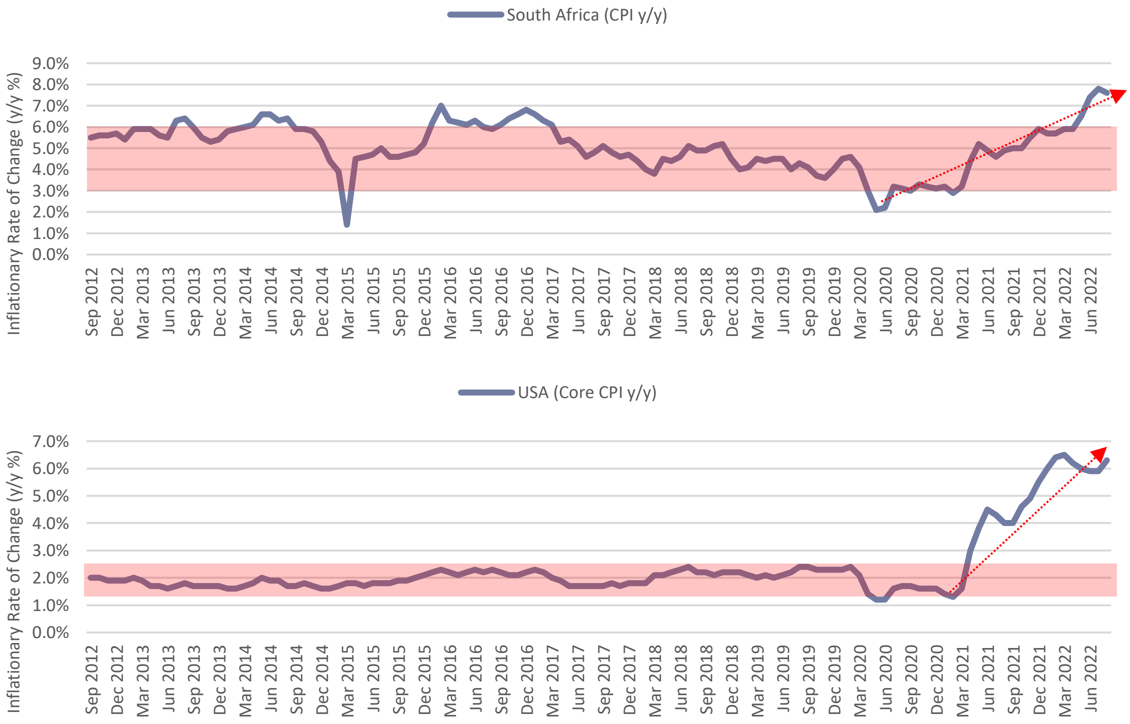
- **COVID has receded:** While COVID is not gone, the pandemic has evolved into an endemic (Figure 4) and, importantly from an economic perspective, Government lockdowns have been completely lifted (other than in China due to their "Zero COVID" policy). This is a net positive for economies as activity can and, in most sectors, is returning to normal.

**Figure 4: COVID Infections in South Africa and Globally**


*Source: [https://ourworldindata.org/explorers/coronavirus-data-explorer](https://ourworldindata.org/explorers/coronavirus-data-explorer) (24 September 2022)*

- **Inflation is above average & remains high:** We touched on the drivers of inflation in our interim note and, since then, despite many key commodity prices retreating (e.g. Crude Oil WTI Futures are down -20% on a six-month view), both domestic and global inflation (Figure 5) has remained above average, stickier than expected and, necessitated contractionary monetary policies from central banks around the world (i.e. interest rates are rising). This is a net negative for economies through higher interest rates, a negative drag on asset valuations and lower consumer disposable income.

**Figure 5: USA & South African Inflation – Broken out of Historical Ranges**




*Source: Refinitiv & Blue Gem Research workings & assumptions*

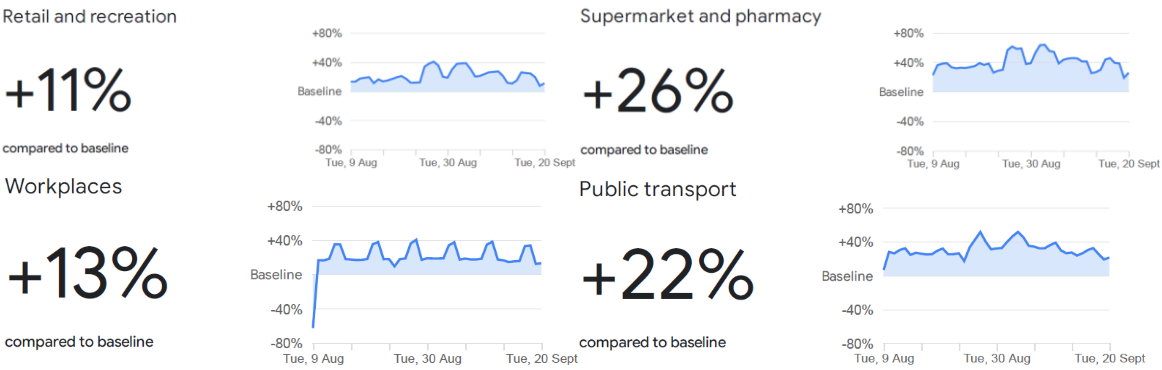
- **Geopolitics remains a key concern**: The Russian-Ukraine war continues while China-US tensions remain high, particularly around Taiwan. Increasingly, unrest is being seen in countries around the world as inflation, energy prices and food become increasing pressure points in society. This is hard to forecast or predict from our perspective but remains a headwind against growth.

- **USA, EU and China likely to enter recessions**: Market indicators are increasingly pointing towards a likely recession in the USA from the Federal Reserve ("the Fed") interest rate hikes, in the EU due to the Russia-Ukraine linked energy crisis there and in China due to the heavy economic cost of its continuing lockdowns under its Zero COVID policy. Given the size of these economic blocks, it is, therefore, increasingly likely that the world will enter a recession in Q3/4 this year and, perhaps, early in 2023. Any "soft landing" would be a net positive as markets are increasingly pricing this negative in.

**Domestic Environment: Driven by Eskom, Transnet & Global Events**

- Figure 4 shows how COVID has receded in South Africa.
- *Google Mobility* points to a strong rebound in domestic activity and economic activity (Figure 6). While these data points are somewhat anecdotal and have their own biases, they *are* granular *and* real-time, and therefore also useful.

**Figure 6: Google Mobility – South African Activity Data**




*Sources: Google.com*

- Economically & politically, South Africa does appear to be improving, though some of this is fortuitous and could change depending on global events:
    - **Eskom**: While Eskom remains a major risk to South Africa, the Government's move to unbundle the utility, lift self-generation regulations & push to get further rounds of renewables online are all positives that partially mitigate this risk going forward. Recently, the addition of Board capacity at the utility further signals the seriousness with which the government are attempting to fix the national utility. Despite this, recent heavy and continuous loadshedding creates downside risk to the domestic economy and, indeed, Metrofile's FY 23E period.
    - **Transnet**: While Transnet remains an inefficient national operator creating large bottlenecks for a commodity-led exporting country like South Africa, recent moves to privatize (or, at least, let private operators onto the national railways) could unleash large pent-up export demand for South Africa's bulk commodities. We continue watching this closely, but at this point we do not yet know the shape or form of private sector help in this area.
    - **Rand, interest rates & inflation**: Above-target inflation has seen the South African Reserve Bank ("the SARB") hike interest rates with the most recent hike putting the local repurchase rate ("the repo rate") at the same level it was pre-COVID. Despite this, a global flight to the US Dollar has driven Rand weakness over the recent period with little respite.
    - **Political Risk**: Finally, the risk of political instability, growing poverty and the upcoming ANC National Elective Conference (NEC) all add downside risks to these above-noted positives.

- We were a lot more positive in our interim note, but globally and domestically events *have* deteriorated. Currently, macro-economic risks are to the downside.
- Despite this, commodities remain in short-supply, South Africa has pent-up potential that positive political and public sector developments could materially unlock and we would caution against any certainty about how the next couple of years play out globally and domestically (either for better or worse).

## Forecast, Valuation & 12m TP Update

- Earlier in this note, we highlighted some of our segmental-level assumptions adjustments. These adjustments were mostly to the FY 23E period and we have left most of our long-term assumptions unchanged (see our Initiation of Coverage for detail & backing on these). We believe that they remain valid.
- We have updated some model-wide assumptions and variables, namely:
    - Lifted our risk-free rate to reflect the South African 10-year bond's higher yield of 10.60% (previously: 9.86%),
    - Lifted our Cost of Debt to reflect the SARB interest rate hike, &
    - Adjusted our dividend policy to reflect the change (though we have not taken into account management's stated share buy-back as it has not yet been quantified nor do we know the timing hereon).
- The combination of the segmental-level work and the updated global assumptions arrive at a Sum-of-the-Parts (SOTP) fair value of 404cps (previously: 405cps). While this fair value appears flat, it must be understood in the context of two major headwinds:
    - Interest rates have risen strongly during the period, pushing up the WACC and down the PV of cash flows (i.e. higher interest rates create headwinds to valuations), &
    - We have taken a decision to include IFRS 16 leases into net debt, which shaves c.34cps off Metrofile's SOTP fair value (thus, if we were comparing like-for-like fair values, Metrofile's fair value has risen +7% since our H1:22 results note).

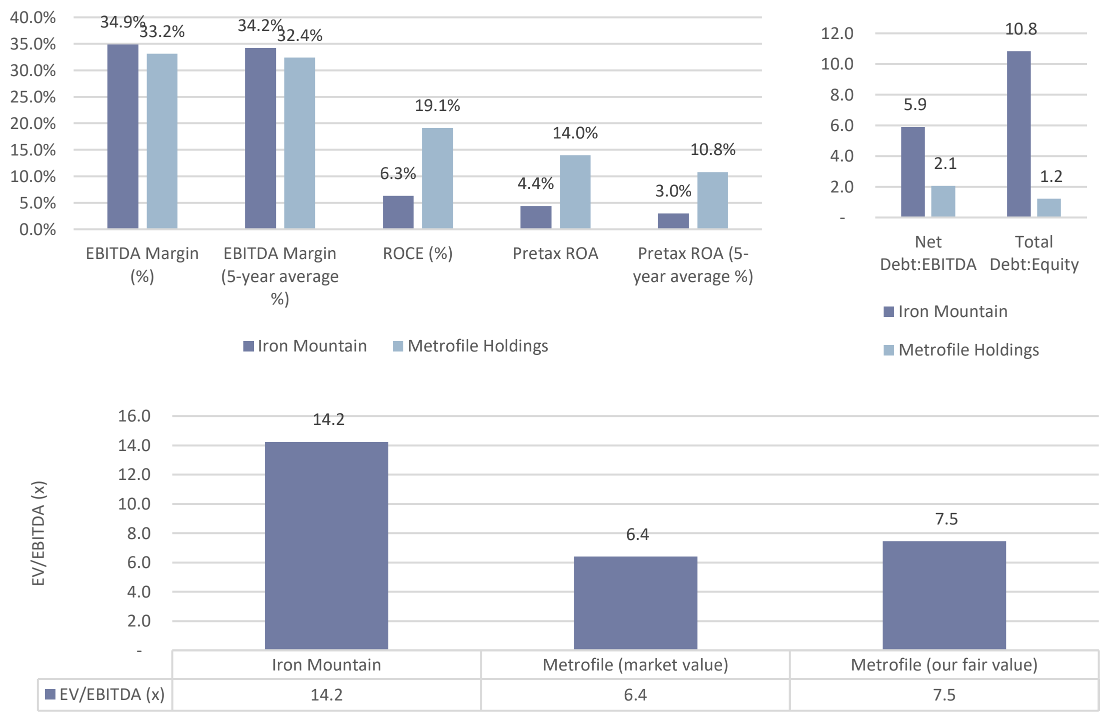
**Table 5: Metrofile Group's Sum-of-the-Parts (SOTP) Fair Value & 12m TP**

| | Sum-of-the-Parts | *Implied EV/EBITDA (x)* | *Implied Price Earnings(x)* |
|---|---|---|---|
| MRM South Africa | R1,438,862,804 | *5.8x* | - |
| MRM Rest of Africa | R206,271,339 | *4.8x* | - |
| MRM Middle East | R357,346,894 | *18.9x* | - |
| Product & Solution* | R1,220,313,906* | *25.8x** | - |
| Less: IronTree (30%-minorities) | -R64,030,506 | - | - |
| Group | -R737,073,991 | - | - |
| Enterprise Value (EV) | R2,421,690,446 | *7.5x* | - |
| Net Debt, Acquisition & Lease Liabilities** | -R669,810,000 | | |
| **Fair Value** | **R1,751,880,446** | - | ***12.7x*** |
| **Fair Value (cps)** | **404cps** | - | ***12.7x*** |
| **12m TP (cps)** | **473cps** | | ***13.7x*** |

*Sources: Metrofile, Refinitiv, Iress, Profile Media, & Blue Gem Research workings & assumptions; * Includes IronTree's enterprise value; ** Previously not included in net debt, removes c.34cps value.*

- Table 5's SOTP fair value for Metrofile implies an EV/EBITDA of 7.5x and a Price Earnings (PE) of 12.7x.
- Both of these measures compare attractively to Iron Mountain (IRM) which is trading at an EV/EBITDA of 14.2x and a PE of 31.1x (Figure 7).
- Despite the lower valuation than Iron Mountain, it is worth noting that Metrofile has in fact the same-or-better returns and a significantly lower relative debt (even if we include IFRS 16 leases into its gearing) in its capital structure.

**Figure 7: Metrofile Holdings versus Iron Mountain**




*Sources: Refinitiv, Koyfin & Blue Gem Research workings and assumptions*

- Taking this comparison one step further, in Table 6 we unpack key metrics between the two documents storage groups *and* their pure-play competitors with digital substitutes.

**Table 6: Metrofile Holdings versus Iron Mountain, Equinix, Digital Realty Trust & Dropbox Inc**

| Name | Market Cap. (USD) | EV/EBITDA (x) | FCF Yield (%) | PE (x) | P/S (x) | Dividend Yield (%) | Dividend Yield (5-year average %) | ROCE (%) | Pretax ROA | Pretax ROA (5-year average %) |
|---|---|---|---|---|---|---|---|---|---|---|
| Iron Mountain | $13,935,435,352.00 | 14.2x | -1.2% | 37.7x | 2.9x | 5.2% | 6.9% | 6.3% | 4.4% | 3.0% |
| Metrofile Holdings | $79,492,254.00 | 6.4x | 10.2% | 10.6x | 1.5x | 5.5% | 6.1% | 19.1% | 14.0% | 10.8% |
| ***Metrofile Discount*** | | ***55%*** | ***-928%*** | ***72%*** | ***49%*** | ***7%*** | ***-12%*** | - | - | - |
| **Digital Storage Peer Average** | | **20.2x** | **1.5%** | **44.4x** | **6.1x** | **2.2%** | **1.7%** | **47.1%** | **6.0%** | **-2.2%** |
| Equinix Inc | $55,488,467,213.00 | 24.1x | -1.7% | 86.7x | 8.0x | 2.0% | 1.8% | 4.2% | 2.2% | 2.2% |
| Digital Realty Trust | $30,870,476,309.00 | 21.0x | 0.0% | 23.5x | 6.8x | 4.5% | 3.4% | 2.0% | 5.0% | 2.3% |
| Dropbox Inc | $7,538,286,798.00 | 15.4x | 6.1% | 23.0x | 3.4x | 0.0% | 0.0% | 135.1% | 10.9% | -11.0% |

*Sources: Refinitiv, various reports & Blue Gem Research workings & assumptions*

- All in all, we are comfortable with our segmentally-driven SOTP fair value for Metrofile and believe that against relative measures it holds up as a justifiable valuation.
- We note again our conservatism around the inclusion of IFRS 16 leases into net debt and how its lowers Metrofile's fair value by c.7%.
- Rolling this fair value for Metrofile forward by our Cost of Equity, we arrive at a 12m TP of 473cps (previously: 472cps) which implies an attractive +46% return (including dividends) from these levels.

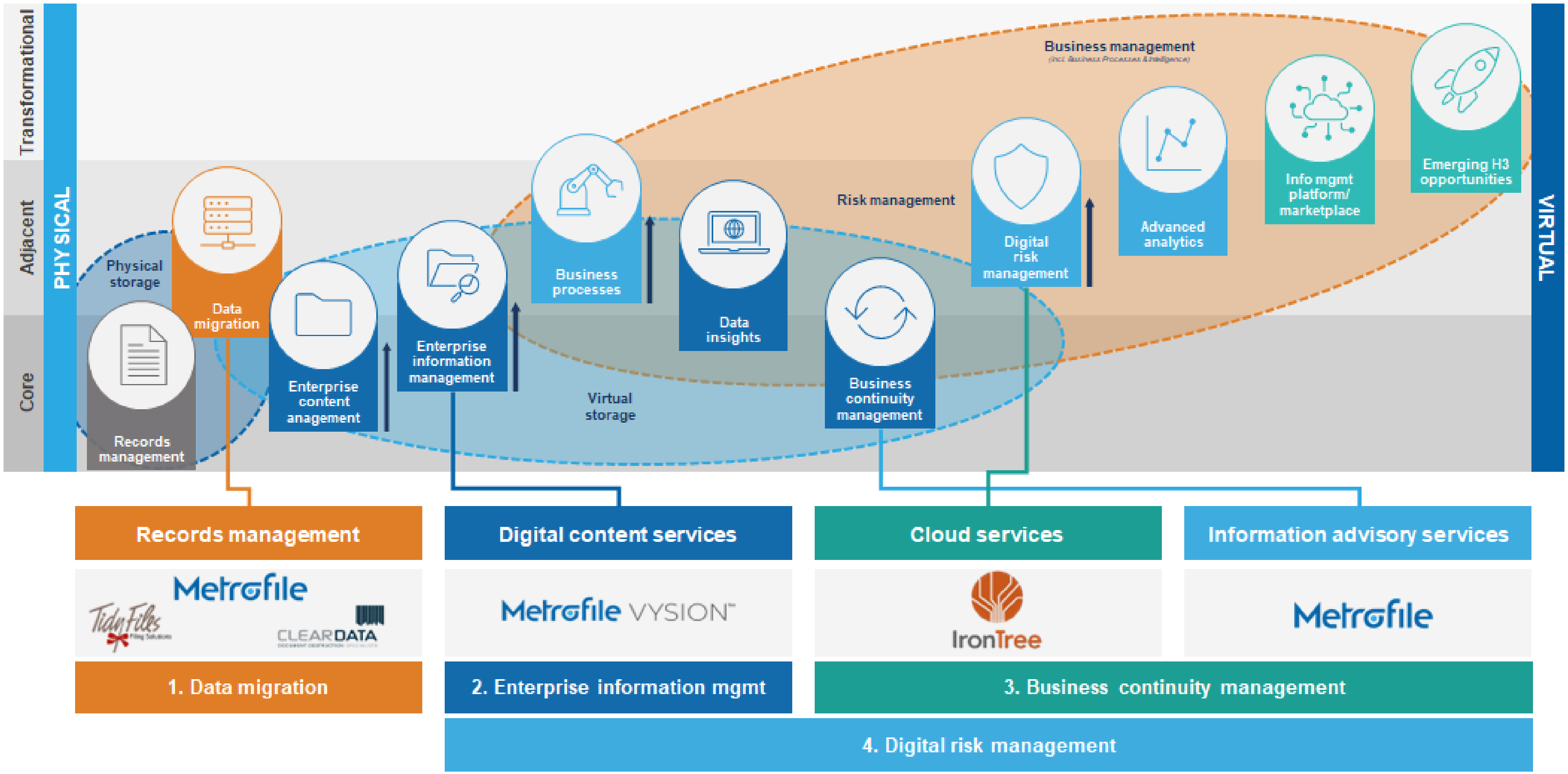
## Key Risks to our Forecast & Valuation

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, &
   - All the numerous domestic and macro risks we highlighted in our macro section of this report.
- **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.

## Annexure A: Illustration of Metrofile's Digital Evolution



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