**Results Note**
**21 October 2024**

Did not sign-up for this report?
Sign-up for future reports here

Metrofile Group

# Metrofile Holdings Ltd

## Disappointing but could be the bottom

**Share Code: MFL – Market Cap: R1.1bn – PE: 15.1x – DY: 5.6%**

| 12m Target Price | 403cps |
|---|---|
| Share Price | 250cps |
| Implied Return | 61% |

**Business Support | South Africa**

### FY 24 Results: Weaker than expected

- Metrofile's revenue rose only +1% with MRM South Africa's revenue slipping -3% as it was hurt by delayed decisions by customers and lower product and digital revenues that more than offset the good box pricing during the period.
- The MRM Middle East's EBITDA margin fell as management had to fend off two large new entrants in the market; MRM South Africa's scanning margins saw pressure from internal issues; and continued weakness in Kenya saw management impair goodwill by R53.5m in this segment.
- Management has decided to wind-up Tidy Files (successfully executed after year-end), triggering a R19.9m one-off in FY 24.
- All these one-offs combined to negatively hit EPS by c.12.6cps with EPS coming in at 3.9cps (FY 23: 32.1cps) but—excluding the one-offs—the Group's Normalized HEPS declined to 20.0cps (FY 23: 32.1cps).
- Despite these troubles, the Group's cash generation remained strong (R287m of EBITDA generated R309m of cash from operations), degearing continues (Net Debt dropped -9% to R537m) and the Group declared a full-year dividend of 14cps.

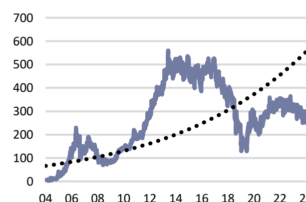
### Our Thoughts: New CEO, revised forecasts

- The Group has a new CEO with a solid background, the current CFO has stepped into MRM South Africa's turnaround as MD, & the Board will announce a new CFO in due course.
- We have been relatively ruthless by lowering some long-term assumptions and downgrading FY 25E HEPS by c.-17% (but still see it recovering from FY 24's trough earnings).

### Forecast, Valuation & Implied Return: Lower discount rate

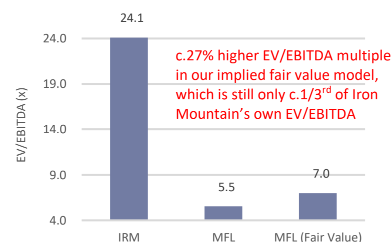
- We see Metrofile's fair value as 347cps (previously: 390cps), implying an EV/EBITDA of 7.0x & a PE of 21.1x; this is less of a downgrade than our forecast earnings as the large drop in South Africa's sovereign bond yields over the period has propped up our segmentally-driven DCF fair values.
- Rolling our fair value forward, we arrive at a total return 12m TP of 403cps (previously: 456cps), implying a high c.61% return (including dividends) from these levels.

**10-year Share Price – Metrofile Holdings Ltd**



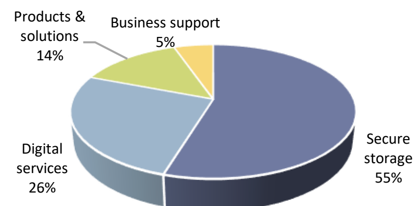

*Sources: I-Net Bridge, Blue Gem Research*

**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 22A | YoY % | FY 23A | YoY % | FY 24A | YoY % | FY 25E | YoY % | FY 26E | YoY % |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 980 | *5%* | 1134 | *16%* | 1141 | *1%* | 1096 | *-4%* | 1194 | *9%* |
| EBITDA | 325 | *1%* | 345 | *6%* | 287 | *-17%* | 318 | *11%* | 346 | *9%* |
| **HEPS (cps)** | **30.8cps** | ***-3%*** | **32.1cps** | ***4%*** | **16.5cps** | ***-49%*** | **27.9cps** | ***69%*** | **34.1cps** | ***22%*** |
| *Return on Equity (%)* | *23.9%* | - | *24.5%* | - | *3.2%* | - | *20.7%* | - | *22.8%* | - |
| Price Earnings Ratio (x) | 8.1x | - | 7.8x | - | 15.2x | - | 9.0x | - | 7.3x | - |
| DPS (cps) | 18cps | *20%* | 18cps | *0%* | 14cps | *-22%* | 16cps | *14%* | 19cps | *19%* |
| *Dividend Yield (%)* | *7.2%* | - | *7.2%* | - | *5.6%* | - | *6.4%* | - | *7.6%* | - |

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

twitter.com/BlueGemResearch

facebook.com/BlueGemResearch


**Keith McLachlan***

BLUE GEM RESEARCH


NOTE: THIS IS COMMISSIONED RESEARCH – www.BlueGemResearch.co.za – **Confused by this report? View our FAQ. Please refer to disclaimer at the end of this document and on website.**

| Key Forecast (R m) | FY 22A | YoY % | FY 23A | YoY % | FY 24A | YoY % | FY 25E | YoY % | FY 26E | YoY % |
|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | **980** | ***5%*** | **1134** | ***16%*** | **1141** | ***1%*** | **1096** | ***-4%*** | **1194** | ***9%*** |
| MRM South Africa | 539 | *-2%* | 613 | *14%* | 606 | *-1%* | 637 | *5%* | 669 | *5%* |
| MRM Rest of Africa | 91 | *-9%* | 105 | *15%* | 104 | *0%* | 111 | *7%* | 120 | *7%* |
| MRM Middle East | 86 | *10%* | 99 | *15%* | 120 | *21%* | 120 | *0%* | 138 | *15%* |
| Products & Services | 264 | *27%* | 318 | *20%* | 311 | *-2%* | 228 | *-27%* | 267 | *17%* |
| **EBITDA** | **325** | ***1%*** | **345** | ***6%*** | **287** | ***-17%*** | **318** | ***11%*** | **346** | ***9%*** |
| *EBITDA Margin (%)* | *33.2%* | - | *30.4%* | - | *25.2%* | - | *29.0%* | - | *29.0%* | - |
| Operating Profit | 240 | *0%* | 255 | *6%* | 200 | *-22%* | 244 | *22%* | 268 | *10%* |
| Net finance charges | -49 | *-1%* | -58 | *18%* | -68 | *17%* | -80 | *18%* | -69 | *-13%* |
| **Net Profit (Parents)** | **134** | *-3%* | **138** | *3%* | **17** | *-88%* | **118** | *609%* | **144** | *22%* |
| *Weighted Ave. Number of Shares (millions)** | *433.7* | *0%* | *429.2* | *-1%* | *422.6* | *-2%* | *422.2* | *0%* | *422.2* | *0%* |
| **EPS (Continuing Operations - cps)** | **30.8cps** | *-3%* | **32.1cps** | *4%* | **3.9cps** | *-88%* | **27.9cps** | *609%* | **34.1cps** | *22%* |
| **HEPS (cps)** | **30.8cps** | *-3%* | **32.1cps** | *4%* | **16.5cps** | *-49%* | **27.9cps** | *69%* | **34.1cps** | *22%* |
| **Normalized HEPS (cps)**** | - | - | **32.1cps**** | - | **20.0cps**** | *-38%*** | - | - | - | |
| *Price Earnings Ratio (x)* | *8.1x* | - | *7.8x* | - | *15.2x* | - | *9.0x* | - | *7.3x* | - |
| **Dividend Per Share (cps)** | **18cps** | ***20%*** | **18cps** | ***0%*** | **14cps** | ***-22%*** | **16cps** | ***14%*** | **19cps** | ***19%*** |
| *Dividend Yield (%)* | *7.2%* | - | *7.2%* | - | *5.6%* | - | *6.4%* | - | *7.6%* | - |
| *Dividend Cover (x)* | *1.7x* | - | *1.8x* | - | *1.2x* | - | *1.7x* | - | *1.8x* | - |
| Property, Plant & Equipment | 610 | *2%* | 607 | *-1%* | 612 | *1%* | 590 | *-4%* | 575 | *-2%* |
| Goodwill | 372 | *19%* | 374 | *0%* | 307 | *-18%* | 307 | *0%* | 307 | *0%* |
| Intangible Assets | 68 | *55%* | 70 | *3%* | 61 | *-13%* | 45 | *-26%* | 30 | *-34%* |
| Total Assets | 1492 | *10%* | 1575 | *6%* | 1509 | *-4%* | 1540 | *2%* | 1616 | *5%* |
| Shareholder's Equity (Parent) | 560 | *0%* | 563 | *1%* | 516 | *-8%* | 568 | *10%* | 632 | *11%* |
| NAV per share (cps) | 129cps | *0%* | 133cps | *3%* | 122cps | *-8%* | 135cps | *10%* | 150cps | *11%* |
| Net Debt | 446 | *3%* | 496 | *11%* | 537 | *8%* | 448 | *-17%* | 366 | *-18%* |
| *Net Debt:EBITDA (x)* | *1.4x* | - | *1.4x* | - | *1.9x* | - | *1.4x* | - | *1.1x* | - |
| *Net Debt:Equity* | *0.8* | - | *0.9* | - | *1.0* | - | *0.8* | - | *0.6* | - |
| Free Cash Flow | 213 | *2%* | 169 | *-21%* | 218 | *129%* | 220 | *101%* | 216 | *98%* |
| Free Cash Flow / EBITDA Conversion (%) | 65% | - | 49% | - | 76% | - | 69% | - | 62% | - |
| ***Free Cash Flow Yield (%)*** | ***13.3%*** | - | ***10.6%*** | - | ***13.7%*** | - | ***13.8%*** | - | ***13.5%*** | - |
| ***Return on Equity (%)*** | ***23.9%*** | - | ***24.5%*** | - | ***3.2%*** | - | ***20.7%*** | - | ***22.8%*** | - |
| ***Return on Assets (%)*** | ***9.0%*** | - | ***8.8%*** | - | ***1.1%*** | - | ***7.6%*** | - | ***8.9%*** | - |
| *Price Earnings Ratio (x)* | *8.1x* | - | *7.8x* | - | *15.2x* | - | *9.0x* | - | *7.3x* | - |
| *Price-to-Book (x)* | *1.9x* | - | *1.9x* | - | *2.0x* | - | *1.9x* | - | *1.7x* | - |
| *Current Ratio* | *1.3x* | - | *0.5x* | - | *1.6x* | - | *2.1x* | - | *2.4x* | - |

*Sources: Metrofile Holdings various reports, Refinitiv, Iress, Profile Media, & Blue Gem Research workings & assumptions; * 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; ** Normalized HEPS as per management disclosure.*

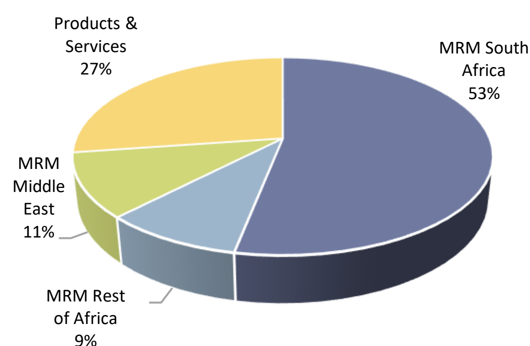
## Summary of FY 24 Results

Metrofile Holdings (code: MFL) reported disappointing results as the expected H2:24 recovery went the other way due to weak performances across most of the Group but particularly out of scanning in South Africa, the Middle East regions margins and weak sales in Products & Solutions:

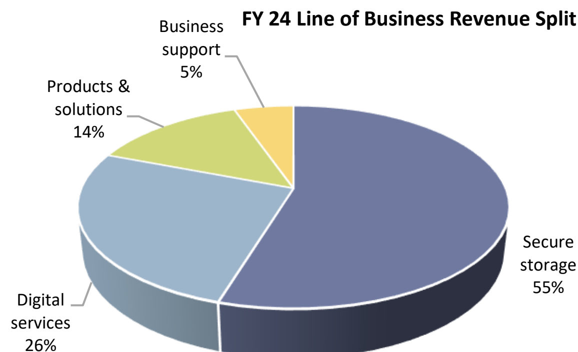
- Group revenue rose only +1% (we had forecast +5%) with MRM South Africa's revenue slipping -3% (we had forecast +5%) to R605m (FY 23: R625m) versus our expectations of R643m. This was mostly driven by delayed decisions by customers in the build-up to the pivotal May 2024 Election in South Africa with slower product sales and revenues from digital despite good box pricing dynamics.
- The MRM Middle East's EBITDA margin fell close to break-even (we expected c.R27m EBITDA here) in order to fend off two large new entrants into the market that were discounting boxes to below cost. MRM South Africa's scanning margins saw pressure from internal issues (corrective action has been taken and we should see better margins during FY 25E). This all resulted in the Group's EBITDA falling to R287m (FY 23: R345m), before considering the below one-offs.
- Particularly Tidy Files was a disappointment and management has decided to wind the business's manufacturing operations up (successfully done after year end), triggering a R19.9m retrenchment one-off. Continued weakness in Kenya saw management impair goodwill by R53.5m in this segment.
- These one-offs combined to negative hit EPS by c.12.6cps with EPS coming in at 3.9cps (FY 23: 32.1cps). perhaps more reflective of operations and excluding the one-offs, the Group's *Normalized* HEPS declined to 20.0cps (FY 23: 32.1cps), missing our expectations of 27.2cps for the period.
- Despite these troubles, the Group's cash generation remained strong (R287m of EBITDA generated R309m of cash from operations), degearing continues (Net Debt dropped -9% to R537m) and the Group declared a full-year dividend of 14cps (putting the stock on a current Dividend Yield of >5%).

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

**FY 24 Regional Revenue Split**




**FY 24 Line of Business Revenue Split**




*Sources: Metrofile Holdings various reports & Blue Gem Research workings and assumptions*

- In FY 24, management bought back 1.5m shares (VWAP of c.297cps) and concluded the final settlement for the remaining 30%-stake in IronTree (for R70m) ~ it is now a 100%-held subsidiary.
- After year-end, Pfungwa Serima stepped down as CEO of the Group, handing the reins to Thabo Seopa (he hails from co-founding an asset management business and previously being the CEO and MD of Trudon, the publisher of Yellow Pages and the Phone book). Shivan Mansingh has moved to being the MD of MRM South Africa and, while the Group locates a permanent CFO, remains CFO too.
- In this report, we go into detail in reworking our forecasts, stripping out Tidy Files' exited operation, adjusting revenue and margin expectations across some operations (most notably the Middle East) and revisiting some box and services assumptions (including lifting IronTree forecasts).
- Overall, despite the simultaneous FY24 challenges, the core of the Group remains inherent profitable, cash generative, its balance sheet is steadily degearing & the recent change in management and the Group's main shareholders hint at future optionality.

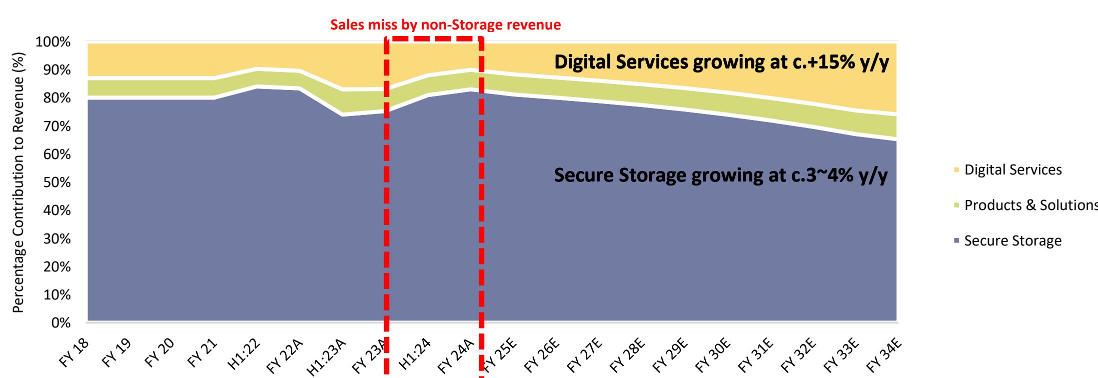
## MRM South Africa

| Forecast & DCF (Rm's): | FY 23A | FY 24A | FY 25E | FY 26E | FY 27E | FY 28E | FY 29E | FY 30E | FY 31E | FY 32E | FY 33E | FY 34E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Net Box Growth (y/y %)* | *-4.5%* | *-1.4%* | *-0.7%* | *-0.2%* | *0.1%* | *-0.6%* | *-1.4%* | *-2.1%* | *-2.9%* | *-3.6%* | *-4.4%* | *-5.1%* |
| *Non-storage Revenue (%)* | *25.0%* | *17.0%* | *18.8%* | *20.0%* | *21.2%* | *22.6%* | *24.1%* | *25.9%* | *28.0%* | *30.3%* | *33.0%* | *34.8%* |
| *EBITDA Margin (%)* | *40.9%* | *34.6%* | *38.8%* | *37.7%* | *36.8%* | *36.0%* | *34.8%* | *33.4%* | *31.6%* | *29.7%* | *27.5%* | *23.8%* |
| **Revenue** | **625** | **606** | **637** | **669** | **707** | **746** | **784** | **821** | **856** | **891** | **924** | **941** |
| *Growth (y/y %)* | *16.0%* | *-3.2%* | *5.2%* | *5.1%* | *5.6%* | *5.6%* | *5.1%* | *4.7%* | *4.3%* | *4.0%* | *3.8%* | *1.8%* |
| EBITDA | 256 | 210 | 247 | 252 | 260 | 268 | 273 | 274 | 271 | 264 | 254 | 224 |
| Working Capital | -18 | 26 | -13 | -5 | -5 | -4 | -4 | -5 | -5 | -4 | -4 | 1 |
| Capex | -14 | -18 | -7 | -7 | -2 | -9 | -9 | -9 | -8 | -8 | -8 | -8 |
| Tax | -56 | -47 | -57 | -59 | -61 | -63 | -64 | -65 | -64 | -63 | -60 | -52 |
| **Free Cash Flow (FCF)** | **168** | **171** | **170** | **182** | **193** | **193** | **196** | **195** | **194** | **189** | **182** | **165** |
| *Discount Factor* | | | *0.89* | *0.79* | *0.70* | *0.63* | *0.56* | *0.50* | *0.44* | *0.39* | *0.35* | *0.31* |
| **Discounted FCF** | | | **151** | **144** | **136** | **121** | **109** | **97** | **86** | **74** | **64** | **690** |
| **Enterprise Value (EV)** | | | | | | | | | | | | **R1,671m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | ***8.0x*** |

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

- While average net boxes were slightly weaker than we expected (-1.3% versus our expected -0.2%), secure storage revenue was in line with our expectations as stronger box pricing during the period was achieved (this bodes well for the MRM Middle East after the above average competition there subsides, as MRM South Africa experienced this several years ago and it shows that pricing dynamics should mean revert once normal economics abound in the market).
- The real pressure in this segment lay in the Products & Solutions revenue that was R10m shy of our forecast and the Digital Services that came in nearly a third lower than we expected:
    - A key element of this miss was the fixing of the scanning margins during the period that saw both some lost revenue and higher costs working their way through while customers delaying decisions pushed out product sales revenues.
    - While we had initially expected the corrected scanning margins to solidify in H2:24, this now only appears likely during FY 25E and we have modelled accordingly.
    - Delayed purchases—and weakness in Financials and Public sector—should normalize but, unfortunately, do not seem to have been simply pushed in the FY 25E period and there may remain pressure here (which has seen us lower our forecast for this revenue stream).
- The result of these two sales misses is that this segment's revenue was -3% lower and, with operating leverage, EBITDA fell -18% to R209m (FY 23: 256m).

**Figure 2: MRM South Africa - Revenue Contribution (Historical & Forecast)**




*Sources: Metrofile Holdings, various records & Blue Gem Research workings & assumptions*

- In terms of MRM South Africa's segmental forecasts, we have:
    - **Secure storage**: Adjusted our opening boxes to reflect the small inflow from the wind-up of Tidy Files, lifted our destructions assumptions while maintaining our gross inflow view (we do expect a slight uptick to occur across the next 18 to 24 months) but tweaking our pricing fractionally higher; the net result is a small downgrade to long-term growth assumptions in this revenue stream.

- **Products & Services**: While tricky to forecast given the abnormality during FY 24, we have shaved off nearly c.R11m in FY 25E revenues here but still see it coming in higher than the FY 24 period. Given that FY 25E trading has started somewhat softly, we think this is prudent and have only modelled a recovery in from FY 26E onwards.
- **Digital Services** (i.e. Scanning revenues): Likewise, digital revenues have been marked down in our FY 25E view by c.R31m of revenue (combination of slower recovery but also better pricing to protect margins that potentially losses the segment some contracts), but we have assumed some improved margins from the correct costing. We will revisit particularly these assumptions at H1:25E as this revenue stream and its margins stabilize.
- Our long-term assumption set for the segment remains more or less unchanged, though updated for the current macroeconomic data.

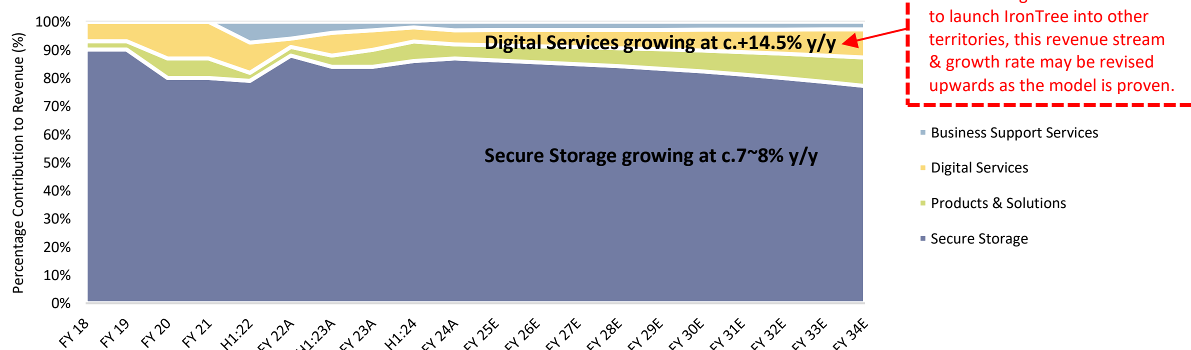
## MRM Rest of Africa

| Forecast & DCF (Rm's): | FY 23A | FY 24A | FY 25E | FY 26E | FY 27E | FY 28E | FY 29E | FY 30E | FY 31E | FY 32E | FY 33E | FY 34E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Net Box Growth (y/y %)* | *2.8%* | *3.5%* | *3.1%* | *4.7%* | *4.2%* | *3.7%* | *3.2%* | *2.7%* | *2.2%* | *1.7%* | *1.2%* | *0.7%* |
| *Non-storage Revenue Contribution (%)* | *16.0%* | *13.0%* | *13.7%* | *14.4%* | *15.1%* | *15.8%* | *16.7%* | *17.6%* | *18.7%* | *19.9%* | *21.3%* | *22.8%* |
| *EBITDA Margin (%)* | *42.3%* | *54.6%* | *51.1%* | *51.1%* | *51.3%* | *51.3%* | *51.2%* | *50.9%* | *50.4%* | *49.7%* | *48.9%* | *48.0%* |
| **Revenue** | **105** | **104** | **111** | **120** | **129** | **139** | **149** | **159** | **169** | **180** | **190** | **201** |
| *Growth (y/y %)* | *14.9%* | *-0.3%* | *6.7%* | *7.4%* | *8.0%* | *7.6%* | *7.2%* | *6.8%* | *6.5%* | *6.1%* | *5.8%* | *5.6%* |
| EBITDA | 44 | 57 | 57 | 61 | 66 | 71 | 76 | 81 | 85 | 89 | 93 | 96 |
| Working Capital | -3 | 4 | -2 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 |
| Capex | -12 | -9 | -16 | -27 | -27 | -27 | -26 | -24 | -22 | -19 | -15 | -10 |
| Tax | -8 | -12 | -12 | -13 | -14 | -15 | -17 | -18 | -19 | -20 | -21 | -22 |
| **Free Cash Flow (FCF)** | **21** | **40** | **27** | **20** | **24** | **28** | **33** | **37** | **43** | **49** | **56** | **64** |
| *Discount Factor* | | | *0.76* | *0.58* | *0.45* | *0.34* | *0.26* | *0.20* | *0.15* | *0.12* | *0.09* | *0.07* |
| **Discounted FCF** | | | **20** | **12** | **11** | **10** | **8** | **7** | **6** | **6** | **5** | **111** |
| **Enterprise Value (EV)** | | | | | | | | | | | | **R197m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | ***3.5x*** |

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

- Consisting of Kenya, Botswana and Mozambique, MRM Rest of Africa's box growth was better than we expected (+3.45% versus our forecast of +2.1%) with firm pricing but other revenues all were weaker than expected.
- The net result was that segment revenue was in line with our expectations and -1% for the period, albeit with strong EBITDA and Operating Profit growth as a c.R7m bad debt was recovered. Reversing this c.R7m bad debt, and margins were more in line with our forecasts.
- Kenya's operations remained weak, though, and management impaired goodwill attributed to it at a Group-level by R53.5m. Management has been changed here and, while we should not expect material short-term results, the Group remains optimistic on the longer-term prospects from this region (we expect IronTree to be rolled out here and/or in the Middle East over the next few reporting seasons).

**Figure 3: MRM Rest of Africa - Revenue Contribution (Historical & Forecast)**




*Sources: Metrofile Holdings, various records & Blue Gem Research workings & assumptions*

- In terms of MRM Rest of Africa's segmental forecasts:
    - We lowered our gross box inflows, lifted our gross destructions (resulting in lower net box growth) and assumed somewhat lower pricing inflation on a per box basis (though, arguably, a fair amount of this from African foreign currency weakness to the Rand).
    - We do note upside in the digital services space from potential offering IronTree (may be branded differently) services into these regions. We will revisit these growth assumptions as this potential is executed on but we have not factored in anything into our forecasts just yet.
    - Like MRM South Africa, our long-term assumption set for the segment remains more or less unchanged, though updated for the current macroeconomic data.

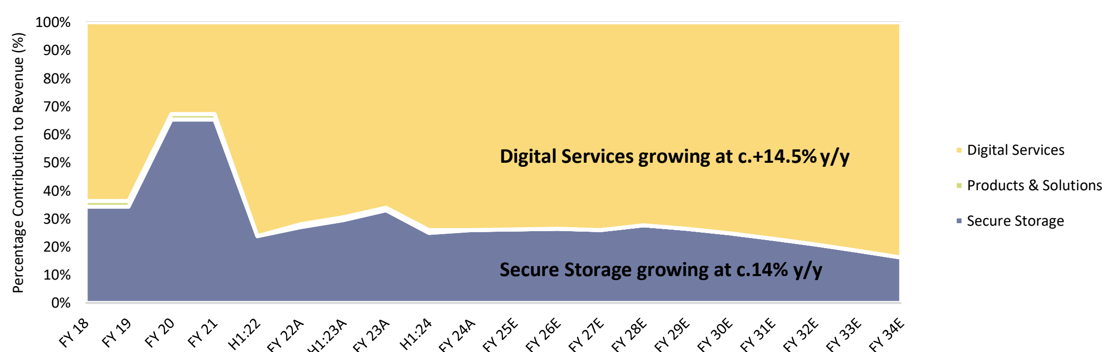
## MRM Middle East

| Forecast & DCF (Rm's): | FY 23A | FY 24A | FY 25E | FY 26E | FY 27E | FY 28E | FY 29E | FY 30E | FY 31E | FY 32E | FY 33E | FY 34E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Net Box Growth (y/y %)* | *9.7%* | *8.8%* | *11.3%* | *9.3%* | *7.3%* | *5.3%* | *3.3%* | *1.3%* | *-0.7%* | *-2.7%* | *-4.7%* | *-6.7%* |
| *Non-storage Revenue Contribution (%)* | *67.0%* | *74.0%* | *73.8%* | *73.6%* | *74.1%* | *72.3%* | *73.6%* | *75.2%* | *77.0%* | *79.2%* | *81.4%* | *83.8%* |
| *EBITDA Margin (%)* | *27.6%* | *6.0%* | *6.2%* | *13.1%* | *18.6%* | *15.4%* | *19.9%* | *23.9%* | *27.4%* | *30.6%* | *33.6%* | *36.5%* |
| **Revenue** | **99** | **120** | **120** | **138** | **157** | **160** | **181** | **202** | **226** | **252** | **280** | **312** |
| *Growth (y/y %)* | *15.3%* | *21.2%* | *0.2%* | *14.9%* | *13.7%* | *2.4%* | *12.5%* | *12.1%* | *11.7%* | *11.5%* | *11.3%* | *11.3%* |
| EBITDA | 27 | 7 | 7 | 18 | 29 | 25 | 36 | 48 | 62 | 77 | 94 | 114 |
| Working Capital | -3 | 3 | -2 | -2 | -2 | -0 | -2 | -3 | -3 | -3 | -3 | -2.3 |
| Capex | -12 | -9 | -18 | -18 | -16 | -13 | -9 | -4 | -7 | -7 | -7 | -6 |
| Tax | - | -0 | -0 | -1 | -2 | -2 | -3 | -4 | -5 | -6 | -8 | -10 |
| **Free Cash Flow (FCF)** | **13** | **1** | **-13** | **-3** | **9** | **9** | **22** | **38** | **47** | **61** | **77** | **96** |
| *Discount Factor* | | | *0.80* | *0.64* | *0.51* | *0.41* | *0.33* | *0.27* | *0.21* | *0.17* | *0.14* | *0.11* |
| **Discounted FCF** | | | **-11** | **-2** | **4** | **4** | **7** | **10** | **10** | **10** | **10** | **313** |
| **Enterprise Value (EV)** | | | | | | | | | | | | **R358m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | ***50.0x*** |

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

- Consisting of operations in the United Arab Emirates ("UAE") and Oman, MRM Middle East saw competitor pressure punctuate this trading period and severely dent its margins.
- Two new large competitors—one is Iron Mountain (code: IRM); see our global comparison later in this note—entered the region and priced below cost to win market share. Management took a tactical decision to lower this segment's prices to retain boxes (and, thus, customers) but they do expect to reverse this pricing regime over the next 3 to 5 years and claw-back to normal margins.
    - **Note**: We have seen this style of competition previously in South Africa when Iron Mountain acquired DocuFile. See our comments in the MRM South Africa section hereon and our previous notes over here. It took approximately 3~4 years for the initial negative impact on margins to reverse to a more normal trading environment).
    - Based solely on this, we think that management's view of a 3 to 5 year margin recovery is not unrealistic and we have modelled this into our forecast for the segment.
- With this context, this segment's revenue actually rose to R120m (FY 23: R99m)—better than our forecast of R116m)—but margins collapsed to near break-even with EBITDA of only R7m (FY 23: R27m) reported (we were looking for an EBITDA of R27m here).

**Figure 4: MRM Middle East - Revenue Contribution - (Historical & Forecast)**




*Sources: Metrofile Holdings, various records & Blue Gem Research workings & assumptions*

- In terms of MRM Middle East's segmental forecasts:
    - Much like the other segments, we have lowered our gross box inflow assumptions and our current per/box pricing but—given the unsustainable price war happening—we have lifted our (long-term) price increase assumptions on a per box basis by 100bps (as margin is clawed back) and we have slightly lowered our gross box outflow assumptions (as new boxes become stickier).
    - Digital revenue assumptions are not markedly changed (slightly raised) while cost-base inflation has been kept at our current run-rate.
    - All other long-term assumptions have been maintained unchanged.
- We do note rising geopolitical risk in pockets across the broader Middle East region and we are watching closely to see if this risk spreads and/or has any effect across operations here.

## Product & Services

**Products & Services**

| **Forecast & DCF (Rm's):** | **FY 23A** | **FY 24A** | **FY 25E** | **FY 26E** | **FY 27E** | **FY 28E** | **FY 29E** | **FY 30E** | **FY 31E** | **FY 32E** | **FY 33E** | **FY 34E** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Non-storage Revenue Contribution (%)* | *96.0%* | *99.0%* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* | *100.0 %* |
| *EBITDA Margin (%)* | *18.1%* | *17.1%* | *21.7%* | *22.9%* | *23.5%* | *22.1%* | *18.5%* | *20.1%* | *19.8%* | *19.5%* | *19.2%* | *17.9%* |
| **Revenue** | **318** | **311** | **228** | **267** | **311** | **353** | **392** | **434** | **470** | **510** | **553** | **590** |
| *Growth (y/y %)* | *20.4%* | *-2.1%* | *-26.7%* | *17.3%* | *16.3%* | *13.7%* | *10.8%* | *10.9%* | *8.3%* | *8.4%* | *8.5%* | *6.7%* |
| EBITDA | 57 | 53 | 50 | 61 | 73 | 78 | 72 | 87 | 93 | 99 | 106 | 105 |
| Working Capital | -13 | 17 | 2 | -5 | -6 | -5 | -5 | -6 | -5 | -6 | -6 | 1 |
| Capex | -18 | -18 | -11 | -12 | -13 | -14 | -16 | -17 | -19 | -21 | -23 | -25 |
| Tax | -10 | -9 | -9 | -12 | -14 | -14 | -11 | -14 | -13 | -13 | -13 | -11 |
| **Free Cash Flow (FCF)** | **17** | **43** | **32** | **33** | **40** | **45** | **41** | **50** | **55** | **59** | **63** | **70** |
| *Discount Factor* | | | *0.89* | *0.79* | *0.70* | *0.63* | *0.56* | *0.50* | *0.44* | *0.39* | *0.35* | *0.31* |
| **Discounted FCF** | | | **28** | **26** | **28** | **28** | **23** | **25** | **24** | **23** | **22** | **546** |
| **Enterprise Value (EV)*** | | | | | | | | | | | | **R773m** |
| ***EV/EBITDA (x)*** | | | | | | | | | | | | ***14.5x*** |

*Sources: Metrofile Holdings, Iress, Profile Media & Blue Gem Research workings & assumptions; *IIronTree is now 100%-held, which boosts this segment's EV and means that IronTree minorities are no longer taken out of the Sum-of-the-Parts (SOTP) in* ***Table 7****.*

- We were too bullish on the recover in the Products & Services segment and this segment only managed a modest revenue growth of +2% to R311m (FY 23: R305m) as Tidy Files and Metrofile VYSION struggled and offset better than expected growth in IronTree:
    - Tidy Files: Following our previous note where we questioned the fit of Tidy Files in the Group, Tidy Files continued its weak trading period and management took the difficult decision to wind the business's manufacturing operations up (its services and storage business was transferred to Metrofile's other businesses). While the wind-up has occurred (successfully) post-period, for the purposes of FY 24, the business's net assets were classified

as Held-for-Sales for a net R15m on the Group's balance sheet. Following discussions with management on this, we have taken the R15m out of the Group's balance sheet in FY 25E (into cash), and removed Tidy Files' manufacturing revenue (about c.10% of Group revenue), its cost-base and its EBITDA (we have assumed break-even at an EBITDA level during FY 24). This reflects in this segment as lower FY 25E revenue but higher EBITDA margin.

  - ClearData: As a confidential destructions business, demand was driven by POPIA legislative requirements and some client acquisitions. Destructions were weighted to Q1 and Q4 of the financial year.
  - Metrofile VYSION: As an enterprise software sales business, the exponential growth of prior periods reversed as customers delayed purchase decisions and pushed out implementations. This negatively impacted on this segment's revenues and profits. We do expect VYSION to recover, but already H1:25E will not reflect this recovery and, thus, we have pushed this recovery out to start during FY 26E.
  - IronTree: As a subscription-based cloud-based IT provider, IronTree has carried on growing strongly during the period and, indeed, we expect it to continue doing so. Metrofile now owns 100% of the business with its final vendor payment flowing through in H2:24. We have fractionally lifted our forecasts here by +1% going forward given its better-than-expected performance.

- In terms of segmental forecasts here, we have tried to strip out Tidy Files (as per management guidance) and have done the following in FY 25E as a base year for this exclusion:
  - Moved its box revenue to MRM South Africa,
  - Removed its Product revenue (c.10% of the Group's revenue or c.R111m, excluding box revenue),
  - Given that it was break-even at an EBITDA level, we have removed its implied operating costs from the segment, &
  - Removed c.R5m of depreciation was associated from the segment too.
- In terms of Products & Services other related segmental forecasts, we have shaved 100bps to 200bps off the growth in Business Support and Product & Solutions revenue growth rates from this segment going forward.
- We will revisit these assumptions after the dust settles on a clean set of numbers post-Tidy Files deconsolidation.

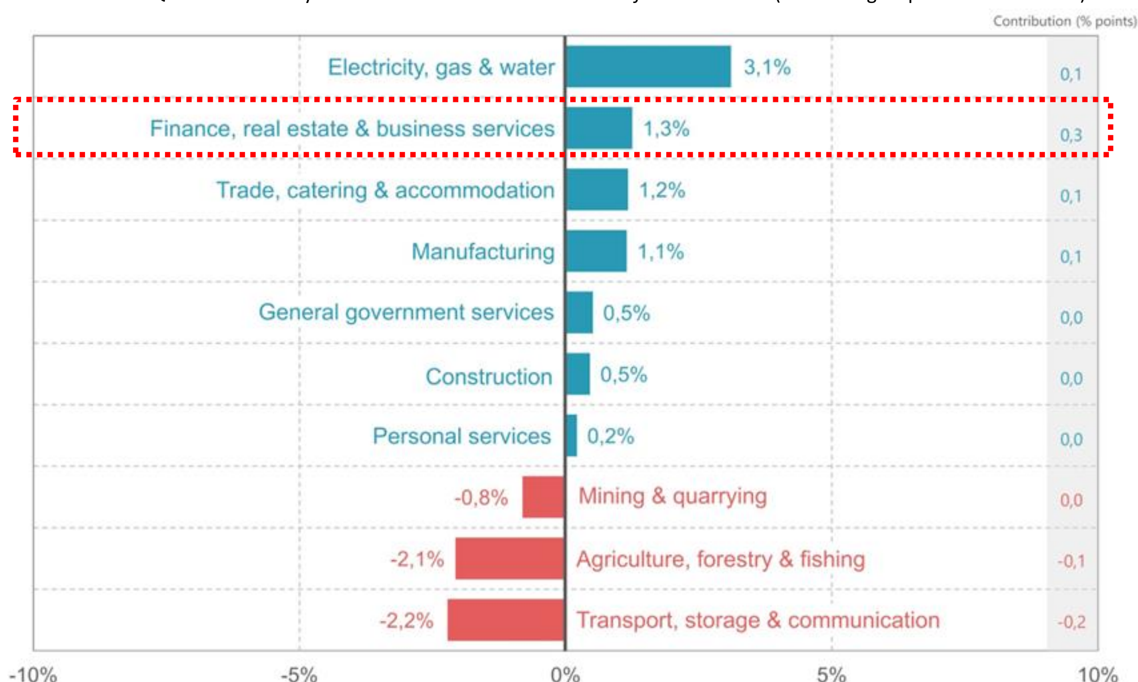
## Macro Environment

**Global Environment: Risk remains**

- **Falling-but-sticky inflation, interest rate cuts starting (but for how long?), & lingering recessionary risks:** Global inflation remains above most central bank targets and, although it is still coming down, it remains to be seen if/when inflation arrives at long-term central bank targets. In the meantime, though, most central banks (including the Fed) are starting to cut interest rates as economic data softens. Whether these rate cuts are too late or not for a "soft landing" remains to be seen and, indeed, not even the central banks themselves know this fact. Finally, growing Chinese macroeconomic risk is attempting to be countered by a rather vague Chinese stimulus package, which further injects uncertainty into global GDP growth and general markets.
- **Geopolitics remains a key concern**: Two major regional wars remain ongoing (indeed, the Middle Eastern conflict appears to be expanding). An incoming USA Election appears quite binary in terms of outcome. All these geopolitical risks are added to with USA-China, China-Taiwan—amongst other—tensions bubbling away under the surface.

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

**Figure 5: South African Q2:24 GDP** – A key sector for Metrofile's "*MRM South Africa*" is finance (the 2nd largest positive contributor)




*Source: StatsSA (link)*

South Africa's economy strengthened in Q2:24 (which lines up with Metrofile's Q4:24 period) but broadly remains vulnerable to external shocks as well as internal frictional challenges.

Externally, China's slowing economy and property sector problems are creating an export drag for South African miners and commodity markets in general. China recently announced a relief package (a combination of monetary easing and fiscal expansionary measures) and its success or failure could directly impact commodity markets and, thus, South Africa's commodity-dependent export economy.

Internally, South Africa's Government of National Unity ("GNU") has seen a surge in positive sentiment and, indeed, some "green shoots" of positive change are occurring (most notably, the initial moves to unbundle Eskom's operations and the tabling of clean-up of South Africa's VISA regime). That said, there remain many challenges from Eskom and Transnet to rampant crime and negative municipal coalitions (e.g. Tshwane Municipality and City of Johannesburg).

Within this context, South African CPI has eased into the South African Reserve Bank's target range of 3-6% (their nominal target is 4.5% and CPI is currently 4.4%). Declining energy and food prices are contributing to this reduction and the stronger Rand exchange rate versus major trade partners all lend to the South African Reserve Bank ("the SARB") recently cutting rates by 25bps (lower than the Fed's recent 50bps cut, though!).

Overall, we think domestic tailwinds are gently starting to blow and medium-term domestic prospects are rising. Despite this, South Africa remains vulnerable to a range of downside risks including external shocks from the numerous global risks lurking around the world.

## Forecast, Valuation & 12m TP Update

- Earlier in this note, we highlighted some of our segmental-level assumptions adjusted. These adjustments were mostly for the FY 25E/26E period and we have left most (but not all – see 'Products

& Services' segment) of our long-term assumptions unchanged (see our Initiation of Coverage for detail & backing on these).

- We have updated some model-wide assumptions and variables, namely:
    - Adjusted our risk-free rate to reflect the South African 10-year bond's higher yield of 9.41% (previously: 10.36%), and
    - Lowered our Cost of Debt to reflect the current interest rates (we have not forecast any interest rate cuts during the period, though note that a shallow rate cutting cycle appears to be occurring).
- The combination of the segmental-level work and the updated global assumptions arrive at a Sum-of-the-Parts (SOTP) fair value of 347cps (previously: 390cps) which is quite a bit higher than the 250cps-range the share price is currently trading at.

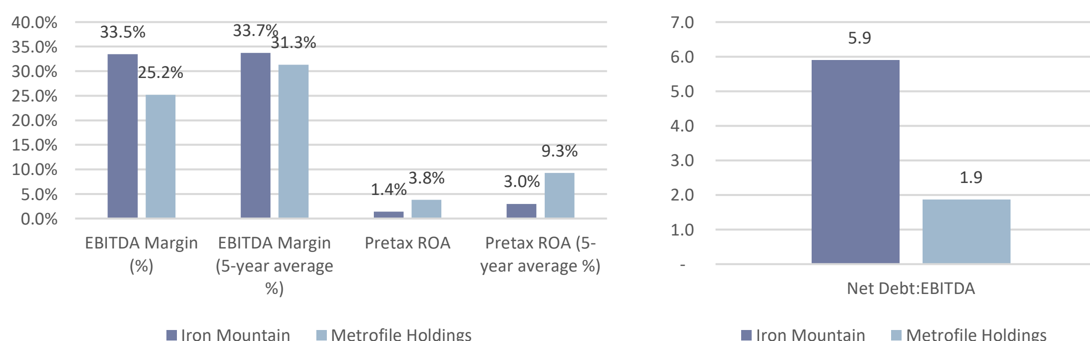
**Table 7: Metrofile Group's Sum-of-the-Parts (SOTP) Fair Value & 12m TP**

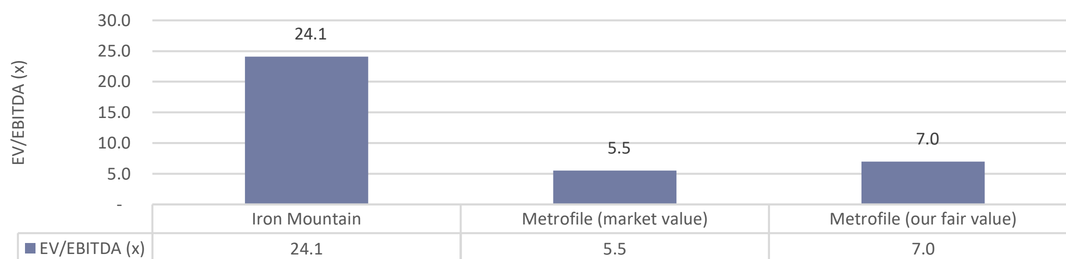
| | Sum-of-the-Parts | Implied EV/EBITDA (x) | Implied Price Earnings (x) |
|---|---|---|---|
| MRM South Africa | R1 671 224 146 | 8.0x | |
| MRM Rest of Africa | R196 758 313 | 3.5x | |
| MRM Middle East | R357 603 025 | 50.0x | |
| Product & Solution | R773 388 705 | 14.5x | |
| Group Central Costs | (R988 359 618) | | |
| Enterprise Value (EV) | R2 010 614 571 | 7.0x | |
| Less: Net Debt | (R537 366 000) | | |
| **Fair Value** | **R1 473 248 571** | | **21.1x** |
| **Fair Value (cps)** | **347cps** | | **21.1x** |
| **12m TP (cps)** | **403cps** | | **14.5x** |

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

- **Table 7's** SOTP fair value for Metrofile implies an EV/EBITDA of 7.0x (Previously: 7.0x) and a Price Earnings (PE) of 21.1x (Previously: 12.9x).
    - Particularly the implied PE multiple is inflated due to the FY 24 earnings pressure.
    - The implied PE is closer to 12.3x when compared to Normalized HEPS, which compares better to the previous implied PE of 12.9x.
- Our best listed comparison (despite being USA-focussed, materially larger and classified as a USA REIT) is Iron Mountain (IRM) – **Figure 6**:
    - Iron Mountain currently trading at an EV/EBITDA of 24x & PE of 154x.
    - This gives us comfort that our implied multiples for Metrofile are not overly bullish.
    - Interestingly, Metrofile has 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.
    - Hence, for a listed comparative, we believe Iron Mountain remains a reasonable (global) peer to compare Metrofile and its valuation against. And, against this measure, Metrofile remains attractive in both fundamentals and valuation, despite its smaller size and Emerging Market risk.

**Figure 6: Metrofile Holdings versus Iron Mountain**



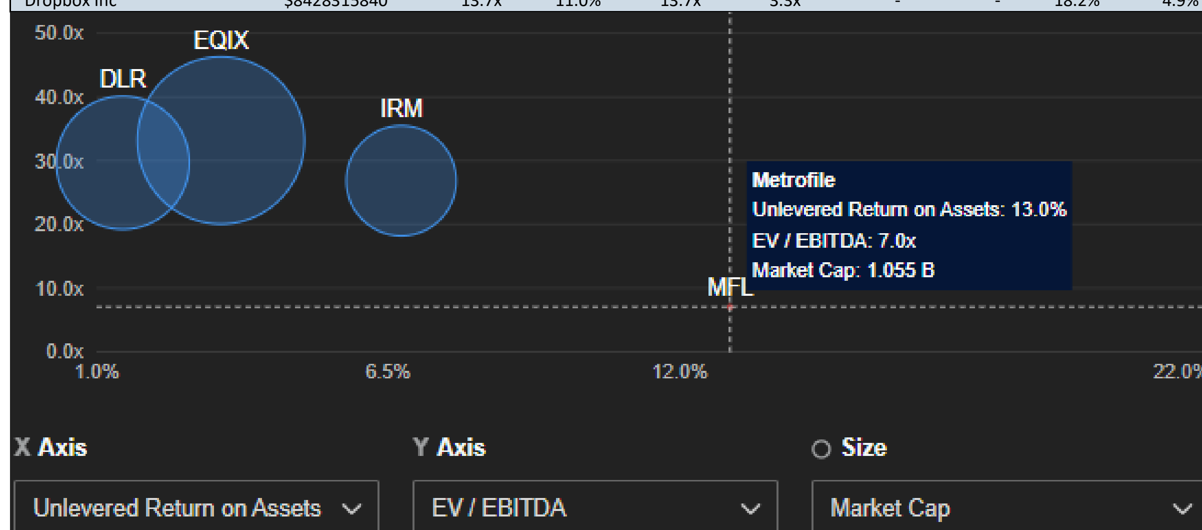



*Sources: Refinitiv, InvestPro, Koyfin & Blue Gem Research workings and assumptions (October 2024)*

- As we have done in the past and given Metrofile's Digital Services growth, it is worth taking this listed peer comparison one step further and (**Table 8)** we compare key metrics between the two documents storage groups *and* their pure-play digital competitors with digital-only substitute products and services.
- This comparison reveals that the market is willing to pay a *premium* on the present digital business models with a view that the future returns will look superior to current returns (some of which does appear to be playing out; see Dropbox's ROA), and/or that the market wants a discount on the traditional storage model given that it is uncertain what future returns will look like in this space with growing digital competitors.
- Logically, as a greater percentage of Metrofile's revenues come from the digital space, this comparison may start to become more material and see the Group's valuation re-rating upwards and, thus, we keep an eye on it and keep updating it with each set of results by the Group (digital revenues now comprise 26% of the Group's revenue with 32% of this Digital revenue coming from cloud services).

**Table 8: 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 %) | Pretax ROA | Pretax ROA (5-year average %) |
|---|---|---|---|---|---|---|---|---|---|
| Iron Mountain | $35300033301 | 24.1x | 21.5% | 154.7x | 6.1x | 2.4% | 5.7% | 1.4% | 3.0% |
| Metrofile Holdings | $66650645 | 5.5x | 13.7% | 15.2x | 0.9x | 5.6% | 5.2% | 3.8% | 9.3% |
| ***Metrofile Discount*** | | ***77%*** | ***-36%*** | ***90%*** | ***85%*** | ***135%*** | ***-8%*** | | |
| **Digital Storage Peer Average** | | **26.2x** | **3.5%** | **46.6x** | **7.6x** | **2.5%** | **2.7%** | **8.1%** | **3.4%** |
| Equinix Inc | $82750258971 | 28.3x | 0.4% | 79.8x | 9.8x | 2.0% | 1.8% | 3.6% | 2.8% |
| Digital Realty Trust Inc | $52624777424 | 36.7x | -0.9% | 46.2x | 9.6x | 3.0% | 3.6% | 2.4% | 2.5% |
| Dropbox Inc | $8428315840 | 13.7x | 11.0% | 13.7x | 3.3x | - | - | 18.2% | 4.9% |




*Sources: Refinitiv, ValuePro, various company reports & Blue Gem Research workings & assumptions (18 October 2024)*

- All in all, we are comfortable with our segmentally-driven SOTP fair value for Metrofile and, given the relative valuation comparatives, this remains a justified valuation approach and a reasonable absolute valuation for the Group's share.
- Rolling our fair value for Metrofile forward by our Cost of Equity, we arrive at a total return 12m TP of c.403cps (previously: 456cps) which implies a c.61% 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:**
    - Global and domestic inflationary and recessionary pressures, particularly in how these influence interest rates via Central Bank decisions,
    - Sovereign, geopolitical and macro risks, including South African, African & Middle Eastern (particularly relevant due to the current conflict in the region, and any expansion that may threaten Metrofile's existing Middle Eastern business) and economic/political deterioration and prospects,
    - A faster macro transition to digital and/or a higher decline in the physical document storage market than we have predicted (some of this has come to bear and we have adjusted longer-term assumptions here downwards – refer to Segmental sections for details),
    - 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 alleviating or improving (give the "GNU" driving positive sentiment, this upside risk may come to pass over the next few years in MRM South Africa),
    - A slower macro transition to digital and/or a lower decline in the physical document storage market than we have predicted (seeming increasingly unlikely),
    - Any growth or pricing assumptions missing to the upside (noting the Middle Eastern box pricing dynamic here as a variable),
    - Excellent execution on or strong traction gained with Metrofile Holdings' digital strategy.

## Disclaimer

NOTE: THIS IS COMMISSIONED RESEARCH **– Confused by this report? View our methodology, FAQ and this disclaimer.**

** Market prices have all been taken as of the closing prices on 18 October 2024.*

**Potentially a Commissioned Report**

With reference to the disclosure contained within the 'Disclosures*' section below, it is possible that Blue Gem Research (Pty) Ltd has agreed with [the Company] Ltd (here after referred to as 'the Company') for the inclusion of the Company in its coverage universe for a certain time period. Part of this agreement includes payment to Blue Gem Research (Pty) Ltd by the Company and, as such, Blue Gem Research (Pty) Ltd, any employees, contractors and/or analysts who worked on this report cannot be considered independent in any way. Thus, this is a commissioned report and cannot be considered financial advice, investment advice or any such similar material.

In the event that this is not a 'Commissioned Report', then all the usual disclaimers concerning independent research are applicable per industry norms.

**Ownership of the Report**

This report is the property of Blue Gem Research (Pty) Ltd, but may be freely distributed so long as in the act of such a distribution no additions to, deletions from and modifications to this report are made. Furthermore, no party without the express permission of Blue Gem Research (Pty) Ltd may sell this report or make any direct form of compensation from the re-distribution thereof.

**Frequency of Next Update**

The frequency of new and/or updated report is left at the discretion of Blue Gem Research (Pty) Ltd. No guaranty or promise is made for any level of frequency or timeliness concerning an update or related report with regards to this report.

**Disclosures***

A. The analyst is an officer, board member, or director of the Company
B. The Company is a client of Blue Gem Research (Pty) Ltd (i.e. this is a Commissioned Report) and Blue Gem Research (Pty) Ltd has received money in exchange for the production of this report.
C. Analyst holds long or short personal positions in a class of common equity securities of this company

| Metrofile Holdings Ltd | B, C |
|---|---|

**Financial Numbers, Forecasts, Valuations and other Assumptions**

While every effort has been made by Blue Gem Research (Pty) Ltd to ensure the accuracy and integrity of the financial numbers, ratios, forecast, valuations and other quantitative and qualitative data in this report, Blue Gem Research (Pty) Ltd does not warranty or guaranty its accuracy. The reader relies on this data and information from this report at his/her own risk. Furthermore, in the case of forecasts and valuations, Blue Gem Research (Pty) Ltd wholly and completely cannot be held liable for any damage or loss caused by any individual, collection of individuals or business or any other party by said party acting or not acting based on the forecasts and valuation(s) included in this report. By their very nature, forecasts and valuations may not be accurate and, indeed, may be wholly and completely wrong.

**Legal Entities**

To South African Residents: Blue Gem Research (Pty) Ltd is not an Authorised Financial Services Provider. This report is not financial advice, investment advice or any such similar material. **This report constitutes "marketing information".** Blue Gem Research (Pty) Ltd and/or its employees and/or officers have no knowledge of any reader's or readers' financial position(s) and, hence, this cannot in any way be construed as direct or indirect advice leading any person or persons to act thereon. Any decision made or not made which can in any way be linked to this report is solely the responsibility of the party or parties making such a decision. I.e. Blue Gem Research (Pty) Ltd cannot be held liable for any result based on any decision that can be directly or indirectly linked to this report.

**General**

For the purposes of this report Blue Gem Research (Pty) Ltd refers to all employees of Blue Gem Research (Pty) Ltd. This research report is based on information from sources that Blue Gem Research (Pty) Ltd believes to be reliable. Whilst every care has been taken in preparing this document, no research analyst or employee or director of Blue Gem Research (Pty) Ltd gives any representation, warranty or undertaking and accepts no responsibility or liability as to the accuracy or completeness of the information set out in this document (except with respect to any disclosures relative to members of Blue Gem Research (Pty) Ltd and the research analyst/s involvement with any issuer referred to above. All views, opinions and estimates contained in this document may be changed after publication at any time without notice. Past performance is not indicative of future results. The investments and strategies discussed here may not be suitable for all investors or any particular class of investors; if you have any doubts you should consult your investment advisor. The investments discussed may fluctuate in price or value. Changes in rates of exchange may have an adverse effect on the value of investments. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Employees of Blue Gem Research (Pty) Ltd and/or their respective directors' may own the investments of any of the issuers discussed herein and may sell them to or buy them from clients on a principal basis. This report is intended solely for clients and prospective clients of Blue Gem Research (Pty) Ltd and is not intended for, and may not be relied on by persons to whom this report may not be provided to by law. This report is for information purposes only. By accepting this document, you agree to be bound by the foregoing limitations and release Blue Gem Research (Pty) Ltd from any potential legal or otherwise liability.

**NOT FOR DISTRIBUTION OUTSIDE OF SOUTH AFRICA.**