

Significant convertible note deal provides two-year window

Shekel Brainweigh Limited (ASX:SBW) has announced the issue of a US\$5m 4-year convertible note to a single investor, Kvutzat Yavne, a Kibbutz from the central district of Israel. The note holder will receive a 7% interest rate paid quarterly and have the right to convert ALL notes into equity two years from the issue date, or upon a transaction involving the sale of all or part of the business at 75% of the 25-day VWAP. For existing shareholders the company now has significant funding and a two-year window to deliver both renewed sales in the core scales business and meaningful sales in the new retail innovation division to ensure a higher share price and limited equity dilution. There are a number of positives for sales growth heading into CY21 including the first “Hubz” vending kit sales expected from Q2CY21, the annualisation of three new scales customers late in 2H20 and an expected “FastTrack” self-checkout launch in 2HCY21. The group is also cycling a 10% decline in retail self-checkout sales and a 45% decline in own brand weighing equipment. From a numbers viewpoint we have increased our operating costs by 12% or US\$1.2m as new human resources are added, while incorporating for the first time some revenue from “Industrial special projects” given greater resources.

Business model

SBW produces weighing scale hardware/software that is employed by OEMs for self-checkout and healthcare applications requiring speed and accuracy. Prices received from customers are typically fixed, and gross margins are in-line with that achieved by most OEM equipment suppliers. The group is looking to extend this market leading technology into new verticals, opening up larger market opportunities, potentially higher gross margins and some recurring SaaS style revenue from data analytics. One of the new verticals (Innovendi vending machines) is in commercialisation while others are nearing commercialisation (Micro-market Capsule and the Hubz).

Keys to the convertible note issue

We view the convertible note terms issued to Kvutzat Yavne as attractive to both Kvutzat Yavne and existing SBW shareholders. For Kvutzat Yavne, it secures a 7% interest rate for 2-years and a 25% discount to the VWAP on conversion from March 2023. For existing SBW shareholders, funding now looks sufficient to deliver the promises and potential of new products, predominantly the Hubz, Micro-market capsule and Fast-track. Delivery of such sales should result in a higher share price and limited dilution from the note issue.

Base case valuation A\$0.35/share with implied dilution

Our base case DCF valuation for SBW remains at \$0.35/share, with higher cost assumptions offset by new revenue assumptions. In terms of potential dilution from the convertible note issue, we have assumed a share price at conversion of \$0.40, which is our DCF before any dilution, implying dilution of 15% to the current share count. We continue to highlight investors are paying nothing for the “new retail” division if the underlying core scales business is valued at 8x our estimated underlying EBIT.

Historical earnings and RaaS Advisory estimates on a reported basis

Year end	Revenue (US\$m)	EBIT (US\$m)	NPAT (US\$m)	EPS (c)	PER (x)	EV/sales(x)
12/19a	18.8	(2.1)	(2.4)	(0.02)	(5.6)	0.60
12/20a	18.3	(4.0)	(4.4)	(0.02)	(4.9)	0.75
12/21e	22.6	(1.6)	(2.1)	(0.01)	(10.4)	0.71
12/22e	27.6	1.9	1.3	0.01	9.5	0.58

Source: Company Data, RaaS Advisory Estimates

Technology – Hardware/software

1 April 2021

Share details

ASX Code	SBW
Share price 30 Mar 21	\$0.145
Market Capitalisation	\$22.2M
Shares on issue	153.2M
Enterprise value	\$18.2M
Cash at 30 Jan '20	A\$4.0M
Free float	~27%

Share performance (12 months)



Upside Case

- Strong growth expected in the group's core self-checkout and healthcare markets
- New verticals have commenced commercialisation, with significant opportunities.
- Mix shift to recurring SaaS fees will increase gross margins and lower days receivables

Downside Case

- Low liquidity with ~27% free float
- Currency translation from USD and AASB16 adds complexity for investors
- Near term ROE likely to be impacted by R&D expenditure

Management

Arik Schor	Executive Chairman
Barak Nir	Chief Financial Officer
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Key implications from the US\$5m convertible note issue

Convertible note structure

The key points to note with regards to the structure of the convertible note are listed below:

- **4-year maturity date**
- **7% interest rate, payable quarterly**
- **Exercise of ALL notes (not some) into equity possible after 2-years**
- **...or upon the sale of the company or most of its assets, a capital raise >5% shares on issue or de-listing**
- **A conversion price of 75% of the VWAP during the preceding 25-days.**

Our view is that this is a very fair structure for both parties, providing a genuine runway for SBW to deliver on new product developments and boost what we consider to be an already undervalued share price without the share overhang that can accompany these types of facilities.

The noteholder gets solid quarterly income and an opportunity to covert into equity at a 25% discount after 2-years. Clearly the share price after 2-years will be all important in the dilution, with various issue prices and resulting dilution listed in the table below.

Exhibit 1: Convertible note dilution at various share prices					
Share price (A\$)	\$0.14	\$0.25	\$0.35	\$0.45	\$0.55
75% discount	0.11	0.19	0.26	0.34	0.41
Shares issued	62.7	35.1	25.1	19.5	15.9
Dilution on current share count	41%	23%	16%	13%	10%

Source: RaaS estimates

Use of funds

We have adjusted our numbers to reflect the likely use of capital, which we estimate to include:

- **Higher Sales & marketing**, (estimated at US\$600kp.a) as the business looks to strengthen relationships directly with retailers, having solely relied on integrators previously.
- **Higher R&D expenditure** (estimated at US\$600kp.a. in the P&L together with US\$400k in capitalised software) as the group invests in more project managers, Dev-ops and support engineers for both “traditional” and “new retail” projects.
- **Reduction in the working capital facility**, which reached 72% of working capital in CY20, having averaged ~60% in the prior 3-years.

SBW has a number of significant programs on the go, and the addition of predominantly human resources across these projects should aid in the timeliness and quality of project delivery to market. The key question is do these additional costs just deliver our previously forecast revenue (i.e. have we underestimated the cost of delivering revenue) or does it accelerate revenue opportunities over and above that forecast.

Increases sales probability and/or acceleration

Our numbers have nothing for Fast-track (a hardware/software product aimed at better identifying products at self-checkouts for use on most self-checkout units, new and already in the field), “Industrial special projects”, which are said to be “highly profitable and carry high top-line sales”, or “Smart carts”.

The US\$5m convertible note raise together with the existing US\$3m in cash at January 2021 both increases the probability of our existing sales assumptions being achieved and increases the likelihood that new sales streams can be delivered in our view.

Key changes to earnings assumptions

On the back of the US\$5m convertible note raise we have made the following changes to our earnings assumptions:

- **Increased operating costs by US\$1.2m near-term (+12%)** which represents predominantly human resources at the Sales & marketing and R&D lines.
- **Increased capitalised software expense by US\$400k for CY21**
- **Increased interest expense by US\$350k p.a**
- **Added a revenue stream for “Industrial special projects”** given the human resources now available to the company to deliver such projects.

While FastTrack also looks a highly likely we don’t have enough visibility on the likely operating metrics to incorporate this into our numbers at present. The same can be said for “Smart Carts”.

- **Kept our existing unit sales assumptions across the product portfolio unchanged, which are listed below.**

Exhibit 2: SBW new product sales by units

Year-end	2019F	2020F	2021F	2022F	2023F
Innovendi	na	41	170	190	200
Hubz Kit	0	10	600	1,100	1,500
Smart Shelves		50	175	350	900
Capsules	0	0	16	36	80

Source: Company Financials & RaaS estimates

Valuation implications

Our DCF valuation has increased from A\$0.35/share to A\$0.40/share before any dilution of the convertible note, and any (downward) adjustment to the discount rate associated with funding security.

If we use our DCF valuation as a guide to the likely share price at conversion, then this would imply 15% dilution on conversion (an issue price of \$0.30/share), and as a result our adjusted (fully diluted) DCF is unchanged at \$0.35/share.

Exhibit 3: Financial Summary

Shekel Brainweigh (SBW.ASX)						Share price (30 March 2021)						A\$	0.145				
Profit and Loss (US\$m)						Interim (US\$m)						H119A	H219A	H120A	H220A	H121F	H221F
Y/E 31 Dec	FY18A	FY19A	FY20A	FY21F	FY22F	Revenue	8.4	10.4	7.9	10.4	8.7	13.9					
Revenue	18.7	18.8	18.3	22.6	27.6	EBITDA	(1.6)	(0.3)	(1.6)	(1.0)	(1.8)	0.9					
Gross profit	8.3	8.2	7.4	10.5	13.2	EBIT	(1.7)	(0.4)	(2.1)	(1.9)	(2.1)	0.5					
GP margin %	44.5%	43.7%	40.6%	46.4%	48.0%	NPATA (adjusted)	(1.6)	(0.9)	(1.8)	(1.6)	(2.1)	0.5					
EBITDA	(0.3)	(1.9)	(2.7)	(0.9)	2.6	Adjustments	(0.5)	(0.8)	(0.7)	(0.3)	(0.2)	(0.2)					
Depn	(0.2)	(0.2)	(0.4)	(0.2)	(0.2)	NPAT (reported)	(2.1)	(1.6)	(2.5)	(1.9)	(2.4)	0.3					
Amort	0.0	0.0	(0.9)	(0.5)	(0.5)	EPS (adjusted)	(0.011)	(0.006)	(0.012)	(0.011)	(0.014)	0.003					
EBIT	(0.5)	(2.1)	(4.0)	(1.6)	1.9	EPS (reported)	(0.015)	(0.012)	(0.016)	(0.012)	(0.015)	0.002					
Interest	(0.7)	(0.3)	(0.4)	(0.5)	(0.6)	Dividend (cps)	0.000	0.000	0.000	0.000	0.000	0.000					
Tax	0.1	(0.0)	(0.0)	0.0	0.0	Imputation	0.0	0.0	0.0	0.0	0.0	0.0					
Minorities	0.0	0.0	0.0	0.0	0.0	Operating cash flow	na	na	na	na	na	na					
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0	Free Cash flow	na	na	na	na	na	na					
NPAT pre significant items	(1.2)	(2.4)	(4.4)	(2.1)	1.3	Divisionals	H119	H219	H120	H220F	H220F	H220F					
Significant items	(0.4)	(0.8)	0.0	0.0	0.0	Traditional Scales	8.4	10.4	7.8	10.2	7.5	11.7					
NPAT (reported)	(1.5)	(3.2)	(4.4)	(2.1)	1.3	New Retail	-	-	0.1	0.2	1.2	2.2					
Cash flow (US\$m)							Total Revenue	8.4	10.4	7.9	10.4	8.7	13.9				
Y/E 31 Dec	FY18A	FY19A	FY20A	FY21F	FY22F												
Adj EBITDA inc. rent	0.8	(0.7)	(2.3)	(0.5)	3.0	Gross profit	3.8	4.4	3.2	4.3	3.9	6.6					
Interest	(0.2)	(0.2)	(0.4)	(0.5)	(0.6)	Gross Profit Margin %	45.5%	42.2%	39.7%	41.3%	44.9%	47.3%					
Tax	0.0	0.2	0.0	(0.0)	0.0	R&D	2.1	0.8	1.4	1.9	1.8	1.8					
Working capital changes	0.5	(0.9)	1.1	(1.7)	(1.7)	General & Admin & Other	3.0	3.0	3.2	3.2	3.7	3.6					
Operating cash flow	1.2	(1.6)	(1.5)	(2.8)	0.7	One-off costs & Non-cash	0.4	0.9	0.2	0.3	0.2	0.2					
Mtce capex	(0.1)	(0.2)	(0.3)	(0.3)	(0.3)	Total costs	5.4	4.7	4.8	5.3	5.7	5.6					
Free cash flow	1.0	(1.8)	(1.8)	(3.1)	0.4	EBITDA	(1.6)	(0.3)	(1.6)	(1.0)	(1.8)	1.0					
Capitalised Software	(0.8)	(1.3)	0.0	(0.4)	0.0	EBITDA margin %	(19.2%)	(3.0%)	(20.6%)	(9.9%)	(20.3%)	7.3%					
Acquisitions/Disposals	(0.2)	(0.1)	0.0	0.0	0.0	Margins, Leverage, Returns	FY18A	FY19A	FY20A	FY21F	FY22F						
Other	0.0	0.0	0.0	0.0	0.0	EBITDA margin %	(1.7%)	(10.2%)	(14.5%)	-4.1%	9.5%						
Cash flow pre financing	0.0	(3.2)	(1.8)	(3.5)	0.4	EBIT margin %	(2.8%)	(11.1%)	(21.9%)	-7.0%	7.0%						
Equity	6.1	0.0	0.0	0.0	0.0	NPAT margin (pre significant items)	(6.2%)	(13.0%)	(24.0%)	-9.3%	4.9%						
Debt	(0.4)	0.0	0.0	0.0	0.0	Net Debt (Cash)	-	6.25	-	2.57	-	1.48					
Net Dividends paid	0.0	0.0	0.0	0.0	0.0	Net debt/EBITDA (x)	(x)	nm	nm	nm	nm	nm					
Net cash flow for year	5.7	(3.2)	(1.8)	(3.5)	0.4	ND/ND+Equity (%)	(%)	33.8%	21.4%	21.7%	(25.3%)	(20.1%)					
Balance sheet (US\$m)							EBIT interest cover (x)	(x)	n/a	n/a	n/a	n/a	30.9%				
Y/E 31 Dec	FY18A	FY19A	FY20A	FY21F	FY22F	ROA		(2.2%)	(10.6%)	(21.8%)	(8.1%)	7.8%					
Cash	6.3	2.6	1.5	4.0	4.0	ROE		(9.4%)	(25.9%)	(82.5%)	(43.4%)	21.7%					
Accounts receivable	5.6	5.8	5.4	6.4	7.5	NTA (per share)		0.11	0.07	0.03	0.02	0.02					
Inventory	3.2	3.5	3.5	4.4	5.6	Working capital		6.9	7.8	6.7	8.4	10.2					
Other current assets	2.0	1.5	1.7	2.0	2.4	WC/Sales (%)		37.0%	41.6%	36.6%	37.2%	36.9%					
Total current assets	17.0	13.4	12.1	16.9	19.5	Revenue growth		2.4%	0.9%	(2.7%)	23.5%	21.9%					
PPE	0.5	0.6	0.6	0.7	0.8	EBIT growth pa		nm	nm	nm	n/a	(222.4%)					
Intangibles	2.0	3.2	2.3	2.2	1.8	Pricing		FY18A	FY19A	FY20A	FY21F	FY22F					
Right of Use Asset	0.0	2.4	2.0	1.1	2.7	No of shares (y/e)	(m)	113	139	153	153	153					
Deferred tax asset	0.0	0.0	0.0	0.0	0.0	Weighted Av Dil Shares	(m)	113	139	153	153	153					
Other non current assets	0.2	0.0	0.0	1.4	3.0	EPS Reported	US cps	(0.01)	(0.02)	(0.02)	(0.01)	0.01					
Total non current assets	2.7	6.2	4.9	5.5	8.2	EPS Normalised/Diluted	US cps	(0.01)	(0.02)	(0.02)	(0.01)	0.01					
Total Assets	19.7	19.6	17.0	22.4	27.7	EPS growth (norm/dil)		nm	nm	nm	nm	-210%					
Accounts payable	1.9	1.5	2.2	2.4	2.9	DPS	cps	0.000	0.000	0.000	0.000	0.000					
Short term debt	4.0	4.1	4.8	5.5	6.7	DPS Growth		n/a	n/a	n/a	n/a	na					
Lease Liability	0.0	1.8	1.6	0.9	2.5	Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%					
Other	1.4	2.6	2.7	3.4	4.1	Dividend imputation		0	0	0	0	0					
Total current liabilities	7.2	9.9	11.4	12.2	16.2	PE (x)		21.2	-	5.6	-	4.9	-				
Long term debt	0.0	0.0	0.0	5.0	5.0	PE market		12.0	-	12.0	-	12.0	-				
Other non current liabs	0.3	0.3	0.3	0.3	0.3	Premium/(discount)			(146.7%)	(141.2%)	(187.0%)	(21.2%)					
Total long term liabilities	0.3	0.3	0.3	5.3	5.3	EV/EBITDA		nm	nm	(5.5)	(17.0)	5.0					
Total Liabilities	7.5	10.2	11.7	17.5	21.5	FCF/Share	US cps	(0.007)	(0.018)	(0.010)	(0.025)	(0.000)					
Net Assets	12.3	9.5	5.3	4.9	6.2	Price/FCF share		(15.5)	(5.8)	(9.8)	(4.0)	(280.2)					
Share capital	7.7	7.7	7.7	9.4	9.4	Free Cash flow Yield		(6.4%)	(17.3%)	(10.2%)	(25.1%)	(0.4%)					
Accumulated profits/losses	2.9	(0.5)	(5.0)	(7.1)	(5.8)												
Reserves	1.3	1.8	2.1	2.1	2.1												
Minorities	0.3	0.4	0.5	0.5	0.5												
Total Shareholder funds	12.3	9.5	5.3	4.9	6.2												

Source: RaaS Advisory



FINANCIAL SERVICES GUIDE

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