

Entitlement offer repriced in response to market conditions

DXN Ltd (ASX:DXN) is a vertically integrated prefabricated modular data centre business with manufacturing facilities in Perth and its own data centre, SYD01, at Sydney Olympic Park in Sydney. In response to the recent market volatility, DXN has withdrawn its previous entitlement offer with funds to be returned to applicants. The company is now offering a two-for-three non-renounceable offer at \$0.02/share to raise \$6.07m, with an attached \$0.04/share option expiring in three years' time. Proceeds from the offer will fund the acquisition of TasmaNet's Data Centre 3 revenues and assets (\$2.43m), \$1.03m in general working capital, \$2.0m for product manufacturing working capital for DXN Modules and data centre marketing. DXN noted that despite the current environment, the commercial appeal of the acquisition of DC3 remained unchanged nor had the company's plan to expand its carrier neutral Edge data centre footprint in Australia. The company also streamlined its board to three directors which will save costs. We have reset our forecasts in light of the near term uncertainty being presented by COVID-19, which potentially could delay the timing for orders for prefabricated modular data centres. Adjusting for this, a higher equity risk premium and the revised entitlements offer, our base case DCF valuation is \$0.12/share. This puts DXN on a 12-month forward EV/sales of 7.5x, a substantial discount to its larger data centre peers.

Business model

DXN Ltd designs, builds, owns and operates prefabricated modular data centres. The company achieved an industry first to become the first modular data centre developer to receive both Uptime Institute Tier-Ready III and Tier-Ready IV design review awards. DXN owns its own modular co-location data centre, SYD-01, in leased premises at Sydney Olympic Park which is being expanded to 800kW capacity from its initial 400kW (1.0MW core supporting infrastructure). Its strategy is to build capacity in stages and gradually installing 5MW or 725 racks as demand fills existing infrastructure. This enables DXN to maintain a capital light model compared to traditional DCs which build greater capacity upfront. Revenue is being generated from manufacturing data centre modules for third parties, operating and renting rack space in its co-location data centre.

H1 FY20 result and earnings reset

DXN reported H1 FY20 revenue of \$2.5m and a net loss of \$6.1m after taking into account \$2.0m in adjustments for the adoption of AASB16. Excluding AASB16 the loss would have been \$4.1m, compared with a loss of \$2.9m one year before. Net cash at the end of December was \$2.43m and the company had drawn \$3.8m of its \$5.0m finance facility. The new entitlement offer will position the company to acquire DC3 in Tasmania which comes with guaranteed revenues and operating profits from the vendor. We have incorporated DC3 into our forecasts and made some adjustments around timing of orders for modular co-location units. This does not change our view that DXN is well placed to benefit from increasing investment in telecommunications in Australia and AsiaPac.

DCF valuation is \$0.12/share

We have factored in the additional shares being issued in the entitlement offer and have assumed in our valuation that the accompanying options are fully exercised in 3 years' time. This delivers a DCF valuation of \$0.12/share, which on a 12-months' forward basis equates to an EV/Sales multiple of 7.5x.

Earnings History and Estimates

Year end	Revenue(A\$m)	EBITDA(A\$m)	NPAT (A\$m)	EPS (c)	EV/Sales (x)	EV/EBITDA (x)
06/19a	2.6	(7.0)	(7.4)	(3.50)	2.18	na
06/20e	8.8	(6.0)	(10.6)	(2.18)	3.20	na
06/21e	19.6	(0.4)	(4.0)	(0.54)	1.65	na
06/22e	27.3	2.8	(1.0)	(0.13)	1.24	12.35

Source: RaaS Advisory Estimates, Company Data

Data Centres

23rd March 2020

Share details

ASX Code	DXN
Share price (20 March)	\$0.018
Market Capitalisation post entitlements offer	\$13.6M
Shares on issue post entitlements offer	756.5M
Enterprise value post entitlement offer	\$20.0M
Net cash post raise	~\$6.4M
Free float	~58%

Share performance (12 months)



Upside Case

- Edge Infrastructure and Manufacturing facility in Perth assists in early cashflows and has capacity to meet both internal and external customer demand
- Capital light compared to traditional data centre operators as building 1MW at a time
- Modularised and smaller data centres will be critical to 5G mobile and the Internet of Things

Downside Case

- Small player in a market dominated by global players with deep pockets
- Significant data centre capacity in the market currently
- Growth of mature centres reverts to CPI

Substantial/Institutional Shareholders

JP Morgan Nominees Australia Pty Ltd (Newgate Capital Partners) 19.22%, Carason Ward Pte Ltd (Dean Coetzee and Tim Desmond) 14.6%, SG Hiscock & Company Limited 12.45%

Board of Directors

John Baillie	Non-Executive Chairman
Richard Carden	Non-Executive Director
John Duffin	Non-Executive Director

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Revised Entitlement Offer Details

DXN has announced that it will withdraw the fully underwritten non-renounceable entitlement issue of one share for every 3 shares held at an issue price of \$0.04/share raising, replacing it with a two for three non-renounceable entitlement issue priced at \$0.02/share to raise \$6.07m pre-costs. The new offer includes a free listed option of \$0.04/option with expiry three years from the date of issue. The new offer price was at a 26% discount to the last traded price before the announcement of \$0.027/share. Lead manager Pinnacle Corporate Finance has agreed to partially underwrite part or all of the new offer, conditions precedent. The new offer will result in about 303.68m new shares and 303.68m new options being issued. DXN noted it would need to secure an extension to the current settlement date for the DC3 acquisition from TasmaNet.

Board changes

DXN concurrently announced that three directors, Terry Smart, Timothy Desmond and former chair Douglas Loh had resigned to allow a streamlined board of three persons, commensurate with a company of DXN's size. The board now comprises, John Baillie (chair), Richard Carden and John Duffin. We anticipate that the changes will save DXN around \$150k a year in directors' fees.

H1 FY20 results

DXN reported sales revenue \$2.5m in H1FY20, an increase of 90% on the previous corresponding period, and total revenue of \$3.4m after including an R&D tax claim. Cost of sales and operating costs were \$2.8m and \$3.7m respectively compared with H1 FY19 COGS of \$1.2m and operating costs of \$4.0m. Costs were also lower than we had forecast. The application of AASB16 resulted in an impairment charge of \$1.97m on the Right of Use assets and added \$0.59m to amortisation from the company's property leases and \$0.11m to interest costs from the lease interest. This resulted in DXN reporting a net loss of \$6.1m versus \$2.9m a year ago. The underlying loss when excluding for AASB16 was \$4.1m, an increase of 51.9% on the adjusted NPAT reported a year ago. We set out the P&L snapshot in the following table.

Exhibit 1: Interim results snapshot (in A\$m unless otherwise stated)				
Period ending December 31	1H19	1H20	% Chg	RaaS H1 FY20 Forecast
Sales Revenue	1.3	2.5	90.0%	4.4
Total Revenue	2.5	3.4	36.8%	5.2
Gross Profit	1.3	0.6	(55.2%)	1.2
EBITDA Adj	(2.7)	(3.1)	13.3%	(2.7)
EBIT Adj	(2.8)	(4.0)	43.4%	(3.3)
NPAT Adj	(2.7)	(4.1)	51.9%	(2.4)
NPAT reported	(2.9)	(6.1)	124.0%	(2.4)
EPS (c)	(1.6)	(1.1)	(33.0%)	(0.5)

Source: Company data, RaaS estimates

DXN ended 31 December with net cash of \$2.43m comprising cash and bank guarantees of \$5.99m and borrowings of \$3.56m.

Earnings reset

We have adjusted our earnings forecast to reflect the uncertain trading conditions being presented by COVID-19. At an investor briefing on March 4, CEO Matthew Madden commented that the company had \$7m work in hand for DXN Modules, the pre-fabricated modular data centre manufacturing facility based in Perth. Much of this work in hand is related to contracts for cable landing stations for several sovereign island nations in the Pacific and are priced in US dollars. The cable landing stations provide connectivity to the subsea cables being built to connect Pacific Islands to high speed broadband. We expect DXN to continue with these contracts but for prudence in our modelling we have slowed down the timing of completion given

some of the structural challenges being presented in the current environment. **This is our modelling based on our experience of the impact of economic disruption, not guidance from the company.**

In our view there is a risk that decisions on awarding contracts for new cable landing stations and modular data centres and taking up rack space in data centres could be pushed back in the near term. Longer term, however, we see the shift to remote workforces and the decision by Telstra Corp (ASX:TLS) to bring forward 5G infrastructure into CY2020 presenting opportunities for modular data centre manufacturers and operators like DXN.

Hence, while we have tempered our forecasts, we still expect strong growth in FY21 and FY22. It also should be noted that since many of the DXN Modules' contracts are priced in USD and the company's cost base is in AUD, it will benefit from the currency arbitrage between its contract price and contract delivery costs.

Exhibit 2: Earnings forecasts reset (in A\$m unless otherwise stated)						
Period ending June 30	FY20 old	FY20 new	FY21 old	FY21 new	FY22 old	FY22 new
Revenue	16.0	7.8	32.1	19.6	42.0	27.3
EBITDA adj	5.0	1.8	12.6	7.5	18.8	11.0
EBIT adj	(3.2)	(6.0)	3.2	(0.4)	9.2	2.8
NPAT adj	(4.4)	(8.2)	1.2	(3.3)	6.1	0.0
NPAT reported	(3.1)	(10.6)	0.7	(4.0)	3.9	(1.0)
EPS (c)	(0.66)	(1.67)	0.14	(0.54)	0.76	(0.13)

Source: RaaS estimates

DCF of \$0.12/share fully diluted

We have used the discounted cashflow methodology to value DXN, applying a WACC of 12.9% (previously 12.1%), beta of 1.9, terminal growth rate of 2.2% and target gearing of 10%, to our base case free cashflows. We have increased our equity risk premium to 7.0% (previously 6.5%). This derives a valuation of \$0.12 per share post entitlement offer and our expectation that the new \$0.04 options will convert in three years' time. Our forecasts also envisage that the company funds around 50% of its capital expenditure in FY21 and FY22 with debt and this has all been captured in our Equity Value set out in the following exhibit. The terminal value accounts for 65% or \$0.08/share of the total value. We have included in the valuation the impact of the non-renounceable rights issue and options conversion. Share on issue currently are 454m.

At \$0.12/share, the implied 12-months' forward EV/Sales multiple of 7.5, which is half the multiple of its much larger peers, NextDC Ltd or Megaport Ltd.

Exhibit 3: DCF valuation	
	Parameters
Discount rate (WACC)	12.9%
Terminal Growth Rate	2.2%
Beta	1.9
Target gearing	10.0%
Present value of free cashflows	42.5
Present value of terminal value	77.1
Enterprise value	119.6
Add net cash inc all capital raises less debt raising expectatoinis	6.3
Equity value	126.0
Fully diluted shares (inc current raise, options conversion)	1060
Equity value per share	\$ 0.12

Source: RaaS estimates

Exhibit 4: Financial Summary

DXN Ltd						Share price (20 March 2020)						A\$ 0.018	
Profit and Loss (A\$m)						Interim (A\$m)							
Y/E 30 June	FY18A	FY19A	FY20F	FY21F	FY22F	H119F	H219F	H120F	H220F	H121F	H221F		
Sales revenue	2.0	1.4	7.8	19.6	27.3	Revenue	2.5	0.1	3.4	5.3	9.3	10.3	
Total Revenue	2.0	2.6	8.8	19.6	27.3	EBITDA	(2.7)	(4.2)	(3.1)	(3.0)	(0.4)	(0.0)	
EBITDA	(4.0)	(7.0)	(6.0)	(0.4)	2.8	EBIT	(2.8)	(4.5)	(4.0)	(4.2)	(1.9)	(1.4)	
Depn	(0.0)	(0.2)	(1.0)	(1.8)	(1.9)	NPAT (normalised)	(2.7)	(4.5)	(4.1)	(4.5)	(2.2)	(1.8)	
Amort	(1.7)	(0.0)	(0.1)	(0.1)	(0.1)	Minorities	0.0	0.0	0.0	0.0	0.0	0.0	
EBIT	(5.7)	(7.2)	(8.2)	(3.3)	0.0	NPAT (reported)	(2.7)	(4.6)	(6.1)	(4.5)	(2.2)	(1.8)	
Interest	0.0	0.0	(0.5)	(0.8)	(1.0)	EPS (normalised)	(1.6)	(1.3)	(1.6)	(0.6)	(0.3)	(0.2)	
Tax	0.0	0.0	0.0	0.0	(0.0)	EPS (reported)	(1.6)	(1.3)	(1.6)	(0.6)	(0.3)	(0.2)	
Minorities	0.0	0.0	0.0	0.0	0.0	Dividend (cps)	0.0	0.0	0.0	0.0	0.0	0.0	
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0	Imputation	30.0	30.0	30.0	30.0	30.0	30.0	
NPAT pre significant items	(5.7)	(7.4)	(8.7)	(4.0)	(1.0)	Operating cash flow	(4.3)	(2.5)	(4.7)	(1.5)	(1.5)	(0.8)	
Significant items	0.0	0.0	(2.0)	0.0	0.0	Free Cash flow	(4.4)	(2.6)	(4.7)	(1.8)	(1.9)	(1.1)	
NPAT (reported)	(5.7)	(7.4)	(10.6)	(4.0)	(1.0)	Divisions	H119F	H219F	H120F	H220F	H121F	H221F	
Cash flow (A\$m)						Port Melbourne	0.0	0.0	0.0	0.0	0.0	0.0	
Y/E 30 June	FY18A	FY19A	FY20F	FY21F	FY22F	Homebush	0.0	0.0	0.0	0.1	0.2	0.4	
EBITDA	(4.0)	(7.0)	(6.0)	(0.4)	2.8	Edge Infrastructure	1.3	0.1	2.5	5.1	8.7	9.4	
Interest	0.0	0.0	(0.4)	(0.8)	(1.0)	Software sales	0.0	0.0	0.0	0.0	0.0	0.0	
Tax	0.0	0.0	0.0	0.0	(0.0)	Other income	1.2	0.0	0.9	0.0	0.0	0.0	
Working capital changes	(1.0)	0.1	0.2	(1.0)	0.3	Total Revenue	2.5	0.1	3.4	5.2	8.9	9.9	
Operating cash flow	(5.0)	(6.9)	(6.2)	(2.3)	2.0	COGS	2.3	0.9	2.0	4.1	5.8	6.3	
Mtce capex	0.0	0.0	(0.3)	(0.7)	(0.7)	Gross Profit	0.3	(0.7)	1.5	1.1	3.1	3.5	
Free cash flow	(5.0)	(6.9)	(6.5)	(3.0)	1.3	Employment costs	1.3	1.7	3.2	2.7	2.6	2.7	
Growth capex	(0.5)	(10.4)	(5.6)	(1.3)	(3.0)	Other operating costs	0.3	0.2	0.4	0.4	0.4	0.4	
Acquisitions/Disposals	0.0	0.0	(2.7)	0.0	0.0	Corporate overheads	1.4	1.4	0.9	0.7	0.7	0.7	
Other	(1.1)	(2.0)	(0.3)	0.0	0.0	Total Operating Costs	3.0	3.3	4.6	3.9	3.7	3.8	
Cash flow pre financing	(6.6)	(19.3)	(15.0)	(4.3)	(1.7)	EBITDA	(2.7)	(4.1)	(3.1)	(2.8)	(0.6)	(0.3)	
Equity	16.0	10.3	10.9	0.0	0.0	Capex required	4.1	0.0	0.0	2.6	0.0	1.3	
Debt	4.4	(0.7)	1.6	5.0	3.1	Margins, Leverage, Returns		FY18A	FY19A	FY20F	FY21F	FY22F	
Dividends paid	0.0	0.0	0.0	0.0	0.0	EBITDA		n/a	(264.2%)	(68.9%)	(2.3%)	10.1%	
Net cash flow for year	13.7	(9.6)	(2.5)	0.7	1.3	EBIT		n/a	(274.1%)	(93.2%)	(16.6%)	0.1%	
Balance sheet (A\$m)						NPAT pre significant items		n/a	(279.2%)	(98.7%)	(20.6%)	(3.7%)	
Y/E 30 June	FY18A	FY19A	FY20F	FY21F	FY22F	Net Debt (Cash)			12.0	2.4	- 14.4	- 18.7	- 20.4
Cash	12.0	5.4	2.5	3.2	4.5	Net debt/EBITDA (x)	(x)	n/a	n/a	n/a	n/a	- 7.406	
Accounts receivable	1.2	1.0	1.3	3.3	4.5	ND/ND+Equity (%)	(%)	n/a	(16.6%)	46.3%	59.6%	63.6%	
Inventory	0.2	1.0	0.4	0.8	1.1	EBIT interest cover (x)	(x)	n/a	n/a	n/a	n/a	61.1	
Other current assets	0.7	0.4	0.7	0.7	0.7	ROA		n/a	(38.2%)	(27.5%)	(8.5%)	0.0%	
Total current assets	14.2	7.8	5.0	8.0	10.9	ROE			(46.7%)	(63.2%)	(27.5%)	(8.3%)	
PPE	0.4	11.1	18.7	18.8	20.7	ROIC		0.0%	(32.1%)	331.9%	28.4%	(0.1%)	
Goodwill	0.0	0.0	0.0	0.0	0.0	NTA (per share)		0.08	0.04	0.02	0.02	0.02	
Investments	0.0	0.0	0.0	0.0	0.0	Working capital		0.6	0.9	0.7	2.1	3.0	
Deferred tax asset	0.0	0.0	0.0	0.0	0.0	WC/Sales (%)		27.8%	33.4%	8.1%	10.6%	10.8%	
Other assets	1.1	3.4	13.5	12.5	11.6	Revenue growth		n/a	31.1%	232.1%	123.8%	39.2%	
Total non current assets	1.4	14.5	32.2	31.3	32.3	EBIT growth pa		n/a	n/a	n/a	n/a	(100.5%)	
Total Assets	15.6	22.3	37.1	39.4	43.3	Pricing		FY18A	FY19A	FY20F	FY21F	FY22F	
Accounts payable	0.9	1.2	1.0	2.0	2.7	No of shares (y/e)	(m)	194	453	757	757	757	
Short term debt	0.0	0.9	2.3	2.3	2.3	Weighted Av Dil Shares	(m)	98	211	840	840	840	
Tax payable	0.0	0.0	0.0	0.0	0.0	EPS Reported	cps	(5.86)	(3.50)	(2.18)	(0.54)	(0.13)	
Other current liabilities	0.1	1.3	2.5	2.8	4.0	EPS Normalised/Diluted	cps	(5.86)	(3.41)	(1.67)	(0.54)	(0.13)	
Total current liabilities	1.0	3.4	5.8	7.1	9.0	EPS growth (norm/dil)		n/a	n/a	n/a	n/a	n/a	
Long term debt/lease liabilities	0.0	2.1	14.6	19.6	22.7	DPS	cps	-	-	-	-	-	
Other non current liabs	0.0	0.0	0.0	0.0	0.0	DPS Growth		n/a	n/a	n/a	n/a	n/a	
Total long term liabilities	0.0	2.1	14.6	19.6	22.7	Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%	
Total Liabilities	1.0	5.5	20.4	26.7	31.6	Dividend imputation		30	30	30	30	30	
Net Assets	14.7	16.9	16.7	12.7	11.7	PE (x)		-	-	-	-	-	
Share capital	20.1	29.7	40.2	40.2	40.2	PE market		13.2	13.2	13.2	13.2	13.2	
Accumulated profits/losses	(5.7)	(13.1)	(23.8)	(27.8)	(28.8)	Premium/(discount)		(100.0%)	(100.0%)	(100.0%)	(100.0%)	(100.0%)	
Reserves	0.3	0.3	0.3	0.3	0.3	EV/EBITDA		2.1	(0.8)	(4.6)	(72.0)	12.3	
Minorities	0.0	0.0	0.0	0.0	0.0	FCF/Share	cps	(2.6)	(1.5)	(0.8)	(0.2)	0.4	
Total Shareholder funds	14.7	16.9	16.7	12.7	11.7	Price/FCF share		(0.7)	(1.2)	(2.3)	(8.6)	5.0	
						Free Cash flow Yield		(144.2%)	(84.1%)	(43.2%)	(11.6%)	19.9%	

Source: RaaS Advisory



FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

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Effective Date: 26th November 2018

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