

Aerometrex Ltd: Don't Buy

ASX:AMX

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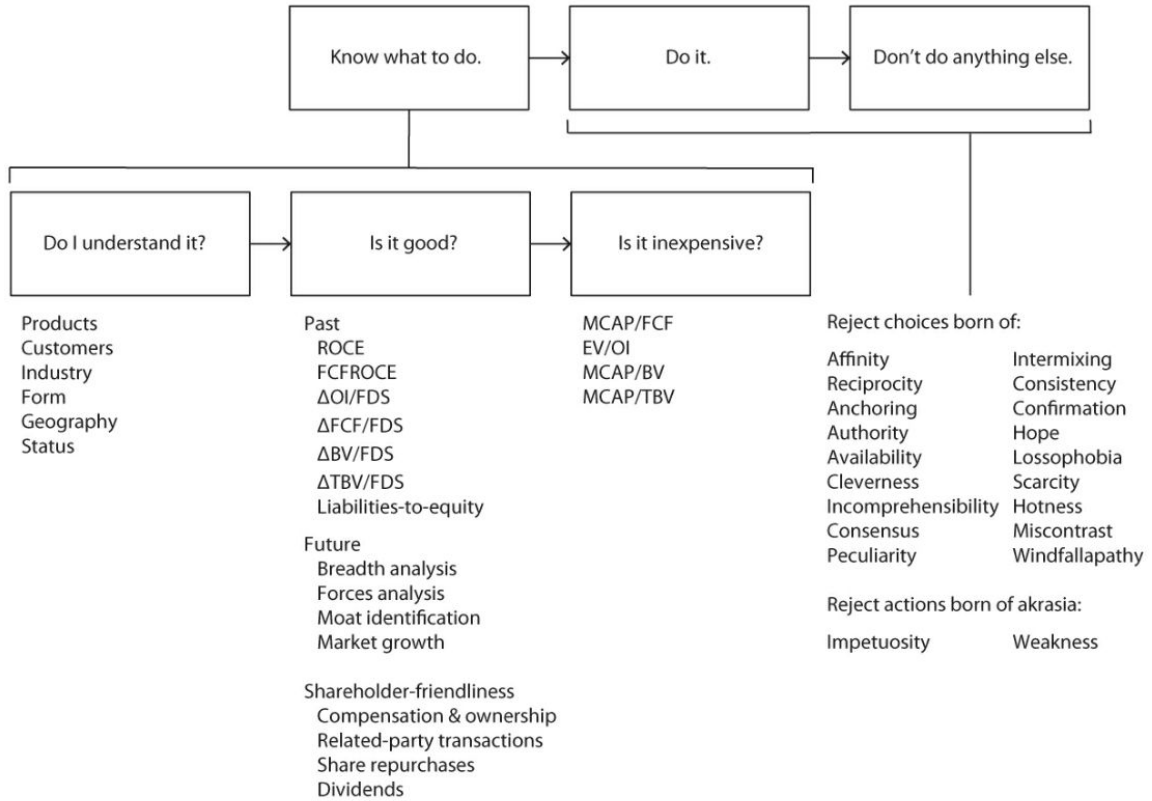
The Automated Bare Knuckle Compounder

Date of Analysis: 11/25/2019. Idea source: Small cap, more than 50M shares. Analysis date price: AUD1.92, cheap price: AUD0.12. The price needs to drop -94% in order to be cheap.

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Framework



Marshall (2017), p. 188.

Do I Understand It? Yes:

Understanding Statement

With Australian, EU and US government, mining, internet media and infrastructure engineering project customers, the vertically integrated surveying and mapping services industry corporation Aerometrex sells data as a service subscriptions to very high resolution imagery captured with a camera they invented and elevation data captured with planes they own (since a 2015 acquisition), along with 3D city models produced using their own proprietary software and have recently changed business model to focus on customers in the fast growing subscription, LiDAR and 3D modeling spaces.

Is it Good? No, poor past performance:

To determine if Aerometrex Ltd is good, it was analysed from three perspectives:

1. Past performance, to see if they've been good stewards of their capital.
2. If the company's future is bright, considering breadth, forces, monopolies and market.
3. If the company is shareholder friendly, such as whether leaders behave like owners.

1. Does Aerometrex Ltd Have Good Average Past Performance? No:

Judgement of past performance is based on averages over the past however many periods the analyst chooses to input. Table of averages:

Summary	Benchmark	Average
ROCE with cash, end of period	Should be at least 15%	14.17%
ROCE without cash, end of period	Should be at least 15%	16.78%
FCFROCE end of period, with cash	Should be at least 8%	12.17%
FCFROCE end of period, without cash	Should be at least 8%	15.02%
Δ OI/FDS	Should keep up with inflation, aim for 4%	39.02%
Δ FCF/FDS	Should keep up with inflation, aim for 4%	131.14%
Δ BV/FDS	Should keep up with inflation, aim for 4%	30.60%
Δ TBV/FDS	Should keep up with inflation, aim for 4%	43.47%
L/E	Should be no higher than 2, 7 if otherwise great.	227.46%

Was the performance in the most recent period good? No. Further detail by year is available in the next table.

	A	B	C	D	E	F	G
	Category	Item	Average	2019	2018	2017	Benchmark
2	Past performance	ROCE with cash and cash equivalents, beginning	30.0%	22.3%	37.8%		Should be at least 15%
3	Past performance	ROCE without cash and cash equivalents, beginning	33.5%	24.0%	42.9%		Should be at least 15%
4	Past performance	ROCE with cash and cash equivalents, end of period	14.2%	15.5%	21.7%	5.2%	Should be at least 15%
5	Past performance	ROCE without cash and cash equivalents, end of period	16.8%	21.0%	23.4%	5.9%	Should be at least 15%
6	Past performance	CFROCE beginning of period, with cash and cash equivalents	21.5%	27.5%	15.4%		Should be at least 8%
7	Past performance	CFROCE beginning of period, without cash and cash equivalents	23.5%	29.6%	17.5%		Should be at least 8%
8	Past performance	CFROCE end of period, with cash and cash equivalents	12.2%	19.2%	8.8%	8.5%	Should be at least 8%
9	Past performance	CFROCE end of period, without cash and cash equivalents	15.0%	25.9%	9.5%	9.6%	Should be at least 8%
10	Past performance	Δ OI/FDS	39.0%	2.4%	622.5%		Should keep up with inflation, aim for 4%
11	Past performance	Δ FCF/FDS	131.1%	211.5%	81.3%		Should keep up with inflation, aim for 4%
12	Past performance	Δ BV/FDS	30.6%	19.9%	47.0%		Should keep up with inflation, aim for 4%
13	Past performance	Δ TBV/FDS	43.5%	-0.4%	106.7%		Should keep up with inflation, aim for 4%
14	Past performance	L/E	N/A	227.5%	171.7%	139.6%	Should be no higher than 200%, 700% if otherwise great.
15	Shareholder friendliness	Highest paid employee salary	N/A	302,200			For US companies, should be less than \$USD30,000,000
16	Shareholder friendliness	Highest paid employee salary compared to the lowest paid	N/A	11.8%			Should be 5% of the lower of FCF or NI
17	Shareholder friendliness	Highest paid outside director	N/A	70,000			For US companies, preferably less than \$USD250,000 and not more than \$USD500,000
18	Inexpensiveness	MCAP/FCF	N/A	53,727			Should be no higher than 8
19	Inexpensiveness	EV/OI with cash and cash equivalents	N/A	70,367			Should be no higher than 7, sell if >25
20	Inexpensiveness	EV/OI without cash and cash equivalents	N/A	68,695			Should be no higher than 7, sell if >25
21	Inexpensiveness	MCAP/BV	N/A	29,547			Should be no higher than 3
22	Inexpensiveness	MCAP/TBV	N/A	53,878			Should be no higher than 3

Past performance is only barely poor, on average. Strictly, they do not satisfy the benchmark for 15% average ROCE with cash, end of period, with this currently sitting on 14.17%. The average across the four forms of ROCE is above 23%. Then again, rules are rules.

2. Does Aerometrex Ltd Have a Bright Future? No:

Does Aerometrex Ltd Have Enough Breadth? Yes:

Does this company have breadth of customers? Yes:

They have all State governments as clients and many engineering and mining project customers around Australia, therefore there is little risk from losing one customer.

Does this company have breadth of suppliers? Yes:

They are vertically integrated due to having their own fleet of planes and cameras, therefore supplier breadth is less of a risk to them, with the remaining suppliers of office space, computer equipment, cloud storage/computing infrastructure and programming talent in plentiful supply. There is a problem of not enough spatial science graduates from Australia's education system but immigration makes up for this, with evidence of plenty of international staff.

Does Aerometrex Ltd Confront Maximum 1 Strong Force? Yes:

The number of strong forces this company confronts is 1. To consider it further, there should not be more than 1.

The bargaining power of customers is Weak:

Number of customers: At least in the tens, possibly hundreds.

Improbability of backward integration: State governments, mining and engineering companies are unlikely to start their own imagery capture, processing and online delivery service at the scale and speed Aerometrex can operate at.

Switching costs: The main competitors Eagle View and NearMap do not offer such good resolution.

Summary: Due to the high number of customers, comparable at best or worse offerings from other suppliers and improbability of backward integration, customers have weak

bargaining power.

The bargaining power of suppliers is Weak:

Number of suppliers: As mentioned above, they are vertically integrated hence suppliers of office space, (cloud) computing power and storage, programming and spatial science staff are the remaining supply risks but they are plentiful bar spatial science staff.

Improbability of forward integration: It is improbable that office rental and computer companies will start an imaging operation like Aerometrex.

Switching costs: The switching costs to change offices would be large, but this is unlikely to occur due to the leadership actually owning this and leasing it to the firm. They may have a special data storage arrangement with a company like Quantum Corp which may cause significant disruption if changing to another storage system, this requires further investigation.

Summary: Due to vertical integration through supplying their own aircraft and cameras, Aerometrex have reduced the bargaining power of suppliers such that it is weak, although their on site data storage and cloud computing/storage arrangement needs investigating further.

The threat of substitutes is Weak:

Wholly different products that perform the same basic function: Surveying trips on the ground to collect data would be extremely costly and time consuming..

Doing without: It would not be possible to do without aerial imagery for many mining and infrastructure projects, not to mention the 3D models needed in city environments for planning purposes. This would necessitate extremely expensive and time consuming survey missions which participants in a modern economy would ridicule.

Direct substitutes: NearMap (28cm resolution) and Eagle View respectively cannot compete with or do not offer the high resolution of Aerometrex' 3D models (5cm). Aerometrex is growing the Metromap subscription web mapping service, for example recently adding a 3D model capability which means they now stand to begin to substitute these two competitors. From Aerometrex' own report "In recent times, Aerometrex has seen a contraction of survey providers in the LiDAR market, with a down-grading of some competitors' capacities. There has also been some market specialisation by providers in specific roles such as powerline

mapping, which has left fewer players in the general LiDAR project arena."

Summary: Aerometrex, due to national coverage, resolution of imagery and 3D models and having a subscription based web delivery platform is viewed as best of breed. The threat of substitution is theirs, not competitors'.

The threat of new entrants is Strong:

Barriers to entry; barriers to success: There is a relatively large barrier to entry for aerial imagery companies since you must buy, invent or rent planes and cameras plus set up a workforce. To succeed, even more capital is required plus participation in industry events and promotional activity to develop a client base. A new entrant could try with drones, especially by inventing or purchasing larger ones which can fly for longer, exploiting advances in battery life. In the end, however, a drone cannot fly as far or as fast as a plane, unless a military one is used. I do not believe these are available to civilians, however. This is something to investigate as it would reduce the cost of operation by removing the pilot. A ground based pilot would still be required, however. It would be on the new entrant to sort these issues and the regulatory scrutiny, but could be a profitable way to enter the market. Perhaps BAE or a US defence contractor like Lockheed Martin might want to force their way in with a UAV platform. This requires further investigation as a military derived platform could outperform what Aerometrex offers..

Economies of scale: Aerometrex has a large fleet of aircraft and operates around the country, they have a large scale and will bring this to bear upon new entrants which start off with perhaps one plane and camera. New entrants could seek to compete using drones, however, especially large ones with 30cm propellers, larger batteries offering 1hr+ flight time etc. It would be possible for such a competitor to develop scale through deploying many such drones and being able to cover larger areas than typical drone operations, enabling them to quickly image mine and construction sites which Aerometrex currently gets much project work from. Using a plane literally is about doing imaging at scale, however, and even drone swarms will never compete with an aircraft flying at speed and at a height enabling large area captures with high resolution.

Higher switching costs: If using satellite imagery instead, the switching cost will be lower resolution. If using drones instead, the cost will be higher for an equivalent area because drones fly more slowly and collect far higher resolution imagery, requiring more resources to process and store, for a product which may offer higher resolution than really necessary.

Hard-to-get permits: New entrants will need to apply for permits to fly in some areas,

especially congested air space like cities, just as Aerometrex does. There is no special advantage here for Aerometrex.

Summary: Drones and military UAVs, or UAVs developed by defence contractors for civilian use, backed by the deep pockets of such firms, present a strong threat in the form of new entrants in this industry. It could be viewed by such firms as an attractive space to start competing in due to the increasing appetite for high resolution imagery and 3D models around the world.

Does Aerometrex Ltd Have a Monopoly? No:

Government: No.

Network: No.

Cost: No.

Brand: No. They are well known but NearMap is just as well known if not more.

Switching costs: No.

Ingrainedness: No.

Market Growing? Yes:

The following is quoted from Karara Market Neutral PLUS Strategy October 2019 monthly report, p. 6: "Aerial mapping is growing industry. Imaging through the use of manned and unmanned aircraft has grown at a compounded annual growth rate of 13% over the past 5 years. Technological improvements have led to higher quality images at accessible prices leading to an expansion in the addressable market. Public and private companies hungry for more spatial data are now able to access providers at economic prices. Future growth is accelerating and expected growth to reach 17% per annum by 2020. Unsurprisingly the USA is the largest addressable market with a large sprawling population across a high number of cities and topographical areas."

3. Is Aerometrex Ltd Shareholder Friendly? No:

Friendly on the Numbers? No:

The CEO's salary is AUD302,200 per year. This is 11.76% of the lower of free cash flow or net income. The highest paid outside director gets AUD70,000 a year. On the numbers, is this a shareholder friendly company? No.

Material insider buying at market

Not possible to judge due to being IPO. 6 of the top 7 shareholders will own together 60% of the company at IPO. The managing director Mark Deuter will own 12.1%, Non-Executive Director Matthew White will own 13.1%. Two directors will buy 150,000 new shares between them at IPO.

Share repurchases

Not possible, this is an IPO.

Related party transactions

21% of the interests of AMX capital, from which they rent the building, is owned by directors. An AMX director is also a director of Business Initiatives, which receives \$9,000 a month for accounting. An AMX director has shares in the Corporate Advisor engaged for the Offer, hence receives an indirect financial benefit from fees attracted by the Offer process.

Dividends

Aerometrex does not intend to pay dividends in the two years following the Offer, as capital will be deployed to pursue growth opportunities.

Shareholder Friendly Overall? No:

No, because the highest paid employee is overpaid.

Is it Cheap? No:

Analysis date price: AUD1.92, cheap price: AUD0.12. The price needs to drop -94% in order to be cheap.

Summary	As at 11/25/2019	Benchmark
MCAP/FCF	53.73	Should be no higher than 8
EP/OI - cash	68.70	Should be no higher than 7, sell if >25
EP/OI + cash	70.37	
MCAP/BV	29.55	Should be no higher than 3
MCAP/TBV	53.88	Should be no higher than 3

Verdict: Don't Buy, Checklist:

SI	Item	Sub Item	Check
1	Do I understand it?		Yes.
2	Is it good?		No, poor past performance.
2.1		Has there been good past performance?	No.
2.2		Is the future bright?	No.
2.2.1		Is it broad with respect to customers and suppliers?	Yes.
2.2.2		Is there, at most, one strong force?	Yes.
2.2.3		Is there a monopoly?	No.
2.2.4		Is the market growing?	Yes.
2.3		Is it shareholder friendly?	No.
2.3.1		On the numbers, is it shareholder friendly?	No.
2.3.2		Overall, is it shareholder friendly?	No.
3	Is it cheap?		No.

REFERENCES

1. Aerometrex Ltd material: [Prospectus](#)
2. [Bell Australia Trust](#).
3. Wil's Value Investing Tool.
4. Marshall, Kenneth Jeffrey (2017). [Good Stocks Cheap](#): Value Investing with Confidence for a Lifetime of Stock Market Outperformance. McGraw-Hill Education. Kindle Edition.