Sandal plc

11th October 2018

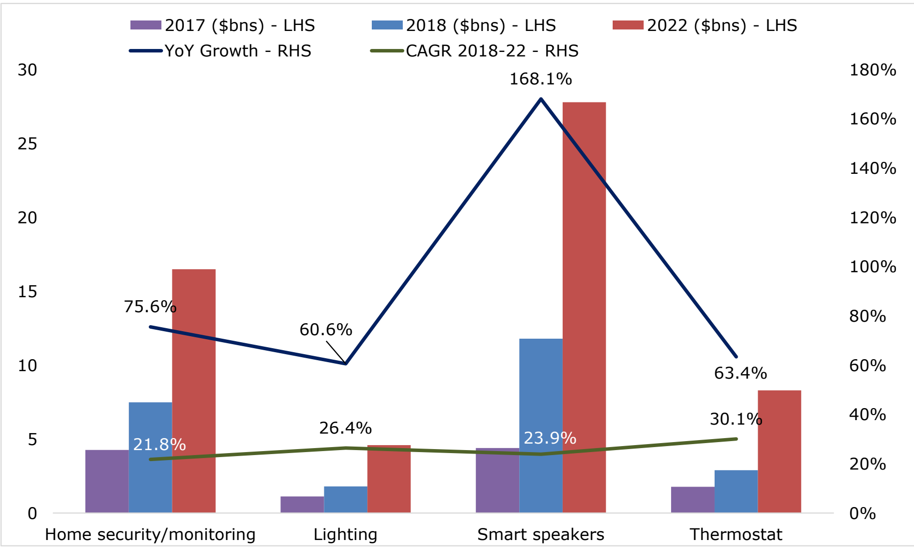
FY19 set for >22% LFL growth & +ve EBIT

With only 42 days until Thanks Giving and another 33 to Xmas, what is going to be this year's 'must-have' socking filler? The accolade is typically won by the latest 'hot' iPhone, electronic gadget or video game. However for 2018, my guess is it will be the 'smart speaker', either the Amazon Echo or Google Home. Why?

Well accordingly to IDC, **worldwide sales of smart speakers will rocket 168.1% in 2018 to $11.8bn** (vs $4.4bn LY - see below); and climb a further 23.9% pa on average over the next 4 years. In turn, creating a surge in demand for MiHome's 1st class smart heating, lighting, power and other internet enabled devices.

Smart home sales are almost off the charts

Buoyant global demand for smart home solutions ($bns)



Source: IDC

Indeed this morning, **the company encouragingly said that for the y/e May'18, its installed base of gateways had jumped 144% to c.12.6k** (5.2k LY). With the total number of connected products similarly leaping 194% - equivalent to 4.33/system up from 3.67 LY (see below). **Driving revenues 71% higher to £1,015km** (£593k) – and demonstrating once again that not only do **consumers like what they buy**, but they are also slotting in extra functionality into their mushrooming smart home networks.

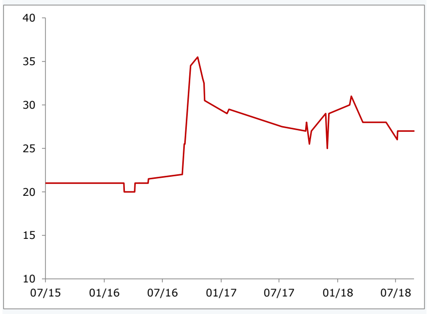
Potential £143m opportunity over next 5 years

This is just the start though. There are c. 23m households in the UK, of which we estimate only around 7% today are using smart lighting, heating, power &/or motion detector equipment. Assuming penetration rates rise to say 50% by 2025 - generating revenues of c.£250/system with MiHome securing a 5% share (vs 1% today) - **then** (in theory) **this would represent a £143m opportunity**. Any future benefits from subscription services, data monetisation and/or professional installation would be on top.

Company Data

EPIC	**NEX: SAND**
Price	27p
52 week Hi/Lo	31p/25p
Market cap	£4.2m
ED SOTP valuation	65p/share

Share Price, p



Source: ADVFN

Description

Sandal (19 employees) is a specialist developer & supplier of electronic products/solutions for smart home, IoT, energy saving and other applications. It joined NEX in March '15 and operates 3 divisions:

1) MiHome is a pioneer in home automation. Its smart platform provides voice activated & remote control of lighting, heating, power & other internet enabled devices, along with being fully integrated with the Amazon Echo & Google Home smart speakers. Partners include Amazon, Google, Howz, EDF.

2) PowerConnections sells a range of patented electricity/converter plugs, line-cords, extension leads, cordsets and adaptors in the UK, US, Europe, Switzerland, South Africa & Australia. Customers include major brands like Sony, Black & Decker and Bosch.

3) Energenie is a leading supplier of energy saving products (eg LEDs, sockets, etc) with retail listings at Homebase, Tool station and Amazon.

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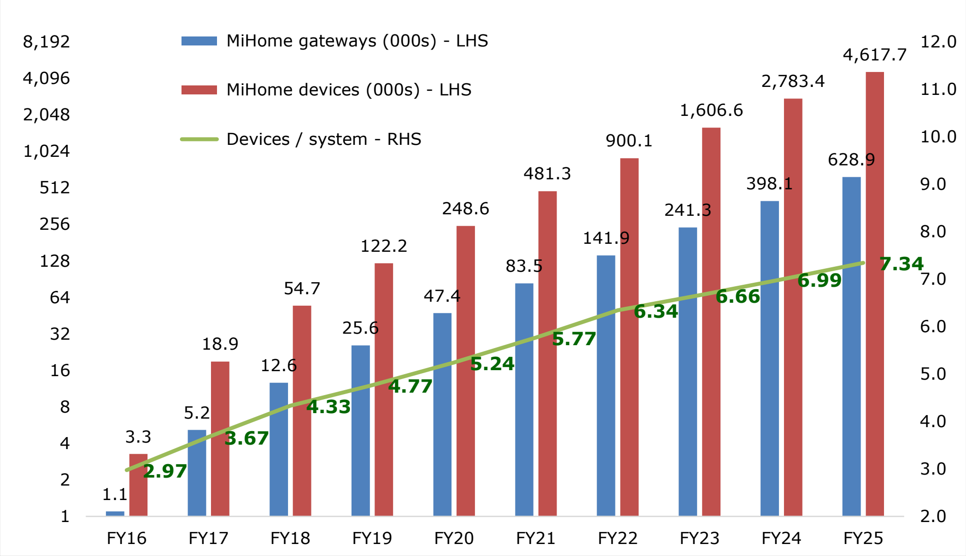
Predicted installed base of MiHome gateways & devices



Source: Equity Development

In fact, our projections could be conservative, especially as Marc Allera (CEO of BT's Consumer Division) reckons that by 2023 "***the average UK house might own 50 connected devices***". IDC's forecasts over the next 5 years are likely to be much higher in Western economies too. Particularly considering most new premium properties already have home management systems fitted as standard, and the battle between Amazon & Google (Apple Homekit is a distant 3rd) for smart speaker dominance has just begun.

Sandal has reached a major tipping point

Fine, but how is the Board planning to take advantage of this exponential growth? Well the good news for shareholders, is that there is more than 1 way to skin a cat – ie rather than simply burning through a boat load of cash.

Sure, greater investment will be required, yet we believe these monies will be spent wisely in order to balance the associated risks & rewards. The key elements of the strategy being to continue:

- Promoting entry level bundles to new domestic users, and then up-selling higher margin products (& perhaps subscriptions) as these networks expand.
- Nurturing MiHome's excellent relationships with Amazon & Google.
- Developing new products, where FY18 saw almost £530k spent on R&D alone (of which £504k was capitalised vs 130k amortisation) - equivalent to 14.6% of turnover.
- Widening 3rd party distribution, where Target Components, Wickes, Grahams Plumbers Merchants and Robert Dyas were all added in the period.
- Aggressively moving into the professional "*do it for me*" market, where MiHome is extending its presence with electrical wholesalers, plumber's merchants and independent installers.

- Looking to enter overseas regions (eg Europe) on the back of strategic partnerships (eg Exertis, Samsung), along with enhancing its domiciliary care interests (Re EDF & Howz).
- Exploring the launch of ongoing subscription services. Here Centrica's Hive system has already demonstrated the potential of the 'done for me' sector - where homeowners prefer a qualified field technician to install, connect and support their systems. Hive are aiming to almost double turnover every year between 2017-22.

Current trading in line with our revised FY19 targets

CEO Alan Tadd commenting "***The smart home sector is rapidly moving beyond the "early adopter" phase and into the mainstream, driven substantially by the Google and Amazon platforms****.*

Energenie MiHome achieved turnover growth of 71% taking this division past £1m for the first time and positioning it to become the future core of Sandal*. Since the year end there has been continued growth in the number of gateways and devices vs LY, in what is traditionally a quiet period.*

We believe that the enlarged Energenie MiHome product range allows Sandal to take advantage of this market growth potential through our existing B2C distribution channels and the new B2B channels which we are continuing to grow in the current financial year."

Ok, but what else came out of today's upbeat prelims?

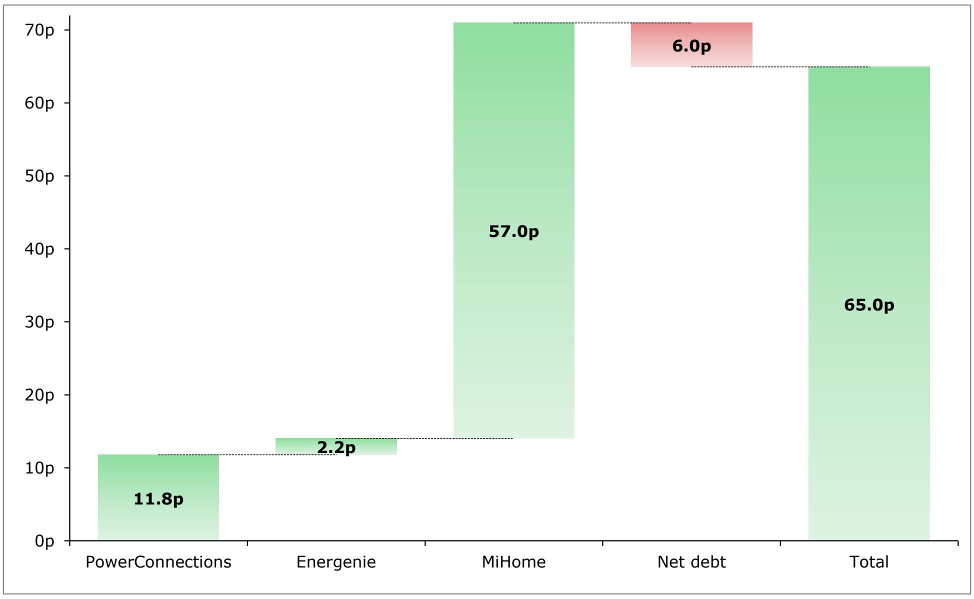
Well **having slightly exceeded our FY18 EBIT targets** (Actuals came in at -£84k vs Est -£246k), **we think Sandal has reached an important milestone**. You see despite MiHome's 71% growth, turnover actually fell 3.3% overall in the period to £3,621k: primarily due to tough comparatives at PowerConnections alongside some portfolio housekeeping at Energenie (Re £72k stock write-off).

However these effects have ended, and both divisions should resume their upwards trajectories going forward. Meaning that altogether, we expect **FY19 sales to rise >22% to £4,433k - pushing the group into the black** (PBT £60k), whilst only being modestly cash flow negative, even after absorbing additional marketing/R&D investment. Elsewhere **net debt is set to close FY19 at £1,236k, up £145k from May18** (£1,091k) – split £500k shareholder loan from Greenbrook Industries (24.7% stake), debt factoring and bank borrowings/overdraft.

Possible 140% upside vs our 65p/share valuation

Finally in terms of the outlook, we understand **Sandal is on track to hit our projections**, and hence we **maintain our 65p/share valuation**: split 11.8p PowerConnections, 57.0p MiHome, 2.2p Energenie and -6.0p net debt (see below).

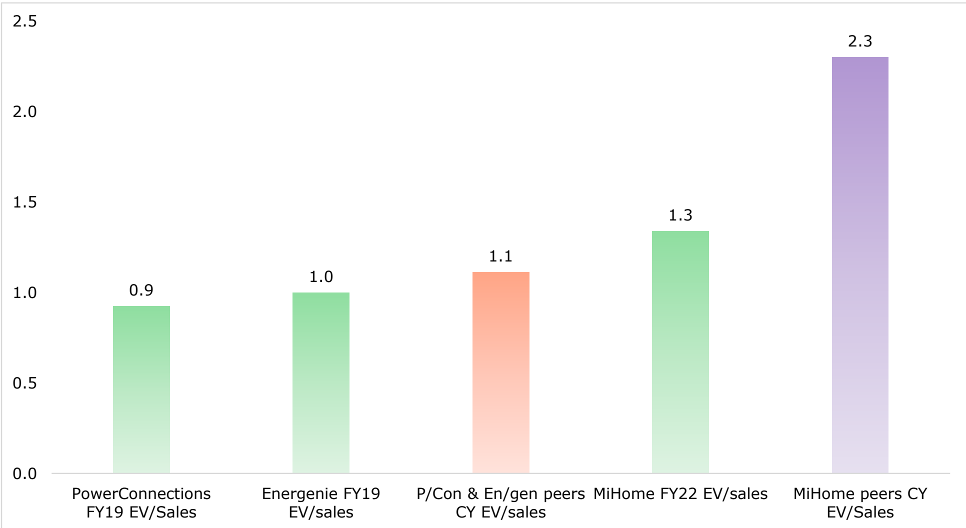
Sum of the parts valuation (pence/share)



Source: Equity Development

That said, if the firm can deliver anywhere near its true potential, then even at 65p the stock would appear cheap vs the rest of the sector (see below):

Implied divisional multiples at 65p/share SOTP valuation



Source: Equity Development

Alan Tadd concluding "***The Company's strategy is to continue to grow Energenie MiHome into what is an expanding smart home space****. This will be with new and existing products both into the UK and whilst also looking to expand into Europe using the distribution network of Exertis.*

Product development focus will be on selected new products to broaden the Energenie MiHome range creating greater use with Amazon and Google products both in the UK and abroad*. In addition, the launch of a monthly subscription service which is expected to generate a recurring revenue stream is being actively explored. The Company will also pursue other strategic partnerships in addition to those already in trial stages with Howz /EDF and Samsung.*

This strategy is likely to require additional capital to enable the Energenie MiHome brand to reach what the Directors believe is its full potential in this market sector*.* *Accordingly the Board will continue to review available options for raising both equity and debt to enable its execution."*

In summary, **Sandal appears to be in the right place at the right time, runs a tight ship and is highly scalable**, delivering EBITDA drop through rates of c. 20%. Plus, the MiHome product range is literally flying-off the shelves – augmented by substantial opportunities in telemedicine, baby/pet monitors, domiciliary/social care and data monitisation to boot.

Summary financial projections (£'000s)

Sandal plc (May yearend)	**2015 Act £000s**	**2016 Act £000s**	**2017 Act £000s**	**2018 Act £000s**	**2019 Est £000s**	**2020 Est £000s**	**2021 Est £000s**	**2022 Est £000s**	**2023 Est £000s**	**2024 Est £000s**	**2025 Est £000s**
PowerConnections	2,680	2,527	2,702	2,237	2,304	2,373	2,444	2,518	2,593	2,671	2,751
ENERGENiE	649	556	450	369	406	446	491	540	594	654	719
MiHome	10	213	593	1,015	1,723	2,885	4,758	7,690	11,964	18,111	27,244
Turnover	**3,339**	**3,296**	**3,746**	**3,621**	**4,433**	**5,704**	**7,693**	**10,748**	**15,151**	**21,435**	**30,714**
PowerConnections		*-5.7%*	*7.0%*	*-17.2%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
ENERGENiE		*-14.4%*	*-19.1%*	*-18.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*
MiHome		*2110.4%*	*178.3%*	*71.0%*	*69.8%*	*67.4%*	*64.9%*	*61.6%*	*55.6%*	*51.4%*	*50.4%*
% growth		***-1.3%***	***13.7%***	***-3.3%***	***22.4%***	***28.7%***	***34.9%***	***39.7%***	***41.0%***	***41.5%***	***43.3%***
Gross Profit	**1,343**	**1,141**	**1,385**	**1,471**	**1,888**	**2,424**	**3,276**	**4,583**	**6,455**	**9,105**	**13,012**
% margin	***40.2%***	***34.6%***	***37.0%***	***40.6%***	***42.6%***	***42.5%***	***42.6%***	***42.6%***	***42.6%***	***42.5%***	***42.4%***
EBITDA	**-234.3**	**-114.0**	**-16.6**	**104.3**	**472.7**	**722.1**	**1,136.5**	**1,715.7**	**2,589.4**	**3,862.4**	**5,747.0**
% margin	*-7.0%*	*-3.5%*	*-0.4%*	*2.9%*	*10.7%*	*12.7%*	*14.8%*	*16.0%*	*17.1%*	*18.0%*	*18.7%*
Adj. EBIT	**-317.0**	**-225.0**	**-108.7**	**-84.2**	**157.8**	**326.2**	**615.5**	**1,091.3**	**1,837.1**	**2,954.0**	**4,642.0**
% EBIT margin	*-9.5%*	*-6.8%*	*-2.9%*	*-2.3%*	*3.6%*	*5.7%*	*8.0%*	*10.2%*	*12.1%*	*13.8%*	*15.1%*
Adj. Profit before Tax	**-327.4**	**-267.5**	**-135.2**	**-142.7**	**59.6**	**215.0**	**503.9**	**991.4**	**1,771.0**	**2,961.5**	**4,642.0**
Adjusted EPS (p)	**-177.0**	**-0.5**	**0.0**	**-0.7**	**0.3**	**1.1**	**2.6**	**5.0**	**8.9**	**14.9**	**23.2**
EPS growth rate		*-99.7%*	*-109.5%*	*-1623.8%*	*-147.2%*	*222.8%*	*133.3%*	*95.7%*	*77.7%*	*66.4%*	*56.0%*
Dividend (p)	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***3.0***	***4.6***
Yield	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*11.0%*	*17.2%*
Valuation benchmarks											
P/E ratio					*79.0*	*24.5*	*10.5*	*5.4*	*3.0*	*1.8*	*1.2*
EV/Sales	*1.6*	*1.6*	*1.4*	*1.5*	*1.2*	*0.9*	*0.7*	*0.5*	*0.4*	*0.2*	*0.2*
EV/EBITDA				*51.0*	*11.2*	*7.4*	*4.7*	*3.1*	*2.1*	*1.4*	*0.9*
EV/EBITA					*33.7*	*16.3*	*8.6*	*4.9*	*2.9*	*1.8*	*1.1*
Adjusted tax rate					*-10.0%*	*-19.0%*	*-19.0%*	*-19.0%*	*-19.0%*	*-19.0%*	*-19.0%*
EBITDA drop through rates					*45.4%*	*19.6%*	*20.8%*	*19.0%*	*19.8%*	*20.3%*	*20.3%*
PEG ratio						*0.11*	*0.08*	*0.06*	*0.04*	*0.03*	*0.02*
Net cash/(debt)	**-175**	**-406**	**-625**	**-1,091**	**-1,236**	**-1,240**	**-1,110**	**-735**	**83**	**1,123**	**2,832**
Net debt : EBITDA				10.5	2.6	1.7	1.0	0.4			
Sharecount (Ks)	172	16,314	16,499	15,637	15,715	15,794	15,873	15,952	16,032	16,112	16,192
Shareprice (p)	**27.0**										

Source: Equity Development forecasts & estimated divisional sales splits, Company historic data. FY18 gross profit includes a non-recurring £72k stock write-off

Key risks

- Slowdown in global GDP and/or distributor de/restocking could impact Sandal's end-markets.
- Forward visibility tends to be only a couple of months – albeit like most, these are generic risks across the whole industry.
- MiHome's dependency on Amazon has an online retail channel could be impacted if they were ever delisted or Amazon started selling its own competing products.
- Anticipated growth/profitability may take longer than envisaged, cost more and/or not be fully realised.
- In the event Sandal wishes to raise more capital, then there is no certainty that this would be achieved at desirable rates.
- Foreign exchange. Although this is primarily a translation risk with c.35% of Sandal's FY18 turnover being generated outside the UK.
- Regulatory and tax changes. For instance, if the government decided to review the possible inappropriate use of the data, sounds, motions and pictures (eg snooping) collected within households by smart appliance manufacturers.
- Competition may intensify as a function of new/existing players.
- Being relatively small, Sandal could get squeezed by larger rivals, partners and customers.
- Retention/recruitment of key staff, etc.
- Protection of intellectual property, especially from trademark infringements.
- In theory (albeit highly unlikely in our opinion), Amazon/Google could disable their integrations with MiHome (&/or vice versa) or begin charging an access fee to their voice-recognition systems.
- As with many smallcap NEX stocks, trading volumes can be low, particularly during seasonally quieter periods and/or between newsflow.

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