PRIMARYMARKETS.com RaaS Research as a Service ARBORTECH CLEVER ENGINEERING

Arbortech Industries Limited

Commentary Note

Tools and accessories

Investing for the next phase of growth

Arbortech is an Australian based branded supplier of unique brick and mortar cutting and woodworking tools and accessories. The Group derives ~82% of sales from offshore, achieves industry high gross margins and continues to invest in new products and new markets. The Group has a SIGNIFICANT product launch in FY20-21 (the HammerSaw) together with investment in new/existing regions, predominantly taking place over the next 18-24 -months. While market acceptance of the potentially disruptive HammerSaw and introduction of existing products into new regions are difficult to forecast, combined they offer significant upside to the current earnings base. When looking to value Arbortech, the current and potential earnings base needs to be balanced with liquidity, size and structure (listed vs. unlisted). With this in mind our DCF is $2.47/share and Compco valuation is $2.23/share.

KEY POINTS

Niche products — The Arbortech brick and mortar Allsaw and range of Woodworking tools & accessories are specialised, appealing to tradespeople and DIY enthusiasts respectively. As a result, distributors are niche in nature, and not the likes of Bunnings or Lowes.

Industry high margins – Group gross margins in FY19 were 66%, well above industry benchmarks and our selected peer group. Such a margin reflects the inherent IP and knowhow, niche market appeal and limited competition in the respective markets.

Offshore presence — 82% of FY19 revenue for Arbortech was derived offshore, mainly from the US and Europe. This is higher than the likes of ASX listed peers Breville Group (78%) and ARB Corporation (37%) and a very attractive investment characteristic in today's investment environment.

New product development — While the brick and mortar Allsaw and Woodworking tools and accessories have evolved over the years and continue to do so, we doubt there has been a more exciting product launch for Arbortech than the **"HammerSaw"** anticipated over the next 12-18 months. Arbortech will release the potentially disruptive **"HammerSaw"**, targeted at industrial markets for the cutting of hard materials utilising technologies developed in house. The product has significant benefits over the incumbent Diamond Saw including safety, operating costs, functionality and convenience.

Investment evident in FY19 and FY20 — FY19 EBITDA declined 25% as SG&A rose 15% (relative to the 3% sales increase) as new human resources were added to service existing regions. FY20 is likely to see a similar investment in human resources to promote both the HammerSaw, the new Allsaw model (AS175) and new woodworking tools. Arbortech is also investing in new regions for existing products including Canada and greater Europe.

FY21 a likely inflection year — The investment in FY19 & FY20 is likely to be seen in FY21 and beyond as product awareness drives new unit sales with investment already made in 1) product development and 2) sales & marketing.

Valuation — In valuing Arbortech we feel the earnings potential of new products must be taken into account. In our DCF we forecast significant new product sales from FY22 together with an uptick in existing products as new regions are penetrated. Balancing this with a 10.4% discount rate and the costs required to go to market, we derive a DCF valuation of $2.47/share.

In terms of an appropriate Compco earnings multiple we have selected two ASX listed Australian brands Breville (BRG) and ARB Corporation (ARB) with significant offshore sales. We adjust the resulting premium multiple for liquidity and size by 30% to arrive at an appropriate Arbortech multiple and apply it to FY19 actual numbers. Our Compco valuation as a result is $2.23/share.

4th October 2019

Company Summary	
Last traded Price	$2.10*
Compco valuation	$2.23
Shares on issue	13.7M
Implied Market Cap	$30.8M
Net Cash at 30 Jun 19	$0.8M
Enterprise Value	$30.0M
Trading Platform	PrimaryMarkets.com
*off market sale mid - 2019	

Key Metrics FY19 (FY18)	
GP%	65.9 (65.7)
EBITDA ($m)	2.5 (2.8)
NPAT ($m)	1.8 (2.0)
EPS (cps)	12.9 (14.8)
ROE	12% (15.0%)
DIVIDEND (cps)	2.5 (2.5)
PAYOUT RATIO (%)	19% (17%)

Significant Shareholders	
Inkster Family	55.6%
Ucone Pty Ltd (Wesfarmers subsidiary)	10.8%

Upside Case

- New product development with a successful release track record
- Entry into new markets for existing products
- Weaker AUD

Downside Case

- Near-term investment for longer-term growth
- Unlisted Public company
- New products have an element of "push" to them rather than market "pull"

Board of Directors	
Chairman/Executive Director	Kevin Inkster
Executive Director	Kristine Inkster
Non-Executive Director	Selwyn Bajada
Company Secretary	Christine Taylor

PrimaryMarkets' Contact Details	
Phone	+61 2 9993 4475
Email	research@primarymarkets.com

RaaS Advisory Contact Details	
Phone	+61 410 439 723
Email	john.burgess@raasgroup.com

COMPANY OVERVIEW

Arbortech in a nutshell

Arbortech, formed in 1988, is an Australian based designer, manufacturer and distributor of a range of own brand brick and mortar cutting tools and woodworking tools and accessories. It has operating subsidiaries in the USA and Germany.

The business currently has two key divisions/products, Allsaw and Woodworking, and across the Group there are ~270 SKU's including regional variations.

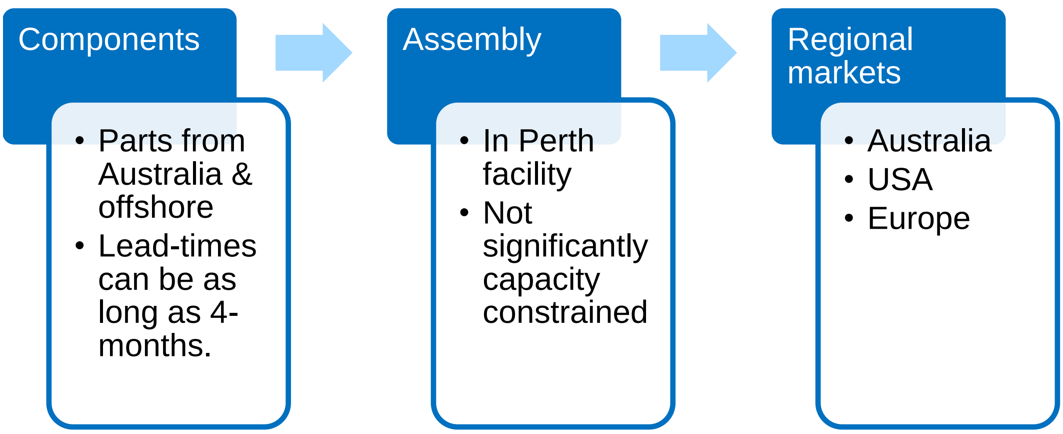
Around 18% of the business is spare parts (mainly blades), which provides a level of recurring revenue for the Group based on units in circulation.

All products are designed is Australia, with components sourced from both Australia and offshore (predominantly Taiwan), and assembled in Australia (Perth). Component lead-time rather than capacity is the major assembly constraint for Arbortech at present, with some components having 4-month lead times.

Following assembly, the end products are then shipped to their respective regional markets, being predominantly the USA and Germany for distribution throughout Europe.

Distributors are typically niche tool stores and not the likes of Bunnings (Australia) and Lowes (US). Key distributors in the US for example include retail stores such as Rockler, Colony Hardware Supply, Woodcraft Supply Corp as well as increasingly Amazon online sellers.

Exhibit 1: Arbortech Supply chain



Source: RaaS estimates

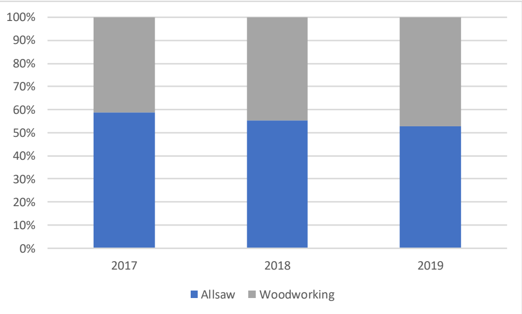
Product mix

The Allsaw brick and mortar saw and related accessories represented 53% of Group revenue in FY19 and 49% of Group gross profit. The FY19 gross profit margin was 61%, which is impressive relative to other listed manufacturers and manufacturing benchmarks.

Woodworking represented 47% of Group revenue in FY19 and 51% of Group gross profit. The gross profit margin in FY19 was 71%. Woodworking achieves a higher gross margin due to its mix of accessories relative to the Allsaw Division, and its niche product offering to the woodworking enthusiast.

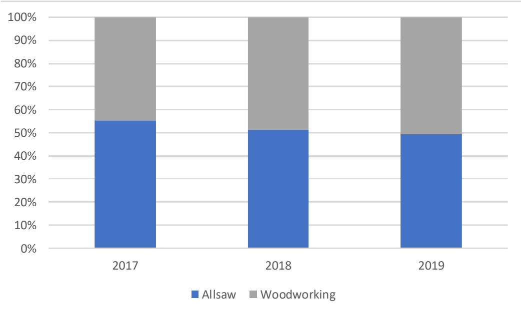
The charts below look at how the revenue and gross profit mix of Allsaw and Woodworking have moved over recent years. In summary Woodworking has grown relative to Allsaw on both fronts.

Exhibit 2: Revenue Split



Source: Company Data

Exhibit 3: GP$ split



Source: Company Data

Regional exposure

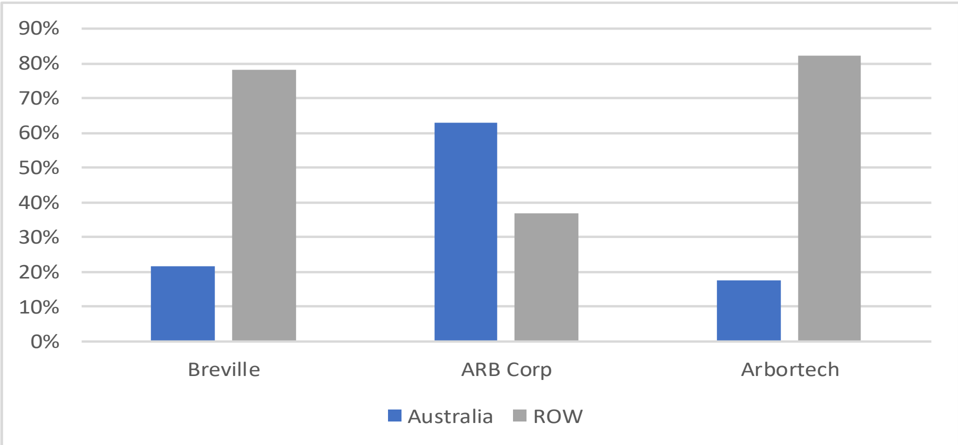
In FY19 Arbortech derived 82% of its total revenues from outside Australia. This level of offshore sales exceeds that of well-known ASX listed companies (and chosen peers) Breville Group Limited and ARB Corporation Limited which design and manufacture products for domestic and offshore customers as the chart below shows. Most of the offshore exposure at present is on the US East Coast and Germany in Europe.

Canada is currently serviced by independent sales reps who work on a commission basis, but Arbortech will shift to a direct sales and representation model in FY20 which is expected to significantly enhance Canadian sales.

There is currently no exposure in Asia or South America, while Eastern and Southern Europe are significantly under-developed.

When assessing growth opportunities and valuation, an established/growing offshore presence is important in justifying growth potential and valuation multiples respectively.

Exhibit 4: FY19 Revenue mix – Australia versus Rest of World



Source: Company data

NEW PRODUCT DEVELOPMENT

Arbortech has a significant product launch scheduled FY20/21 of the HammerSaw and full-year impact of a recently upgraded key product, the Allsaw AS175, both of which promise accelerated sales into FY21 and onwards.

There has been little pre-marketing of both products to-date, so the cost of such activities has been and is likely to be borne in FY19 and FY20 respectively, with the benefits seen from FY21.

A brief background of each product is discussed below:

Allsaw AS175

Superseding the AS170 model is the new Allsaw AS175 which recently hit the market and offers several new features to its predecessor including:

- A new and more powerful motor, promising better performance, durability and lower maintenance
- An improved pulley/belt drive offering more efficient power transmission and durability
- Lower Hand Arm Vibration
- A new dust boot or dust collector.

It is intended that a battery version of the AS175 will be offered which promises to increase the market size for this product.

Despite the enhancements there is not expected to be a material change in either the COGS or selling price of the end-product, rather greater market opportunities.

HammerSaw

The HammerSaw is seen as a revolutionary technology in the cutting of hard materials such as reinforced concrete relative to the incumbent technology (Diamond Saw). The HammerSaw technology is covered by a suite of existing and pending patents worldwide.

The target markets for the HammerSaw include quarrying, demolition, excavations, trenching, forestry, landscaping and mining, basically any industry that requires the cutting of hard materials. The Company believes the product solves the problem of delivering the very high impact forces necessary to cut such materials by driving the blade in a robust geared hula hoop fashion.

The key features and benefits of the HammerSaw relative to the Diamond Saw technology are listed in the table below:

Exhibit 5: Features of the HammerSaw vs. Incumbent Diamond Saw Technology

Feature	Incumbent technology	HammerSaw
Surface Speed/Safety	Peripheral surface speeds of 90ms Potentially catastrophic accidents on failure	Peripheral surface speed of 1.5ms Low failure risk due to slower speed of cut
Operation	Requires high power and torque to overcome the high friction needed to spin the blade, which requires multiple small depth cuts and therefore water to cut	Operates at high torque but uses a high frequency hammering action. As a result, the HammerSaw does not require cooling and can cut dry, offering significant cost savings and safety improvements
Convenience	The high friction and surface speeds requires high strength & grade steels and materials which is costly and offers a short life span.	The low rotation speed allows the blades to be fabricated from low grade steels with brazed Tungsten Carbide – all lower cost.
OHS	Produces fly dust which is easily respirable and therefore has high silicosis risk	Produces a course and heavy dust which falls to the ground and does not become airborne
	Blades can shatter and fly in the air	Blade breaks (if any) fall to ground
Steering	No curved steering possible	Can be steered along a curved cut

Source: Company

The pricing (much higher), expected GP margin (slightly lower) and distribution channels will be markedly different to current products and therefore require significant sales & marketing spend, together with some assembly/warehousing facility upgrades.

A branded and OEM version of the product is expected to be made available and although no OEM agreement has been signed to-date, the OEM product is expected to dominate sales longer-term. The OEM product is likely to require a lower sales & marketing effort than the branded product.

RECENT RESULTS DISCUSSION

FY19

Despite currency tailwinds (estimated at 7.5% for FY19 before natural offsets) and modest revenue growth (+3%), Arbortech reported an EBIT decline of 25% in FY19 driven by two key factors:

- Unit sales for the Allsaw were under forecast (partly attributable to the delayed release of the AS175), with Allsaw revenue down 1.2% compared to Woodworking revenue which increased 8.5%.
- There was significant investment in human resources over the year as the Group ramped up support for existing markets (Europe and the US) and new product certification/marketing costs, with operating costs as a result up 15% in absolute terms.

On the positive side, Group gross margins held at solid levels (66%), with Allsaw maintaining a GP% of 61% despite the revenue decline, indicating discounting was not a major reason for the revenue decline.

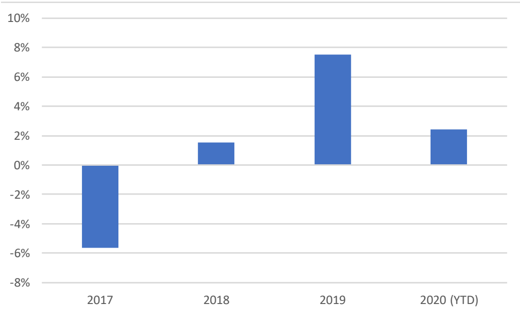
Exhibit 6: Arbortech P&L FY19 versus FY18

Line item	30- Jun-18	30-Jun-19	Comment
Operating Revenue	11.5	11.8	
% growth	21%	3%	3% growth vs. 21% in FY18 (on FY17)
GP	7.8	7.8	
GP%	68%	66%	Holding at a high level
Operating Costs	4.8	5.5	
% growth	4%	15%	Investing in new regions (Europe & Canada)
EBITDA	3.0	2.3	
D&A	0.1	0.1	
EBIT	2.9	2.1	
% growth	134%	-25%	Reduced sales leverage and higher operating costs

Source: Company Data

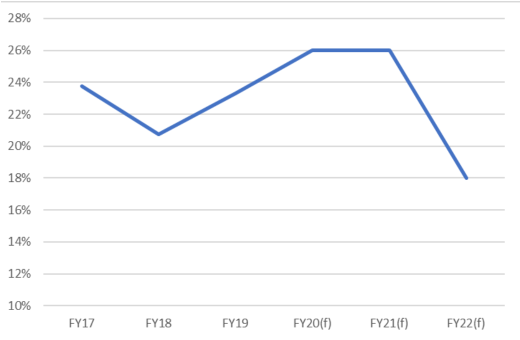
The following two charts look at weighted currency tailwinds/(headwinds) over the last four years for Arbortech and the marketing cost to sales over the last 3-years and our forecasts for FY20-FY22.

Exhibit 7: Weighted average FX movements



Source: Company Data

Exhibit 8: Marketing & Promotion to sales



Source: Company Data & RaaS estimates

EARNINGS OUTLOOK

FY20 is shaping as another investment year for Arbortech, with the HammerSaw development, push into new markets with existing products and education around existing product upgrades. FY21 is likely to be an inflection year as this investment and marketing spend is rapidly repaid in the form of higher unit sales at above industry gross margins.

FY20-21 will require further investment in human resources and sales & marketing as end customers currently have little knowledge of the potentially disruptive HammerSaw product release. The fact that HammerSaw has a different sales channel and different end customers to the existing product range heightens the spending requirements to educate the market around the new products and ultimately drive new unit sales.

The decline in Gross Profit margin is a function of mix (as the HammerSaw grows) rather than pricing or input cost pressures, together with some inherent conservatism built into the existing margins.

With much of the development spend already undertaken, the ramp-up of sales and gross profit off an established cost base promises significant NPAT and ROE uplift from FY21 and in particular FY22.

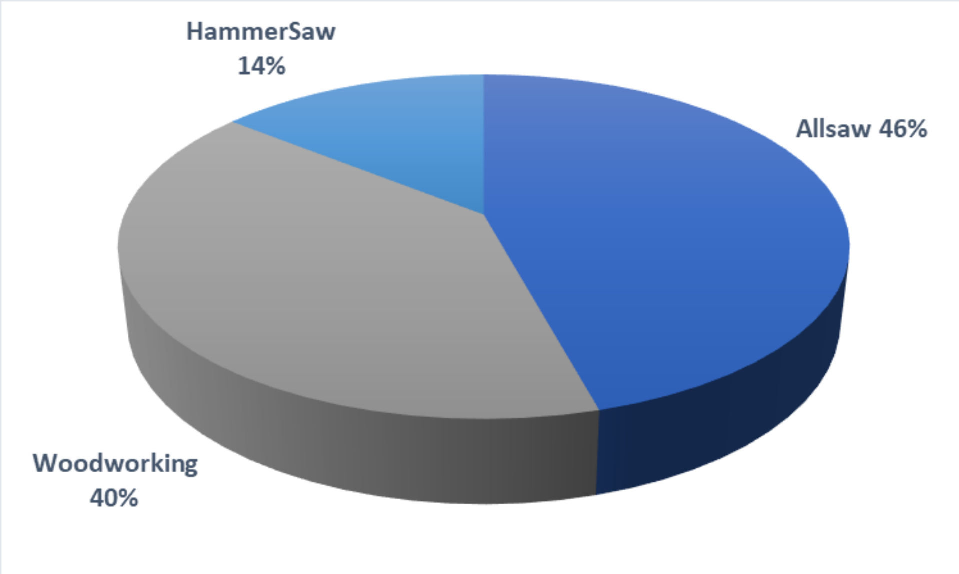
Exhibit 9: Arbortech earnings forecasts

A$m	2019A	2020F	2021F	2022F	2023F	2024F
Operating Revenue	11.84	13.65	16.43	20.82	23.83	26.27
GP	7.81	8.83	10.41	12.16	13.77	15.07
GP%	65.9%	64.7%	63.4%	58.4%	57.8%	57.4%
Operating costs	5.34	6.43	7.51	7.51	7.96	8.42
EBITDA	2.47	2.40	2.90	4.66	5.81	6.65
(EBITDA Margin)	21%	18%	18%	22%	24%	25%
ROE	**12%**	**11%**	**12%**	**16%**	**17%**	**16%**

Source: Company financials & RaaS Advisory estimates

In terms of mix, the chart below shows that by FY24 we estimate the HammerSaw to be 14% of total sales, which as mentioned above is the key reason for forecast GP% declines.

Exhibit 10: Arbortech revenue mix in FY24



Source: RaaS estimates

OTHER FINANCIAL COMMENTARY

Cash flow

The key feature of the Group's cash flow is the capitalised Research & Development (R & D) spend, which in FY19 was $967k or 8.2% of sales. This spend relates to the development costs of new products and/or upgrades to existing products and is expected to be a recurring feature of the Company's spend.

Capex has been lumpy in recent years but relatively low compared to sales. In FY20 and FY21 we have forecast a total spend of $1.7m relating to plant expansion in addition to maintenance capex as the Group scales for HammerSaw production. Medium-term we have forecast maintenance capex of 1.3x depreciation outside of any further upgrade in assembly/warehouse capacity.

Working capital to sales at June 30, 2019 was 30%, while inventory to sales was 29%. We have kept this relationship to sales stable over the forecast period.

The dividend payout ratio is low at ~20% of EPS as the Group balances investment for the future with shareholder returns. As a result, we see dividends flat until the forecast acceleration in earnings in FY22.

Balance Sheet

The capitalised R&D spend represents the intangibles line on the balance sheet, which was $9.4m as at June 2019. This number is a good guide as to what has been spent on past and new product development, and therefore what returns may be possible from this spend over time if certain ROE assumptions are applied.

The Group had a net cash position of ~$800k as at June 2019 providing a strong balance sheet to fund growth. The forecast increase in capex is assumed to be debt funded and push the Group into a net debt position but could also result in some equity funding.

THE BOARD AND MANAGEMENT

Exhibit 11: Board and Management profiles		
Director		**Background/ Responsibility**
Kevin Inkster	Executive Director - Chair	Founder and inventor of technologies; IP protection.
Kristine Inkster	Executive Director	Founder, operational planning and culture
Selwyn Bajada	Non-Exec	Company Director and corporate adviser
Christine Taylor	Company Secretary	Regulatory and financial
Management		
Sven Blicks	Group General Manager	Management of global operations
David Pellegrine	Vice President Sales USA	Head of US operations
Source: Company data		

STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS

Exhibit 12: SWOT Analysis	
STRENGTHS	**WEAKNESSES**
Niche product with strong brand	Significant ongoing R&D spend required
Balance sheet strength	Funding ability limits pace of expansion
Industry high gross margin	Exposure to the building & construction cycle
Intellectual Property and knowhow	
Some recurring revenue in the form of parts (blades)	
Successful record transitioning technology to product	
OPPORTUNITIES	**THREATS**
New product (HammerSaw) into new markets	Higher AUD
Step-change (AS175 - battery) of existing product	Potential product copies
Entry of new markets with existing products	
New woodworking products	
Source: RaaS Advisory	

PEER COMPARISON

We view peers of Arbortech to be branded and/or OEM designers/manufacturers of "hi-tech" niche hardware products with an offshore presence. We have selected the following listed companies as key comparatives and provide a brief description of each below.

Breville (ASX:BRG), develops, markets and distributes a range of small electrical appliances across the globe. In Australia they distribute under the Breville and Kambrook brands, in North America under the Breville brand and in the UK under the Sage brand. In FY19 22% of sales were in Australia and the balance across the Rest of the World.

ARB Corporation (ASX: ARB) is engaged in the design, manufacture and distribution of motor vehicle accessories for the four by four market. The company has operations in Australia, the USA, Thailand and Middle East and Europe. In FY19 the group derived 63% of sales from Australia and 37% from the Rest of the World.

Micro-X (ASX:MX1) is engaged in the design, development and manufacturing/assembly of ultra-lightweight carbon nano tube-based x-ray products for the global healthcare and security markets. Their first product (the DRX Nano Revolution) is commercially available via their US based distribution partner Carestream. Most sales to date have been via Carestream into the US market.

Orbital (ASX:OEC) invents and builds products predominantly for the unmanned aerial vehicle markets (UAV). Their products include engine and propulsion systems used by the likes of Boeing to power their UAV products. While revenue was A$15m in FY19, the company has guided to revenue of $20-$25m in FY20 as new US production facilities come on stream.

Advanced Braking Technology (ASX:ABV) is engaged in the development and manufacture of Sealed Integrated Braking Systems for use in harsh terrains in industries such as mining and forestry. The products are sold under their own brand in mining countries such as Australia, South Africa and the US, but no sales breakdown is available.

From the table below and the descriptions above we would make the following comments with regards to Arbortech and our selected peer group.

- The two established, profitable, larger cap companies (BRG and ARB) trade at a significant premium to the ASX200 market based on actual FY19 multiples (42% and 27% respectively according to the Credit Suisse Industrials ex Infrastructure multiple of 19.0x as at September 2019). We suspect this is due to the opportunities international exposure offers relative to the size of the Australian market.
- While the three smaller peer companies identified are all loss making at present, there is clearly value attributed to their products under development/reaching commercialisation. MX1 and OEC recorded significant losses in FY19 but have valuations of $59m and $26m respectively, indicating investor willingness to value future market sales of new products.
- Arbortech has superior gross margins relative to the peer group, an indication of the IP/pricing power and limited competition inherent in their products.
- Arbortech's working capital to sales is at the mid-point of peers. Working capital is a challenge for all players in this space, having to hold inventory and typically deal with larger companies than themselves (and therefore at the mercy of relative payment terms).

Exhibit 13: Peer Comparison

Company	Code	Price ($)	Mkt Cap ($m)	EV ($m)	Revenue ($m)	NPAT ($m)	PER (x)	EV/sales (x)	EV/ EBITDA (x)	GP%	WC/ sales
Breville	BRG	16.32	2,122	2,112	760	76.3	27.8	2.8	18.5	36%	24%
ARB Corp	ARB	19.59	1,561	1,553	443	60.6	25.8	3.5	17.0	56%	34%
Micro X	MX1	0.31	46	53	2	-15.0	nm	27.3	nm	10%	18%
Orbital	OEC	0.32	25	26	15	-4.6	nm	1.7	nm	43%	63%
Advanced Brake	ABV	0.03	8	9	8	-1.7	nm	1.2	nm	36%	23%
Arbortech	**na**	**na**	**na**	**na**	**12**	**2.1**	**na**	**na**	**na**	**66%**	**30%**

Source: Company financials, RaaS Advisory analysis, Stockopedia (prices as at 1st October 2019)

LISTED vs UNLISTED MARKET VALUATION CONSIDERATIONS

When comparing ASX listed companies against unlisted public companies the following should be considered, particularly as they relate to Arbortech.

- **Senior management salaries**. The two key Senior management at Arbortech earn a salary of around $220k per annum. The CEO's of smaller listed peers ABV and MX1 earned $329k and $303k respectively in the FY19 financial year. Some adjustment in EBITDA may be required for the fact that Arbortech Senior managers would likely receive a larger salary as a listed entity.
- **Liquidity**. There is a premium for liquidity in public markets, whether it be in the form of trading multiples or the beta applied in constructing a DCF valuation. Arbortech would likely to be penalised for liquidity in a public market environment.
- **Investor mandates**. Many sophisticated investors have mandates precluding them from investing in unlisted companies, small companies or both. Small unlisted public companies therefore tend to have a smaller investment audience/pool than a large listed company, which can limit pricing tension/liquidity.
- **Listing costs**. Listed companies pay ASX listed & associated on-costs of ~$500k per annum. An adjustment may be needed when comparing the earnings & multiples of listed vs. unlisted companies for listing costs.

The factors above need to be considered when applying listed company multiples to unlisted public company earnings.

VALUATION

Earnings/Sales Multiple

Using the peer metrics above we provide a range of valuation considerations using actual FY19 metrics as the base. We would argue the current metrics of both the larger peers (in the form of premium multiples to the market) and smaller peers (positive valuations despite material EBITDA losses) provide significant acknowledgement of the future earnings potential of new and existing products in this space, and therefore are applicable to Arbortech.

From a large cap peer perspective, we have used the average EV/EBITDA multiple of BRG and ARB based on their actual FY19 results and current share prices. The biggest assumption in this approach to value Arbortech in our view is the discount applied to this peer group due to the small cap/unlisted company issues discussed above. We have selected a 30% discount as appropriate, and as a result derive an EV/EBITDA multiple valuation of $2.23/share under this approach using a multiple of 12.5x against 17.8x for the larger cap peers.

The selected small cap peers are all loss making, which makes earnings multiple comparisons difficult. An EV/sales approach may be useful in understanding what markets are prepared to pay for the future earnings of new products in their infancy. Combined with a more conservative valuation of the existing earnings stream, a blended earnings/sales multiple approach provides a sense check to other valuation approaches. Assuming an 8x EBITDA multiple for the "core" Arbortech business (adjusted for estimated new product costs in the FY19 result), new products have an implied value of $6.0m at our $2.23 valuation.

Exhibit 14: Capitalisation of current earnings – two valuation approaches

EV/EBITDA relative to large peers	
BRG/ARB Average EBITDA multiple – FY19 *	17.8x
Arbortech EBITDA – FY19 reported ($m)	2.47
Implied Arbortech valuation ($m)	44.0
Discount for size/private company nature (or 12.5x)	30%
Implied Arbortech valuation ($m)	30.8
Value per Arbortech share (13.7m shares on issue)	**$2.23**
Core EBITDA + EV/sales multiple	
Core FY19 EBITDA (ex-estimated new product marketing costs)($m)	3.1
EBITDA multiple	8.0x
Value of core business ($m)	24.8
HammerSaw sales estimate FY23 ($m)	2.3
Implied revenue multiple	2.6x
Value of new business	6.0
Value of total business	30.8
Value per share	**$2.23**

Source: Company Financials & RaaS estimates * Prices as @ 1 October 2019

Sensitivities to our 30% EBITDA discount assumption are tabled below.

Exhibit 15: Arbortech EV/EBITDA valuation at various discount assumptions

Discount	30%	20%	40%
Implied multiple	11.8x	13.5x	10.1x
Implied valuation	$2.23	$2.43	$1.82

Source: Company Data

A comparison of relative EPS growth assumptions between Arbortech and key peers is tabled below. Our numbers suggest superior growth for Arbortech into FY21 for the reasons discussed.

Exhibit 16: Relative EPS growth – Arbortech vs. Larger cap peers				
	FY20(f)	FY21(f)	FY22(f)	CAGR (20-22)
ARB Corp	6.2%	8.5%	na	7%
Breville	12.9%	11.8%	Na	12%
Arbortech	**-3.2%**	**21%**	**68%**	**28%**

Source: Stockopedia & RaaS Advisory estimates

DCF Valuation

A DCF valuation is arguably best placed to capture current earnings and the potential upside from new product developments, while also the capturing the cost of development and the forecast risk in the form of the discount rate applied.

We have explicitly modelled Arbortech out to FY24 and then applied a medium-term growth rate for the remaining 5-years before our terminal growth assumptions kick-in.

We have derived a DCF valuation of $2.47/share based on the following key assumptions:

- A discount rate of 10.4% which incorporates a beta of 1.5x for forecast/liquidity risk, a 6.5% equity risk premium and 1% risk free rate (which is slightly above the current 10-year government bond rate).
- CAGR EPS growth of 22% over the forecast period as new product sales accelerate. FY20 EPS growth however is forecast to decline 3% as investment is made in new product marketing.
- Elevated New Product Development R&D in FY20 and FY21 (7.5% and 6% respectively) before settling at 5% medium-term. Our terminal year has no R&D spend.
- Current working capital to sales metrics remain stable, resulting in significant working capital requirements over the forecast period. Once again, our terminal year has no working capital increase.
- Arbortech is currently entitled to an R&D tax offset rate of 16 cents until their turnover reaches $20m (FY22 by our forecasts). From then the offset rate will fall to 11 cents (between $20m and $25m) and 8.5 cents above $25m revenue. We have taken such offsets into account through the forecast period and applied a full tax rate in the terminal year (as no R&D is assumed).
- Gross margins declining from 65.9% in FY19 to 57.4% by FY24. Some of this is mix related with the HammerSaw assumed to be lower margin, while some is erring on the side of conservatism with the existing product range.
- A medium-term growth rate of 5%.
- A terminal growth rate of 2%.

Exhibit 17: Arbortech DCF sensitivities				
Variable	**Current Assumption**	**+/-**	**Chg (cps)**	**% Chg**
WACC	10.4%	1.0%	0.50	20%
LT GP%	57.5%	1.0%	0.12	5%
MT Growth rate (FY25-29)	5.0%	1.0%	0.09	4%
R&D/sales	5.0%	1.0%	0.09	4%

Source: Company financials & RaaS Advisory estimates

DISCLAIMER AND DISCLOSURE OF INTEREST

This document (Report) is issued by PrimaryMarkets Pty Limited an authorised representative of its wholly owned subsidiary Linqto Asia Capital Pty Limited, Australian Financial Services Licence No. 334838 (individually and collectively PrimaryMarkets). This Report is intended solely for the use by wholesale/institutional clients within the meaning of section 761G of the Corporations Act 2001 (Cth) (Act), sophisticated investors pursuant to Section 708(8) of the Act, professional investors pursuant to Section 708(11) of the Act and/or otherwise persons to whom a disclosure document is not otherwise required to be given under Chapter 6D of the Act.

To the extent that any recommendations or statements of opinion made by PrimaryMarkets in this Report constitute financial product advice, they constitute general financial product advice only and do not constitute personal financial product advice in any manner whatsoever. Accordingly, any such recommendations or statements do not take into account the investment objectives, financial situation, taxation requirements and/or the particular needs of any recipient. Before subscribing for securities in the Company named in the Report (the Company) you should consider, with the assistance of your independent financial and legal advisers, whether the potential investment is appropriate in light of your particular investment needs, objectives and financial circumstances.

Any recommendations or statements of opinion contained in this Report are based on assumptions made by PrimaryMarkets. These assumptions may or may not eventuate and accordingly, any such recommendations or statements of opinion may prove to be incorrect. This Report has been distributed in confidence and may not be reproduced or disclosed to any other person without the prior written consent of PrimaryMarkets.

The information contained in this Report has been prepared by PrimaryMarkets with due care but no representation or warranty whatsoever is made, express or implied, in relation to the accuracy and/or completeness of this information. This Report is based on information obtained from sources believed to be reliable and PrimaryMarkets has made every effort to ensure the information in this Report is accurate however PrimaryMarkets does not make any representation and/or warranty that any information in this report is accurate, reliable, complete and/or up to date. Except for any liability which cannot be excluded, PrimaryMarkets disclaims all liability for any error or inaccuracy in, or omission from the information contained in this Report or any loss or damage suffered, directly or indirectly by the reader or any other person as a consequence of relying upon the information.

PrimaryMarkets and its Directors, employees, agents and consultants accept no obligation or liability whatsoever to correct and/or update any information and/or opinions in this Report. Opinions expressed are subject to change without notice and only accurately reflect the opinions of PrimaryMarkets at the time of writing this Report. PrimaryMarkets and its Directors, employees, agents and consultants accept no liability whatsoever for any direct, indirect, consequential and/or other loss arising from any use of this Report and/or further communication in relation to this Report. The historical information in this Report is, or is based upon, information that has been released to the general market.

Each recipient of this Report acknowledges that PrimaryMarkets, its Directors, employees, authorised representatives, consultants, associates, related entities and/or family members may have interests in the securities of the Company. If you require further information in relation to the parties referred to above and their interest(s) in the Company please contact PrimaryMarkets at info@primarymarkets.com.

PrimaryMarkets Pty Limited ABN 24 136 368 244

Level 12, 179 Elizabeth Street

Sydney 2000

PO Box A298 Sydney South

NSW 1235 Australia

www.primarymarkets.com

T: +61 2 9993 4475

FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

ABN 99 614 783 363

Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

ABN 92 168 734 530

AFSL 456663

Effective Date: 26th November 2018

About Us
BR Securities Australia Pty Ltd (BR) is the holder of Australian Financial Services License ("AFSL") number 456663. RaaS Advisory Pty Ltd (RaaS) is an Authorised Representative (number 1248415) of BR.
This Financial Service Guide (FSG) is designed to assist you in deciding whether to use RaaS's services and includes such things as

- who we are
- our services
- how we transact with you
- how we are paid, and
- complaint processes

Contact Details, BR and RaaS
BR Head Office: Level 14, 344 Queen Street, Brisbane, QLD, 4000
RaaS. 20 Halls Road Arcadia, NSW 2159
P: +61 414 354712
E: finola.burke@raasgroup.com

RaaS is the entity providing the authorised AFSL services to you as a retail or wholesale client.

What Financial Services are we authorised to provide? RaaS is authorised to

- provide general advice to retail and wholesale clients in relation to
  - Securities
- deal on behalf of retail and wholesale clients in relation to
  - Securities

The distribution of this FSG by RaaS is authorized by BR.

Our general advice service
Please note that any advice given by RaaS is general advice, as the information or advice given will not take into account your particular objectives, financial situation or needs. You should, before acting on the advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Prospectus, Product Disclosure Statement or like instrument. As we only provide general advice we will not be providing a Statement of Advice. We will provide you with recommendations on securities

Our dealing service
RaaS can arrange for you to invest in securities issued under a prospectus by firstly sending you the offer document and then assisting you fill out the application form if needed.

How are we paid?
RaaS earns fees for producing research reports. Sometimes these fees are from companies for producing research reports and/or a financial model. When the fee is derived from a company, this is clearly highlighted on the front page of the report and in the disclaimers and disclosures section of the report.
We may also receive a fee for our dealing service, from the company issuing the securities.

Associations and Relationships
BR, RaaS, its directors and related parties have no associations or relationships with any product issuers other than when advising retail clients to invest in managed funds when the managers of these funds may also be clients of BR. RaaS's representatives may from time to time deal in or otherwise have a financial interest in financial products recommended to you but any material ownership will be disclosed to you when relevant advice is provided.

Complaints
If you have a complaint about our service you should contact your representative and tell them about your complaint. The representative will follow BR's internal dispute resolution policy, which includes sending you a copy of the policy when required to. If you aren't satisfied with an outcome, you may contact AFCA, see below.
BR is a member of the Australian Financial Complaints Authority (AFCA). AFCA provide fair and independent financial services complaint resolution that is free to consumers.
Website: www.afca.org.au; Email: info@afca.org.au; Telephone: 1800931678 (free call)
In writing to: Australian Financial Complaints Authority, GPO Box 3, Melbourne, VIC, 3001.

Professional Indemnity Insurance
BR has in place Professional Indemnity Insurance which satisfies the requirements for compensation under s912B of the Corporations Act and that covers our authorized representatives.

RAAS ADVISORY DISCLAIMER and DISCLOSURES