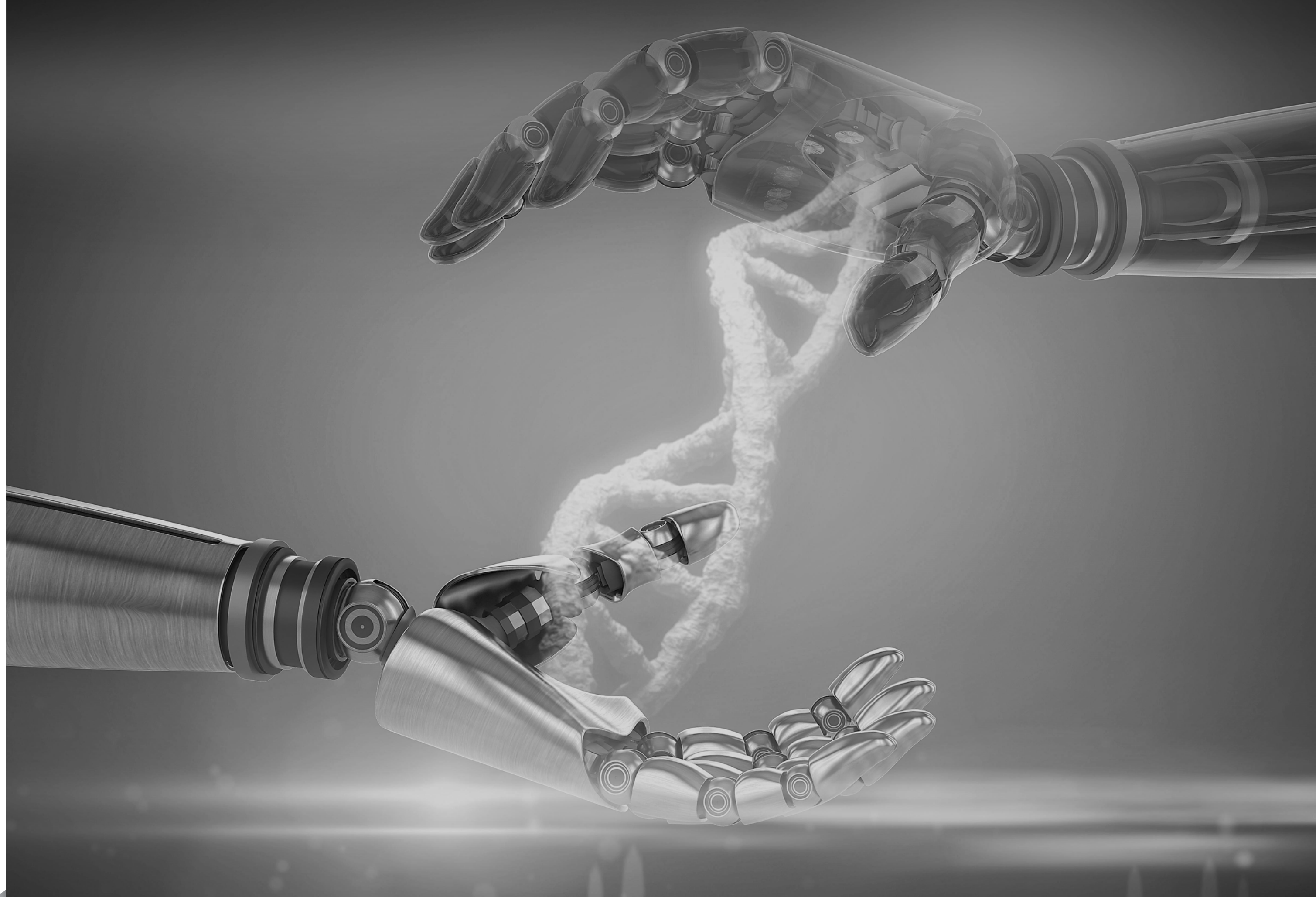
STOCKS DOWN UNDER

5 JULY 2022

Emerging Stocks Down Under

"The world is not yours for the taking, but for the trying."

- Scott Galloway (b. 1964), marketing professor, entrepreneur & author



AUDINATE

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Stocks Down Under rating: ★★

ASX: AD8
Market cap: A$588M

52-week range: A$4.99 / A$11.01
Share price: A$7.51

When you consider the best performing IPOs of the last decade, companies like Xero and AfterPay come to mind. But audio fidelity company Audinate is up there too, having listed in 2017 with a market capitalisation of ~$72m. But it is now capitalised at over $610m. Can we rely on further growth and is the stock at the right price to buy right now?

Share price chart

Source: Tradingview

No more spaghetti...of cables

Audinate is the developer of Dante, a technology which stands for Digital Audio Network Through Ethernet. Dante allows the transmission of high-quality media through standard IT networks. It eliminates the need for cables and can be used in a wide range of settings, including stadiums, music studios, shopping malls and airports. With Dante, all your microphones, speakers, amplifiers, cameras and monitors are interconnected, making it seamless to set up all these devices and to make changes to configurations.

Dante comprises of software and hardware (chips and modules) that are sold to Original Equipment Manufacturers (OEMs), such as Sony and Bose, and integrated into their products - similar to computer chips. As of 31 December 2022, there were 403 OEM brands that are shipping Dante enabled products and there were 3,301 such products on the market. It has a total addressable market of over $1bn and has 13 times the market adoption of its nearest competitor (Ravenna, which is only present in 259 products). Audinate receives revenue in the form of sales of Dante chips and modules or in royalties on each sale.

In FY21, it generated A$33.4m in revenue (up 10%) and A$3m in EBITDA (up 50%). It recorded a loss after tax of A$3.4m, but this was down 17% year-on-year. It is important to note that Audinate considers EBITDA and its gross profit a more reliable metric considering depreciation, tax expenses and R&D credits that influence net profit. Looking to 1HY22, it generated a revenue of A$20.2m (up 32%) and EBITDA of A$2.0m (up 11%). Its gross profit was A$15.3m (up 29%), thereby making its gross margin 75.6%.

Looking to its cash flow statement, operating activities were positive by A$551,000 although its free cash flow was negative by $5m. This compares to $3.2m and -$1.9m in the prior corresponding period, but this included annual bonus payments that were expenses in FY21. We observe that the company has a very strong balance sheet with cash of $60.3m with no debt. Audinate's most recent update came on 6 June, in which the company stated it expects its FY22 revenue to exceed US$30m (A$44.1M).

Supply chain issues

Yes, we all know our Stocks Down Under readers are sick of hearing that three-word phase. Some of you may think firms are just using it as an excuse to disguise bad performance. But the chip industry has been doing it tough even prior to the pandemic, suffering since the US-China trade war during the Trump presidency. COVID-19 made things worse with factory shutdowns taking their toll as has increased regulatory and compliance requirements in recent years. Audinate did its best to adapt, strengthening processes to manage product manufacturing and the selection and management of suppliers and contract manufacturing partners.

But in 2022, the issue is more with demand rather than supply. Audinate and its industry peers are shipping more units than this time last year, but it is struggling to keep up with demand. The company has told shareholders it has initiated strategic partnerships, some of which have helped it ramp up production, and it launched drop-in replacement products. It also claims that its software can help companies that are feeling the pinch, in that they will reduce the number and type of chips that will be needed to procure and diversify their designs with different chip manufacturers.

The company has US$3.7m in inventory levels that will help it meet demand heading into FY23 and has established a second manufacturing line with VTech in Malaysia. However, there is a risk that sales orders could be cancelled in the event of disruptions, or that product launches will be delayed.

Is Audinate a buy now?

Our beloved way of judging revenue raising companies is looking at consensus estimates or multiples for future earnings. We observe that consensus estimates for FY22 suggest A$41.3m in revenue, which would be up 22% from FY21's figures. But as we noted above, company guidance just calls for more than $30m in revenue. Consensus estimates forecast a ~60% drop in EBITDA to A$1.2m. Looking to FY23, consensus estimates are for $55m in revenue and $5m EBITDA, representing growth of 33% and 331% respectively from FY22's consensus estimates. For these earnings, you are paying 110.2x EV/EBITDA, which we think is very high considering the stage the company is at.

We accept Audinate has a track record of growth and if it achieves this growth, the multiple will fall - this is the price you're paying today. But remember, these earnings are well ahead of what it will achieve in FY22, and they inevitably assume no supply chain issues whatsoever. We think Audinate has positioned itself well, but we cannot discount the possibility of any supply chain issues. Investors willing to accept some risk, but not as much as they would with a pre-revenue company, may feel comfortable investing in this one. But for our part, we're two stars on this one, because of its high multiples and the chip industry's supply chain issues.

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