Pointer Telocation

Q117 results

Great start to the year, and more in the pipeline

Tech hardware & equipment

Pointer Telocation (PNTR) has reported solid Q1 figures backed by strong 25% subscriber growth and 7% growth in per subscriber revenues. Boosted by operating leverage this translated into wider service margins and a 43% increase in operating profit. In coming quarters, as individual fleet vehicles are equipped with PNTR's telematics, subscriber revenues from the FEMSA and NYC taxicab contracts should start to boost group revenues. We see Q117 as a good start to the year and, with management discussing similar contracts with other companies and exploring new acquisitions, more good news is likely to follow in the coming quarters. We have increased our multiple based valuation by 26% to $13.6 (NIS48.9) per share, while maintaining our DCF valuation at $14.9 (NIS53.6) per share.

Year end	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	EV/EBITDA (x)	P/E (x)	Yield (%)
12/15	60.6	6.4	66.8	0.0	10.3	16.1	N/A
12/16	64.4	6.6	61.8	0.0	9.3	17.4	N/A
12/17e	71.9	8.4	78.4	0.0	7.5	13.7	N/A
12/18e	78.1	10.6	97.6	0.0	6.2	11.0	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Record margins, strong ARPU and net additions

First quarter numbers showed strong momentum in non-acquisition related subscriber additions, with 9,000 organic net additions versus 5,000 in Q116. Helped by an ARPU uptick during the quarter and very strong margin growth in the mobile resource management business, led by the group's high operating leverage, this flowed down to a 43% y-o-y increase in operating profit and a similar 44% y-o-y increase in net profit from continuing operations.

FEMSA and NYC contracts to boost coming quarters

We see the potential for the positive trends of the first quarter to continue in coming quarters as the subscriptions for the vehicles in the FEMSA and NYC contracts start to be activated. A potential acquisition for this year as well as a planned new product launch later in the year should help keep momentum positive.

Valuation: Multiples show significant undervaluation

Pointer shares have gained c 17% on the positive Q1 results. Nevertheless, with the stock rated on a prospective FY17 EV/EBITDA multiple of only 7.5x, PNTR trades at a 46% discount to the telematics sector multiple of 14.0x. We believe that with the group's potential to win further business along the lines of the recent FEMSA contract, as well as the operating leverage provided by its SaaS business model, PNTR represents very good value at present. We have increased our multiple-based valuation from $10.8 (NIS39.6) to $13.6 (NIS48.9) per share, applying an unchanged target average 10-20% discount to median sector P/E and EV/EBITDA multiples for the current and next forecast years. Our DCF valuation remains unchanged at $14.9 (NIS53.6) per share.

5 June 2017

Price*	**NIS39.99/ US$10.75**
Market cap	**US$86m**

*Priced as at 23 May 2017; multiples based on Nasdaq price.

	NIS3.5971/US$
Net debt ($m) at 31 March 2017	9.0
Shares in issue	8.1m
Free float	71.39%
Code	PNTR
Primary exchange	Nasdaq
Secondary exchange	TASE

Share price performance

%	1m	3m	12m
Abs	16.8	38.7	83.8
Rel (local)	14.4	36.7	56.9
52-week high/low		US$10.8	US$5.2

Business description

Pointer Telocation (PNTR) is a leading provider of MRM services and products to the automotive and insurance industries. Key services are asset tracking, fleet management and monitoring goods in transit/IoT. Its main markets are Israel, Brazil, Argentina, Mexico and Europe.

Next events

Q217 earnings	August 2017

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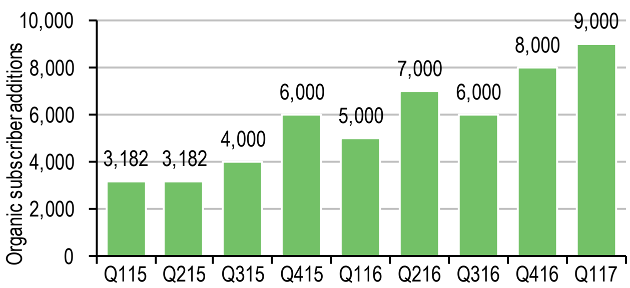
Results review

The first quarter saw good momentum in subscriber additions. Pointer's organic subscriber additions (stripping out the addition of 16,000 subscribers from the Cielo acquisition in Q416) have shown a strong uptrend over the last nine quarters (see Exhibit 1), with organic additions in Q117 almost triple the average for the first three quarters of 2015.

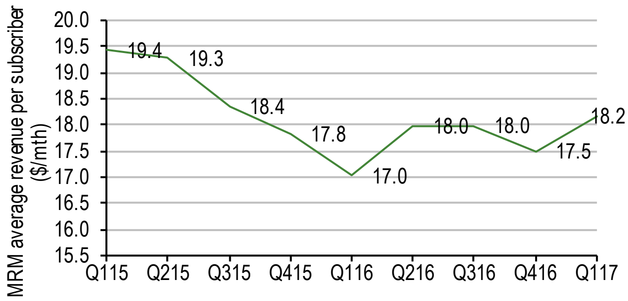
Mobile Resource Management (MRM) ARPUs also ticked up: We were also encouraged to see the uptick in Q1 ARPU to $18.2, in comparison to $17.5 in Q416 and $17.0 in Q116 (see Exhibit 2). We understand that currency movements had a mildly positive impact on the ARPU, helped by stabilisation of the Brazilian real. The results still impress, however, given the growth in subscriber numbers and the addition of truck fleet subscribers from the Cielo Telecom acquisition in Q416. We expect some pressure on ARPU levels in coming quarters as new fleet contracts, such as the for-hire driver contract in New York City, are being based on a low-ARPU clean SaaS model where the low ARPU is offset by Pointer Telematics not having to fund the telematics equipment installed in the vehicles. We currently forecast a 4% decline in ARPU in 2017 to $17.6.

Exhibit 1: Positive trend in quarterly organic net additions



Source: Pointer Telocation. Note: Q416 additions exclude 16,000 subscribers arising from the acquisition of Cielo Brazil.

Exhibit 2: Positive uptick in Q1 MRM ARPUs



Source: Pointer Telocation

Record MRM gross margin performance helped by operating leverage: PNTR achieved a 33% increase in gross profit and a record 56.6% gross margin on its MRM service revenues in Q117 after 55.8% in Q416. The margin reflects the benefit of high operating leverage on the basis of the group's SaaS model, which results in virtually no incremental cost to new subscriber additions. Although the more volatile product side experienced a sharp dip in profitability with the gross margin falling from a high 41.3% in Q4 to 36.0% (see Exhibit 3), total gross profit grew 28% y-o-y to $9.4m.

Marketing costs and G&A costs grew broadly in line with gross profit. Marketing costs are particularly worth commenting on. They grew 25% y-o-y to $3.3m in keeping with PNTR's more aggressive marketing strategy as it seeks to capitalise on recent successes in the NYC and FEMSA contracts. We see this as the right strategy as the company looks to be in a good position to exploit the growth in the relatively new driver monitoring segment and its strong position in the market, helped by the NYC contract and its JV with Mobileye. We see the group's high level of operational gearing adding to the potential ROI from intensive marketing at this stage as high-margin contributions from new subscribers should be significantly higher than incremental marketing costs.

The benefits of high operating gearing were reflected in a 44% y-o-y increase in net profits from continuing operations to $1.57m (adjusting for the spin-off of a subsidiary in H116). Operating cash flows fell 1.1% y-o-y to of $1.50m due to an increase in working capital expansion.

Nevertheless, helped by its ongoing cash generation, the group was able to reduce net debt by $0.9m to $8.1m during the quarter, which should put it in a good position to pursue its goal of undertaking another acquisition this year.

Earnings forecasts materially unchanged: Our forecasts have not been changed as a result of the Q117 earnings figures. We have updated our 2015 reported earnings as a result of a revision to G&A expenses and debtor balances. This has increased our reported net income for 2015 by 1.8% to $3.87m.

Outlook

We believe that PNTR has good prospects to continue the strong subscriber growth trend helped by recent contract wins.

The NYC passenger driver and FEMSA Coca-Cola bottler contracts announced in Q117 (see our notes Good figures and yet another impressive deal and Taking a ride with Uber) are expected to have their main impact on subscriber growth in Q2 and Q317. Pointer records new subscriptions from the date it installs its equipment in each vehicle and starts charging for its services. The bulk of the subscriptions for the five-year NYC contract (in which it is partnering with Mobileye), which in its initial phase will cover c 4,000 vehicles, are expected to be activated in Q2. The subscriber additions for the FEMSA contract are expected to take place mostly in the middle quarters of the year, with the greatest number of subscribers being added in the third quarter. Thus far no numbers have been released as to the size of the contract, but we estimated in our research that if the trial covers 20% of FEMSA's Mexican delivery fleet that this would be c 1,500 vehicles.

Driver safety tools look set to become a major driver of business growth: PNTR has been able to demonstrate the success of its driver safety tools in significantly reducing the insurance premiums of two of its fleet customers. As well as targeting fleet managers with this information, it is also talking to insurance companies with the aim of them offering fleets discounted insurance premiums in return for installing PNTR's equipment. The company is also promoting the idea with taxi services to install driver assessment equipment so that each driver is rated on their quality and riders can choose their driver based on quality. With a high number of taxi and ride hailing vehicles in operation across the US, as indicated by the 239,900 taxi drivers (US Bureau of Labor Statistics) and estimates of 327,000 Uber drivers in 2015 (businessinsider.com) in the US, this has the potential to become a significant new revenue stream for the company.

Exhibit 3: Pointer Telocation quarterly results summary

$m	Q117	Q116	Change y-o-y (%)	2017e	Q117 as % of FY17e	Q216	Q316	Q416
Product Revenues	**6.68**	**5.51**	**21.3**	**23.92**	**27.9**	**6.05**	**5.39**	**5.84**
Change (%)	21.3	(4.8)	N/A	5.0	N/A	5.1	6.0	3.4
Services Revenues	**12.35**	**9.32**	**32.5**	**47.99**	**25.7**	**10.17**	**10.52**	**11.56**
Change (%)	32.5	(3.2)	N/A	15.4	N/A	4.4	11.1	22.2
Service revenues, change local currency (%)	0.0	7.0	(100.0)	21.2	0.0	20.0	18.0	27.0
Revenue	**19.03**	**14.83**	**28.4**	**71.91**	**26.5**	**16.21**	**15.92**	**17.40**
Change (%)	28.4	(3.8)	N/A	11.7	N/A	4.7	9.3	15.2
Cost of Products	(4.28)	(3.40)	25.9	(14.89)	28.7	(3.78)	(3.30)	(3.43)
Gross profit Products	**2.4**	**2.1**	**14.0**	**9.0**	**26.6**	**2.3**	**2.1**	**2.4**
Gross margin products (%)	36.0	38.3	N/A	37.8	N/A	37.5	38.8	41.3
Cost of Services	(5.36)	(4.07)	31.7	(21.15)	25.4	(4.70)	(4.79)	(5.11)
Gross profit Services	**7.0**	**5.2**	**33.1**	**26.8**	**26.0**	**5.5**	**5.7**	**6.5**
Gross margin services (%)	56.6	56.3	N/A	55.9	N/A	53.7	54.5	55.8
Cost of Sales	(9.64)	(7.47)	29.1	(36.04)	26.7	(8.48)	(8.09)	(8.53)
Gross profit	**9.39**	**7.36**	**27.6**	**35.88**	**26.2**	**7.73**	**7.83**	**8.86**
Gross margin (%)	49.4	49.6	N/A	49.9	N/A	47.7	49.2	50.9
Research and development	**(0.97)**	**(0.91)**	**7.2**	**(4.07)**	**23.8**	**(0.92)**	**(0.87)**	**(0.98)**
% of sales	0.0	6.1	N/A	5.7	N/A	5.7	5.5	5.6
Selling and marketing	**(3.31)**	**(2.65)**	**24.9**	**(12.80)**	**25.8**	**(2.97)**	**(3.10)**	**(3.06)**
% of sales	0.0	17.9	N/A	17.8	N/A	18.3	19.5	17.6
General and administrative	**(2.75)**	**(2.13)**	**28.8**	**(10.10)**	**27.2**	**(2.09)**	**(2.15)**	**(2.63)**
% of sales	0.0	14.4	N/A	14.0	N/A	12.9	13.5	15.1
EBITDA (continuing operations)	**3.22**	**2.16**	**48.7**	**12.06**	**26.7**	**2.27**	**2.23**	**3.09**
EBITDA margin	**16.9%**	**14.6%**	**N/A**	**16.8%**	**N/A**	**14.0%**	**14.0%**	**17.8%**
Operating profit normalised	2.48	1.73	43.4	9.22	26.9	1.79	1.82	2.31
Operating margin normalised	13.0%	11.7%	N/A	12.8%	N/A	11.0%	11.4%	13.3%
One-off items	0.00	0.00	N/A	0.00	N/A	0.00	(0.20)	(0.41)
Operating profit	**2.26**	**1.58**	**42.6**	**8.72**	**25.9**	**1.65**	**1.40**	**1.62**
Operating margin (%)	11.85	10.67	N/A	12.13	N/A	10.15	8.80	9.32
Net finance costs	(0.16)	0.08	(300.0)	(0.83)	19.4	(0.32)	(0.38)	(0.42)
Other expenses	0.00	0.01	(100.0)	0.00	N/A	(0.00)	(0.01)	(0.01)
PBT normalised	2.32	1.82	27.8	8.39	27.6	1.46	1.43	1.88
PBT	**2.10**	**1.67**	**25.7**	**7.89**	**26.5**	**1.32**	**1.01**	**1.19**
Reported tax	(0.53)	(0.58)	(8.5)	(1.97)	26.8	(0.28)	(0.30)	(0.69)
Profit after tax reported	**1.57**	**1.41**	**11.0**	**5.92**	**26.5**	**0.88**	**0.71**	**0.50**
Profit after tax from continuing operations	**1.57**	**1.09**	**43.8**	**5.92**	**26.5**	**1.04**	**0.71**	**0.50**
Profit after tax normalised	1.74	1.36	28.1	6.39	27.2	1.09	1.07	1.41
EPS - basic ($)	0.20	0.18	9.6	0.74	26.7	0.11	0.09	0.06
EPS - diluted ($)	0.20	0.18	9.7	0.72	27.0	0.11	0.09	0.06
EPS - basic normalised ($)	0.22	0.18	23.7	0.81	27.3	0.14	0.14	0.18
EPS - diluted normalised ($)	0.22	0.17	23.8	0.78	27.6	0.14	0.13	0.18
Ratios								
MRM subscribers	**231,000**	**185,000**	**24.9**	**250,800**	**92.1**	**192,000**	**198,000**	**222,000**
Net additions	9,000	5,000	80.0	28,800	31.3	7,000	6,000	24,000
Avg. service rev. per MRM subscriber ($/mth)	**18.2**	**17.0**	**6.8**	**16.9**	**107.4**	**18.0**	**18.0**	**17.5**
Cash flow/balance sheet summary								
Operating cash flows	**1.51**	**1.52**	**(1.1)**	**10.57**	**14.2**	**3.44**	**1.43**	**2.55**
Cash conversion (operating CF to operating profit, %)	66.7	96.1	N/A	121.2	N/A	208.9	102.1	157.2
Cash flows from investment	(0.75)	(1.10)	(31.9)	(3.98)	18.9	(1.28)	(0.69)	(8.88)
Purchases of property, plant and equipment	(0.77)	(1.58)	(51.3)	(4.32)	17.8	(1.28)	(0.72)	(0.57)
Cash & cash equivalents	5.75	N/A	N/A	4.88	N/A	7.75	14.07	6.07
Net debt ($m)	8.06	N/A	N/A	3.22	N/A	3.17	2.23	8.95
Net debt (cash)/Equity (%)	17.20	N/A	N/A	6.45	N/A	7.64	5.17	20.97
Current ratio	1.32	N/A	N/A	1.27	N/A	1.51	1.90	1.27
Quick ratio	1.05	N/A	N/A	0.99	N/A	1.25	1.62	1.01

Source: Pointer Telocation, Edison Investment Research

Valuation

For our multiple based share valuation of Pointer Telocation we continue to target a 10-20% discount to the sector based on sector median P/E ratio and EV/EBITDA multiples for the current and next forecast years. With market multiples having moved higher in recent months we have increased our multiple-based valuation from $10.8 (NIS39.6) to $13.6 (NIS48.9) per share (representing the mid-point of a range of $12.2-14.9 (NIS44.0-53.6) per share). We have not revised our DCF-based share valuation, which remains unchanged at $14.9 (NIS53.6) per share.

Exhibit 4: Pointer peer group valuation table

	Main	Share	Market	Sales	EBITDA	EV/sales (x)		EV/EBITDA		P/E		Last	Net debt
$m	focus	Price (LC)	Cap ($m)	FY1 (m)	margin FY1 (%)	FY1	FY2	FY1	FY2	FY1	FY2	Div yield	(cash)/ equity
Pointer Telocation	**Isr, Latam, SA**	**10.8**	**74**	**72**	**16.8%**	**1.3**	**1.2**	**7.5**	**6.2**	**13.7**	**11.0**	**0.0%**	**21.0**
CalAmp Corp	NAM	18.8	665	361	15.2	2.0	1.8	13.0	11.3	15.7	13.7	0.0	28.4
ID Systems Inc	NAM	6.2	88	40	0.1	2.0	1.5	2,286.2	13.9	(271.3)	16.6	0.0	(34.6)
Ituran Location and Control Ltd	Isr, Brzl, Arg	31.3	734	216	N/A	3.3	3.1	N/A	N/A	18.0	15.9	2.7	(24.9)
MiX Telematics Ltd	SA	76.0	138	1,497	18.9	1.0	1.0	5.3	4.8	300.5	255.1	N/A	(16.8)
Numerex Corp	NAM	4.1	79	72	10.0	1.2	1.1	12.2	7.8	(35.3)	21.9	0.0	16.0
ORBCOMM Inc	US/Europe	9.7	692	216	25.3	3.8	3.6	15.0	12.9	(60.3)	(153.2)	0.0	45.7
Sierra Wireless Inc	NAM	27.0	867	678	7.9	1.2	1.1	15.1	13.2	26.4	23.1	0.0	(16.3)
Trakm8 Holdings PLC	UK	1.0	48	27	9.1	1.5	1.3	16.8	8.8	36.8	15.4	1.9	25.8
QUALCOMM Inc	NAM	59.3	87,582	22,711	36.3	3.1	3.1	8.6	9.1	13.6	14.3	3.4	(53.3)
Quartix Holdings PLC	UK	3.9	238	23	29.6	7.7	7.2	26.0	22.7	32.9	28.9	1.7	(34.1)
Median			**238**	**216**	**1,260.2%**	**2.0**	**1.5**	**14.0**	**10.2**	**15.7**	**15.9**	**0.0%**	**(16.3)**
Average/Median* - MCAP<$300m			111	283	955.1%	1.4	1.2	14.5	8.3	23.3	19.2	0.0%	(0.4)

Source: Bloomberg, Edison Investment Research

Exhibit 5: Financial summary

$m	2015	2016	2017e	2018e	2019e
Year end 31 December	US GAAP	US GAAP	US GAAP	US GAAP	US GAAP
INCOME STATEMENT					
Revenue	60.57	64.35	71.91	78.06	82.89
Cost of Sales	(31.31)	(32.58)	(36.04)	(38.54)	(40.44)
Gross Profit	29.25	31.78	35.88	39.53	42.46
Selling and marketing	(10.47)	(11.77)	(12.80)	(13.89)	(14.76)
General and administrative	(8.58)	(9.00)	(10.10)	(10.60)	(11.07)
Research and development	(3.41)	(3.67)	(4.07)	(4.15)	(4.41)
EBITDA	8.80	9.75	12.06	14.51	16.28
Normalised operating profit	7.10	7.64	9.22	11.21	12.56
Amortisation of acquired intangibles	(0.54)	(0.47)	(0.18)	(0.16)	(0.14)
Exceptionals	(0.91)	(0.60)	0.00	0.00	0.00
Share-based payments (inc. In COGS)	(0.31)	(0.32)	(0.32)	(0.33)	(0.33)
Reported operating profit	5.34	6.25	8.72	10.72	12.08
Net Interest	(0.73)	(1.05)	(0.83)	(0.58)	(0.37)
Profit before tax (norm)	6.36	6.58	8.39	10.63	12.19
Profit before tax (reported)	4.60	5.19	7.89	10.14	11.71
Reported tax	(1.13)	(1.85)	(1.97)	(2.53)	(2.93)
Profit after tax (norm)	5.23	4.93	6.42	8.09	9.26
Profit after tax (reported)	3.47	3.35	5.92	7.60	8.78
Minority interests	0.08	(0.02)	(0.03)	(0.04)	(0.05)
Discontinued operations	0.33	0.15	0.00	0.00	0.00
Net income (normalised)	5.30	4.91	6.39	8.05	9.22
Net income (reported)	3.87	3.48	5.89	7.57	8.74
Basic average number of shares outstanding (m)	7.73	7.82	7.92	8.02	8.12
EPS – basic normalised ($)	0.69	0.63	0.81	1.00	1.13
EPS – diluted normalised ($)	0.67	0.62	0.78	0.98	1.10
EPS – basic reported ($)	0.50	0.44	0.74	0.94	1.08
Dividend ($)	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	N/A	6.3	11.7	8.5	6.2
Gross margin (%)	48.3	49.4	49.9	50.6	51.2
EBITDA margin (%)	14.5	15.2	16.8	18.6	19.6
Normalised operating margin (%)	11.7	11.9	12.8	14.4	15.2
BALANCE SHEET					
Fixed assets	68.78	51.61	52.56	53.51	54.40
Intangible assets	31.83	40.29	40.11	39.95	39.80
Tangible assets	3.28	5.61	6.75	7.86	8.89
Investments & other	33.67	5.71	5.71	5.71	5.71
Current assets	34.66	25.28	26.13	31.92	41.23
Stocks	4.70	5.24	5.80	6.20	6.51
Debtors	9.49	11.46	12.81	13.91	14.77
Cash & cash equivalents	7.25	6.07	4.95	9.16	17.22
Other	13.21	2.50	2.58	2.66	2.74
Current liabilities	(30.45)	(19.83)	(20.53)	(21.03)	(22.06)
Creditors	(9.82)	(13.96)	(15.51)	(16.68)	(17.63)
Short-term borrowings	(4.82)	(4.84)	(3.87)	(3.10)	(3.10)
Other	(15.81)	(1.04)	(1.16)	(1.26)	(1.34)
Long-term liabilities	(17.95)	(14.36)	(8.09)	(4.80)	(4.55)
Long-term borrowings	(8.39)	(10.18)	(4.23)	(1.23)	(1.23)
Other long-term liabilities	(9.57)	(4.18)	(3.86)	(3.57)	(3.31)
Net assets	55.04	42.69	50.07	59.60	69.02
Minority interests	1.07	(0.16)	(0.19)	(0.23)	(0.28)
Shareholders' equity	56.10	42.53	49.88	59.37	68.75
CASH FLOW					
Operating cash flow before WC and tax	8.80	9.75	12.06	14.51	16.28
Working capital	0.77	1.08	(0.31)	(0.30)	(0.22)
Exceptional & other	1.99	(1.62)	0.00	0.00	0.00
Tax	(0.05)	(0.12)	(1.18)	(1.27)	(2.93)
Net operating cash flow	11.51	9.09	10.57	12.94	13.14
Capex	(3.62)	(4.13)	(4.32)	(4.79)	(5.17)
Acquisitions/disposals	0.00	(8.65)	0.00	0.00	0.00
Net interest	(0.89)	0.00	(0.83)	(0.58)	(0.37)
Equity financing	0.02	0.10	0.00	0.00	0.00
Dividends	0.00	0.00	0.00	0.00	0.00
Other, incl.PPE sales	1.26	1.05	0.38	0.42	0.46
Net cash flow	8.28	(2.54)	5.80	7.99	8.06
Opening net debt/(cash)	11.90	5.95	8.95	3.15	(4.83)
FX	(0.71)	(0.46)	0.00	0.00	0.00
Other non-cash movements	(1.61)	0.00	0.00	0.00	0.00
Closing net debt/(cash)	5.95	8.95	3.15	(4.83)	(12.89)

Source: Pointer Telocation, Edison Investment Research

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