Research as a Service

QANTM Intellectual Property Ltd

Executive Summary to Initiation Report

Commercial & Professional Services

18 April 2023

Registering potential operating leverage

QANTM Intellectual Property Ltd (ASX:QIP) owns a group of intellectual property (IP) services businesses operating under the independent brands of Davies Collison Cave (DCC), FPA Patent Attorneys and Sortify.tm. It is a major player in the mature and regulated Australian patent, trade marks and IP legal services market with 16.5% market share (H1 FY23) in its key patents segment (68% of revenue) and a diversified mix of local and foreign clients (~45%/55% split; ~50% US$ revenue). QIP produces ~$97m service revenue (3.7% five-year CAGR) primarily via various workstreams underlying the patent and trade marks lifecycles, and has a history of profitability and cash flow generation which facilitates high dividend pay-outs. Its two key areas of strategic focus are: (1) Completing its business transformation programme ($8m-$10m cost) and the subsequent realisation of EBITDA margin expansion (low-30s medium-term target vs. ~27% currently); and (2) A two-pronged geographic expansion via DCC/FPA (Asian region focused) and Sortify's online trade marks platform. Successful execution of these strategies would facilitate increased operating leverage and/or scale.

Scope

This report has been commissioned by QIP to present an independent explanation of the business model to a wider audience and to explore the value created by the company for its stakeholders. The views expressed in this report are those of RaaS and should not be construed as an endorsement by the company.

Business model

QIP has three core offerings: (1) Patent and trade mark attorney services (88% of service charge revenue); (2) IP-focused litigation and legal services (12% of service charge revenue); and (3) Legal technology services via Sortify's online trade marks registration platforms and tools. QIP has a diverse mix of local and foreign clients (est. ~45%/55% revenue split) with no client accounting for >2% of service charges. It has sizeable US$ exposure (~50% of service charges vs. primarily A$ costs). QIP generates service charges from event-driven fixed fees (est. ~55%) and hourly rate fees (est. ~45%). Patent applications trigger various workstreams that extend over several years. On the cost side, employees account for ~80% of the total.

Focus: business transformation programme + Asian expansion

QIP's two key areas of strategic focus are: (1) Completing its current business transformation programme (incorporating technology modernisation [$8m-$10m cost] and business simplification) and subsequent realisation of EBITDA margin expansion (low-30s medium-term target) primarily from productivity-related benefits; and (2) A two-pronged geographic expansion via (a) DCC/FPA (Asian region focused – with a medium to long term aim for >25% of revenue from Asia vs. ~8% currently), and (b) Sortify's online trade marks platform (medium-term aim for ~5% of revenue from Sortify). Successful execution of these strategies would facilitate increased operating leverage and scale and the attendant financial benefits.

DCF valuation of $1.57/share or $217m market cap

Our QIP DCF-based valuation is $1.57/share (9.7% WACC). This implies EV/underlying EBITDA multiples of 8.7x for FY23f and 8.1x for FY24f. As a cross-reference, QIP is trading at FY24f EV/underlying EBITDA discounts of: (1) 60% to its closest peer, the ASX-listed IP services group IPH Ltd (ASX:IPH), on 11.4x (and a 56% P/E discount); and (2) 24% to a group of five UK-listed legal services firms. Meanwhile, applying the FY23f EV/EBITDA multiple implied by IPH's recent Smart & Biggar (Canadian) acquisition gives an equity value of $1.23/share on a minority interest/portfolio basis (7.0x using a 35% control premium).

Historical earnings and RaaS estimates (in A$m unless otherwise stated)

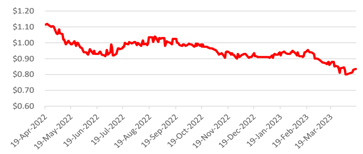
Year end	Revenue	EBITDA adj.*	EBITDA	NPAT	EPS adj.* (c)	P/E adj.* (x)	EV/EBITDA adj.* (x)	Dividend yield (%)
06/22a	127.3	26.3	21.6	7.1	9.3	9.0	5.3	7.8
06/23f	134.8	27.9	23.5	8.2	9.5	8.8	5.1	7.2
06/24f	139.9	29.9	28.4	12.2	11.0	7.6	4.6	9.1
06/25f	145.5	32.4	31.6	14.7	12.3	6.8	4.2	12.1

Sources: Company data; RaaS estimates for FY23f-FY25f; *Adjusted for non-recurring items

Share Details

ASX code	QIP
Share price (17-Apr-23)	$0.835
Market capitalisation	$116M
Shares on issue	138.6M
Net debt at 31-Dec-22	$31.8M
Free float (inc. all vendors/ excl. non-insider vendors)	~55%/ ~74%

Share Performance (12 months)



Upside Case

- Achieves targeted low-30s EBITDA margins by FY26/FY27
- Uptake/expansion of Sortify's online trade marks platform exceeds expectations
- Earning-accretive M&A in Asia

Downside Case

- Lower-than-expected transformation programme benefits
- Prolonged economic downturn → R&D/ innovation spend may not be insulated
- Changes to regulation (e.g. local agents)

Board of Directors / CEO

Sonia Petering	Non-Executive Chair
Craig Dower	CEO & MD
Leon Allen	Non-Executive Director
Gavin Bell	Non-Executive Director
Kathy Gramp	Non-Executive Director

Company Contact

Craig Dower (CEO & MD) +61 3 9254 2666
investor.relations@qantmip.com

RaaS Contacts

Clare Porta, CFA +61 413 040 540
clare.porta@raasgroup.com

Finola Burke +61 414 354 712
finola.burke@raasgroup.com

QANTM Intellectual Property Ltd

QANTM Intellectual Property Ltd (ASX:QIP) owns a group of intellectual property (IP) services businesses operating under the independent brands of Davies Collison Cave (DCC), FPA Patent Attorneys (FPA) and Sortify.tm (Sortify). It is a major player in the mature Australian patent, trade marks and IP legal services market with 16.5% market share (H1 FY23) in its key patents segment (68% of service revenue) and a diversified mix of local and foreign clients (est. ~45%/55% split and ~50% US$ revenue). QIP produces ~$97m service revenue primarily via various workstreams underlying the patent and trade marks lifecycles - and has a history of profitability and cash flow generation which facilitates high dividend pay-outs. Its two key areas of strategic focus are: (1) Completing its current business transformation programme (incorporating technology modernisation [$8m-$10m cost] and business simplification) and the subsequent realisation of EBITDA margin expansion (low-30s medium-term target vs. ~27% currently); and (2) A two-pronged geographic expansion via (a) DCC/FPA (Asian region focused), and (b) Sortify's online trade marks platform. Successful execution of these strategies (in whole or part) would facilitate increased operating leverage and/or scale and the attendant financial benefits.

Investment Case

The investment case for QIP reflects the following features and catalysts:

- **Business transformation programme = impetus for EBITDA margin expansion**: QIP continues to progress its multi-year business transformation programme which incorporates technology modernisation and business simplification programmes (with total technology-related cost outlays of $8m-$10m over FY21-FY24). The technology modernisation programme is a key plank underpinning QIP's low-30s EBITDA margin objective in the medium-term (based on service charge revenue). We envisage the programme's benefits will primarily be productivity related (i.e. from future cost and capex containment and possible incremental revenue growth) with direct cost reductions forming a small component. In addition, QIP should benefit as the cash flow impost of the programmes subside from FY24.

- **EBITDA margins – low-30s medium term target:** In August 2022, QIP articulated its aim of delivering low-30s EBITDA margins in the medium-term (based on service charge revenue) compared to 27.2% in FY22. This objective was subsequently reaffirmed in February 2023. The factors and initiatives underpinning the objective are: (1) Organic growth including via rate card adjustments to offset salary increases and other cost inflation, targeted business development, and increased contributions from Sortify and the new DCC Hong Kong office; and (2) The business transformation programme benefits. Our medium-term forecasts assume a progressive increase in EBITDA margins to ~30% in FY26/FY27.

- **Geographic expansion - remains Asia focused**: Geographic expansion in the Asian region remains a key component of QIP's strategy. QIP's aim is for Asian revenue to account for >25% of the total in the medium to longer term (vs. ~8% currently). Jurisdictions of interest include Indonesia, Thailand, Philippines and Vietnam. US$16m (~A$24m) of QIP's US$25.5m (~A$36m) acquisition debt facility remains available and assuming a 60/40 mix of consideration cash/shares, this implies the maximum acquisition consideration QIP would outlay is ~$40m. In addition to pursuing Asian opportunities for DCC/FPA, geographic expansion plans are actively being formulated and executed at Sortify. Whilst further Asian launches are also a focus, we expect Sortify's expansion plans could include countries in other regions such as Europe.

- **Sortify's growth trajectory**: Sortify's automated trade marks registration platforms for self-filers (typically small businesses and start-ups) are available in five countries (Australia, New Zealand, UK, Singapore and Malaysia). In Q2 FY23, it became the largest trade marks filing agent in Australia (moving ahead of DCC) and remained the second largest in New Zealand. It has clear potential to launch in a number of additional markets, including in Asia, at low cost (i.e. scalability). QIP is aiming for Sortify to become a material part of its revenue (est. >$5m [i.e. 5% of total revenue]) in the medium-term (vs. est. ~1% currently).

- **Sortify's technology and automation projects for DCC/FPA**: QIP is leveraging Sortify's automation and IP technology within DCC and FPA (as part of the current technology modernisation programme) in order to: (1) Reduce and streamline administrative tasks thereby deriving productivity gains; and (2) Enhance client service. This was one of the broader strategic underpinnings of the acquisition.
- **Major player in the Australian IP services market:** QIP is a major player in the mature and regulated Australian patent, trade marks and IP legal services market with 16.5% market share (H1 FY23) in its key patents segment (68% of service charge revenue). It is the #1 (Sortify) and #2 (DCC) filer of trade marks in Australia and the #2 filer (Sortify) in New Zealand. DCC Law is a leading Australian IP legal services firm.
- **Patent workstreams and revenue lifecycles**: The filing of patent applications is the trigger for various workstreams (and service fees and charges) from the subsequent stage of prosecution/examination which extends over a number of years. Some applications from local clients generate multiple additional workstreams where foreign IP protection is sought.
- **Diversified, high-quality client base**: DCC and FPA have a diversified mix of local and foreign clients (est. ~45%/55% split) across several industry sectors with no individual client accounting for >2% of revenue.
- **Solid revenue, earnings, and dividend generator.** QIP currently produces ~$97m service revenue (3.7% five-year CAGR) primarily via various workstreams underlying the patent and trade marks lifecycles. The current ~27% underlying EBITDA margins (and ~22% statutory EBITDA margins) enable it to be profitable, cash flow generative, and pay fully franked dividends. QIP has a dividend pay-out policy of 70%-90% of NPATA. Our forecasts incorporate pay-out ratios of 70% in H2 FY23 and FY24, and 80% in FY25. In turn, this should provide a solid dividend stream (7.2% fully franked dividend yield in FY23f and 9.1% in FY24f).
- **Sound financial profile – 1.15x net debt/underlying EBITDA; history of operating and free cash flow**: Although QIP's net debt has increased in recent years (largely to fund the Sortify acquisition), its net debt/underlying EBITDA ratio was 1.15x at 31 December 2022. It has a history of strong cash conversion and operating and free cash flows (e.g. $18.2m and $15.1m FCF in FY21 and FY22 respectively). The weaker cash flow performance in H1 FY23 has been attributed to a combination of several timing issues – and is expected to normalise in H2 FY23.

DCF Valuation and Peer Comparisons

Our **DCF valuation for QIP is $1.57/share** (based on a WACC of 9.7%). We view DCF as an appropriate methodology for valuing QIP given: (1) Its operations are largely mature (and in a regulated industry) and it has a sound earnings and cash flow history and trajectory, and (2) Its capex requirements are relatively low. Our DCF valuation implies EV/underlying EBITDA multiples of 8.7x for FY23f and 8.1x for FY24f.

We have also considered the trading multiples of: (1) IPH Ltd (ASX:IPH), an Australian-based company providing IP services in nine jurisdictions; and (2) Five UK-listed legal services firms. QIP is currently trading at discounts of:

- 60% to IPH on its FY24f EV/underlying EBITDA of 11.4x (and a 56% P/E discount). Whilst there is a significant difference in IPH's revenue and earnings scale relative to QIP, we consider it provides a sound valuation yardstick against an ASX-listed player in the same industry.
- 24% to the group of five UK-listed legal services firms on FY24f EV/underlying EBITDA (6.1x average).

These peer comparisons imply an enterprise value range of $181m-$342m and an equity value of **$1.14-$2.29/share** for QIP on FY24f forecasts.

Meanwhile, applying the FY23f EV/EBITDA multiple implied by **IPH's recent Smart & Biggar acquisition** gives an equity value of **$1.23/share** on a minority interest/portfolio basis (7.0x using a 35% control premium).

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: 6th May 2021

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: Suite 5GB, Level 5, 33 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 from 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 authorised representatives.

DISCLAIMERS and DISCLOSURES

This report is an abridged version of the full initiation report and both reports have been commissioned by QANTM Intellectual Property Ltd and prepared and issued by RaaS Advisory Pty Ltd. RaaS Advisory has been paid a fee to prepare this report. RaaS Advisory's principals, employees and associates may hold shares in companies that are covered and, if so, this will be clearly stated on the front page of each report. This research is issued in Australia by RaaS Advisory and any access to it should be read in conjunction with the Financial Services Guide on the preceding two pages. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. Opinions contained in this report represent those of the principals of RaaS Advisory at the time of publication. RaaS Advisory provides this financial advice as an honest and reasonable opinion held at a point in time about an investment's risk profile and merit and the information is provided by the RaaS Advisory in good faith. The views of the adviser(s) do not necessarily reflect the views of the AFS Licensee. RaaS Advisory has no obligation to update the opinion unless RaaS Advisory is currently contracted to provide such an updated opinion. RaaS Advisory does not warrant the accuracy of any information it sources from others. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

Assessment of risk can be subjective. Portfolios of equity investments need to be well diversified and the risk appropriate for the investor. Equity investments in listed or unlisted companies yet to achieve a profit or with an equity value less than $50 million should collectively be a small component of a balanced portfolio, with smaller individual investment sizes than otherwise.

The science of climate change is common knowledge and its impacts may damage the global economy. Mitigating climate change may also disrupt the global economy. Investors need to make their own assessments and we disclaim any liability for the impact of either climate change or mitigating strategies on any investment we recommend.

Investors are responsible for their own investment decisions, unless a contract stipulates otherwise. RaaS Advisory does not stand behind the capital value or performance of any investment. Subject to any terms implied by law and which cannot be excluded, RaaS Advisory shall not be liable for any errors, omissions, defects or misrepresentations in the information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the information. If any law prohibits the exclusion of such liability, RaaS Advisory limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.