ITL Limited

Interim result points to turnaround

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At A Glance

ITD AU	Outperform
relative to	ex 100
volatility index	very high
stock price as of 24 Feb 05	$0.14
valuation	$0.21
GICS sector	healthcare
market cap	$14m
number of shares on issue	99.6m

Investment fundamentals

Y/E 30 June	04a	05e	06e
revenue ($m)	21.7	23.2	25.1
reported profit ($m)	-2.0	-0.9	1.3
adjusted profit ($m)	-1.4	-0.2	1.9
earnings per share (adjusted)	-1.4c	-0.2c	1.9c
price to earnings ratio	n/a	n/a	7.7x
dividend per share	nil	nil	nil
yield	n/a	n/a	n/a
franking	n/a	n/a	n/a

What does ITL Limited do?

ITL is an Australian based medical safety product innovator and manufacturer formed in 1994. To this point it has targeted the blood collection market where it has secured a dominant global position for specific products. ITL will continue to develop a new generation of medical safety devices to provide earnings growth.

ITL has also expanded into the design and manufacture of medical procedure kits that broaden its income base.

Event

- ITL has released its interim result, a reported loss of $1.6m, but with clear signs of a turnaround within the business.
- Revenues for the half were $11m, while the company incurred one off charges close to $2m from restructuring the company to better position it for a return to profitability.
- The outlook for the current half is very encouraging, with the expectation of further revenue growth and a profit after tax of $0.8m.

Impact

Result clears the deck – CEO Bill Mobbs has used this result to position ITL for growth and a return to profits. He and the Board have taken the opportunity to remove significant staff costs and write-off capitalised R&D following the failure of the Clinical Choice product range with the Procedure Kits division.

Healthy current half outlook welcome – The Company anticipates a solid turnaround in the current half with expectations "to post half-year revenue of $12 million and a profit after tax of $800,000, with EBITDA [Earnings before interest, tax, depreciation & amortisation] of $1.75 million". This is welcome news for shareholders.

Underlying operations travelling well – Both the Innovative Products and Procedure Kits divisions look to be in a lot better state. Existing contracts are being renewed while new contracts are being written. With a focus on profitability for the year ahead, rather than just growing revenues, we should expect to see an improvement in profit margins.

Valuation, target & catalyst

Valuation: 21c

Catalyst: Delivery on earnings expectations

Action & recommendation

An investment in ITL is not without risks given its history since listing. However, with the efforts of significantly reducing unnecessary costs within the business, ITL is now positioned to grow earnings. Looking one year out, we see a meaningful recovery in profitability.

Notwithstanding a reduction of our valuation to 21 cents (reflecting lower cash balance and reduced earnings from the first half), the stock looks cheap. The current share price of 14 cents compares with our valuation and a net tangible asset value of 13.5 cents per share.

Accordingly, we are upgrading our recommendation to Outperform.

Operational review results in significant one-off charges

The result included $1.985m of one off charges. This follows a decision by the company to act on the underperformance of the company with Joint Managing Directors and the failure of the Clinical Choice range within the Procedure Kits division.

The charges were made up of:

- $891,000 of separation payments;
- $964,000 write-off of capitalised Research & Development associated with the Clinical Choice product range; and
- $130,000 of US patent litigation expenses, representing the tail end of the Platypus patent infringement litigation.

We believe this effort places ITL in a far better position to grow profits with excessive costs removed and the ability to concentrate on product ranges that will grow revenues.

Innovative products

The Innovative Products division staged a healthy turnaround in the first half compared to the same period in the previous year. Revenues were up 30% to $3.9m, while the profit of $0.65m compares with a loss of $0.5m in the same period in the previous year.

The Samplok Sampling Kit, which received US Food & Drug Administration approval early in 2004, is now a very strong product for ITL. Meanwhile, volumes for the Donor Care product are stable. It was with this product where ITL struck problems in the previous corresponding period, when US blood collection volumes were down significantly.

We expect to see a further improvement in profitability in this division as we understand ITL air freighted a significant amount of product from its Malaysian manufacturing plant to US customers in order to fill demand during the last half. This practice has effectively ceased with the supply chain working more effectively.

Procedure Kits

This division wrote revenues of $7.0m but reported a loss of $1.15m. This is not directly comparable with the same period in the previous year because that only contained two months of operating form the Surgicare business, which accounts for the bulk of the business generation. The first half revenue compares with full year revenue for 2004 of $12.3m from Surgicare.

Included in this division's loss for the half were substantial one-off charges for the write-off of capitalised R&D associated with the failed Clinical Choice products, as well as staff redundancies. We note that the original vendors of Surgicare to ITL, Peter & Nola Gray, left the company during the half. In a further effort to reduce costs, ITL also closed its NZ sales office and cut it sales force in Malaysia.

The outlook for the procedure kits market is still positive. There is still a large amount of the market that is unconverted to procedure kits - we believe only 10-15% of procedures utilise procedure kits. This compares with a penetration rate for kits in the US is in the order of 60-65% of procedures.

Current valuation range sits between $0.19 – 0.22

We have based our valuation on a Capitalisation of earnings method. We have pitched the range below that of the average Emerging Leaders Enterprise value / Earnings (before interest, tax, depreciation & amortisation) multiple for 2005 given the difficulty ITL has had in reaching expectations.

Our valuation range for ITL now sits between $0.19 – 0.22 (previously $0.34). This reflects the lower cash balance (after debt) at 31 December 2004 and Earnings (before interest, tax, depreciation & amortisation) forecasts for the current year, excluding one-off charges incurred during the December half.

Capitalisation of earnings

	EV/EBITDA multiple		Valuation		
Emerging leaders (ex resources)		9.4x			
	Low	High	FY05E EBITDA	Low ($m)	High ($m)
ITL Ltd	7.4x	8.4x	$2.3m	17.0	19.3
Add net cash (after debt)				2.2	2.2
Equity value				19.2	21.5
Value per share				**$0.19**	**$0.22**

EV – Enterprise value. A measure of what the market believes a company's ongoing operations are worth. Enterprise value is equal to (company's market capitalisation + debt + preferred stock - cash and cash equivalents). EBITDA - Earnings before Interest, Tax, Depreciation and Amortisation.
Source: MFS Research, MRE, ITL Ltd

Recommendation Definition

'Outperform' - return > 5% in excess of benchmark return

'Neutral' - return within 5% of benchmark return

'Underperform' - return > 5% below benchmark return

term: 12 months

Volatility Index Definition

This factor has been calculated from the volatility of historic price movements.

Very High - Highest Risk. Stock should be expected to move up or down 60 - 100% in a year. Investors should be aware this stock is highly speculative.

High - Stock should be expected to move up or down at least 40 - 60% in a year. Investors should be aware this stock could be speculative.

Medium - Stock should be expected to move up or down at least 30 - 40% in a year.

Low/Medium - Stock should be expected to move up or down at least 25 - 30% in a year.

Low - Stock should be expected to move up or down at least 15 - 25% in a year.

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Macquarie Equities Limited acted as Retail Broker to the issue of ITL Limited ordinary shares, announced 17 September 2003. The analyst and/or associated parties own or have other interests in securities issued by ITL.