AUSTRALIAN RESEARCH
INDEPENDENT INVESTMENT RESEARCH

Shoply Limited (SHP)

Initiating Coverage

February 2014

INDEPENDENT INVESTMENT RESEARCH

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Investment Profile	
Share price ($) as at 2 February 2014	0.018
Issued capital:	
Ordinary shares (M)	240.0
Options (M)	173.5
Fully Diluted (M)	413.5
Market capitalisation ($M)	4.3
52-week low/high ($)	0.007/0.039

Board and Management

Andrew Plympton: Non-Executive Chairman

Simon Crean: Chief Executive Officer

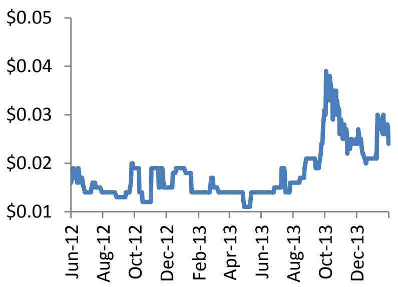
Domenic Carosa: Non-Executive Director

Mark Goulopoulos: Non-Executive Director

Sophie Karzis: Non-Executive Director & Company Secretary

Damian London: Non-Executive Director

Share price performance



EXPANSION INTO ONLINE SHOPPING TO DRIVE GROWTH

Shoply Limited (ASX code: SHP) transformed its business in 2013 to an online shopping company through the acquisition of three businesses - EzyDirect.com.au, Ohki.com.au and Eljo.com.au, and subsequently the acquisition of a number of domain names. The company has retained its online advertising division which provides the distribution of text and display advertising to publisher networks through it's two products, AdFeed and Footar, however moving forward the online shopping division will be the focus for the company with limited growth potential in the online advertising division.

KEY POINTS

Name Change: At the AGM in December 2013, shareholders voted in favour of changing the company name to Shoply Limited. The reason for the name change is to incorporate the new direction of the company into the online shopping market.

Online Shopping Division: The company has recently expanded into the online shopping industry through the acquisition of the assets of three companies. The three companies service the office supply and consumer electronics markets. SHP purchased the companies for minimal outlay, with a total combined cost of $164,000 and the acquisitions potentially doubling FY'13 revenues. The businesses largely employ a "drop shipping" supply strategy, which involves placing an order with the supplier once a purchase has been made. This reduces the need for the company to hold inventory, however is typically a lower margin strategy than if the inventory was purchased and held by the company. The company has begun migrating to holding inventory for those products experiencing regular turnover. Subsequent to these acquisitions, the company has acquired a number of domain names which it intends to utilise for the sale of goods across a range of retail categories.

Online Advertising Division: The online advertising division comprises two products: (1) AdFeed; and (2) Footar. The two products source and aggregate text based and visual advertising feeds and displays them to their network of publishers. Revenue is generated on a CPC (cost per click) and CPM (cost per mille) basis for the AdFeed and Footar products, respectively. CPC means the company/publisher are paid by the advertiser every time an advertisement is clicked while CPM means the company/publisher is paid per 1,000 impressions for the visual based advertising provided by Footar. The AdFeed business provides a steady revenue while the revenue from the Footar business tends to be more volatile. Gross margins improved across both businesses in FY'13.

Capital Position: At the time of writing this report the company had $0.89M in cash. The cash balance was bolstered by the capital raising completed in October 2013, in which the company raised $840k. Assuming no major acquisitions are made, the company has sufficient cash levels to sustain business operations for another 12 months. In the recently released December 2013 Quarterly Cash Flow report, the company included the operating cash flows from the online shopping division, however given revenues from the divisions are not split out we cannot identify how much of the revenue is attributable to the online shopping division. We expect the online division to bolster revenues in FY'14, however note that with two of the three websites having to be relaunched due to closure whilst in administration, returning sales to previous levels may take some time.

Investment Opportunity: SHP provides investors an opportunity to gain direct exposure to the online shopping and online advertising markets. There are limited investment offerings at the small end of the market to gain exposure to these markets, resulting in the company providing a unique investment opportunity. We do note however, that an investment in the company is not without its risks. The company is currently operating on a tight budget with cost blowouts potentially eradicating value. Furthermore, success of the company will be dependent on the ability of the management team to successfully integrate, operate and grow the online shopping businesses acquired. The online shopping market is very competitive and with low barriers to entry management will have to devise strategies to retain and grow the customer base.

OVERVIEW

- Shoply Limited (ASX code: SHP) recently expanded in the online shopping industry through the acquisition of three businesses. The company now has two divisions, the online shopping division and the online advertising division, which previously was the sole product offering of the company. While the company will continue to run the online advertising division, the online shopping division will be the focus for the company moving forward. The company changed its name to Shoply Limited in December 2013 to better reflect the new direction of the business.
- Since relisting in 2010, the company has worked to make the online advertising business profitable, with a maiden profit reported in FY'13. Expansion into online shopping through the acquisition of the three assets has the potential to double the current revenues of the company if the businesses can reach previous sales. Two of the three websites acquired had to be relaunched, so the ability to regain previous sales figures may take some time. Simon Crean took over the role of CEO in September 2013 to further the online shopping business.
- In October 2013, the company completed a share placement to raise $0.84M. The placement involved the issue of 31.2M shares at 2.7 cents per share. Given the company is running on a tight budget and in a growth phase, the capital raising provided an important boost to the working capital requirements of the company.
- The company seeks to grow the online shopping division primarily through acquisition, however has also started acquiring domain names with the intention of expanding supplier relationships to cater to retail categories in addition to those its currently exposed to.

FINANCIAL POSITION

- As at 31 December 2013, the company had $891,000 cash on hand. The cash position was bolstered by the capital raising completed in October 2013. The company currently has no debt.
- We are unaware at this stage of the financial situation of the recently acquired online shopping assets. We know they were purchased at a low cost and we have been provided with FY'12 revenue figures for the respective businesses, however we have not been provided with a breakdown of the operating cashflows for the online shopping division as yet.
- The company generated gross margins of 43% in FY'13, up from 36% in FY'12 and delivered a maiden profit, resulting from a reduction in administrative expenses and no depreciation or impairment charges. Operating margins however were tighter at 6%, with operating expenses largely eroding sales growth. The FY'13 results do not include any online shopping figures.

ONLINE SHOPPING DIVISION

- The company expanded into the online shopping business in 2013. SHP entered the market through the acquisition of the assets of three companies: (1) EzyDirect.com.au; (2) Ohki.com.au; and most recently (3) Eljo.com.au.
- The company has been able to acquire these companies for minimal capital outlay, with a total combined cost of $164,000.
- During the September quarter 2013, the company expanded its warehousing premises and improved the operations from order management to distribution. Even with the new warehouse premises the majority of orders are met using "drop shipping", whereby the product is sourced from suppliers upon purchase/order of the product. Drop shipping reduces the requirement for the company to hold inventory, however takes a large amount of control away from the company. We expect the company to increase the amount of inventory held over time as product turnover becomes more recognisable.
- EzyDirect.com.au sells office supplies, while Ohki.com.au and Eljo.com.au sell consumer electronics. The company is seeking to grow the companies organically through an increase in sales and margin management. The company will be seeking to acquire additional online shopping assets across mainstream retail categories.

- The company has recently acquired three domain names - toystore.com.au, sportinggoods.com.au and homeappliances.com.au. The company seeks to expand its supplier relationships to cater for these new websites and retail categories.
- The online retail space, in particular consumer electronics, is a competitive market with the company competing with both domestic and international retailers.
- The online shopping division is yet to be included in the financials so we will not know the true impact of the businesses until the half year and financial year reports are released. The company has mentioned that they are expecting the businesses to have a gross margin of 5%-30%. We expect the margins to be at the smaller end of the scale given the drop shipping style of supply. Therefore, the company will need to generate sufficient sales volumes to be profitable.
- The businesses acquired thus far service only domestic customers. There is the potential for the company to expand the businesses to international markets, or acquire businesses that service other geographic markets.
- At this stage the company plans to run the websites separately, however there is the potential if sufficient scale can be generated to consolidate the assets into a single website and operate it as an online shopping mall.

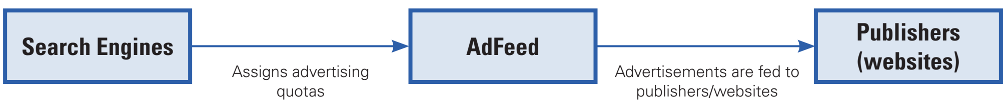
ONLINE ADVERTISING DIVISION

- The online adverting division currently comprises two products: (1) AdFeed; and (2) Footar.
- Profit before tax across the two segments increased significantly over FY'13 to $609.2k from $22.4k in FY'12. The growth in profit was driven by a combination of increased revenues and improved gross margins.
- The division derives the majority of its revenue from North America and South East Asia with 75% of advertisements served to these two markets across the two businesses. The company also distributes advertisements to publishers in Latin America, and India, with Latin America starting to generate greater revenues through increased website traffic.

ADFEED

- AdFeed offers a search and text based product where online advertising feeds are sourced from Microsoft and Yahoo search engines and displayed across 15 advertising networks throughout 15 countries.
- The company is assigned a quota of advertisements to be distributed to publishers (websites). Publishers and the company are compensated on a cost per click basis, whereby the search engines pay every time someone clicks on the advertisement.
- The company essentially acts as an intermediary between the advertisers (the search engines) and the publishers (websites).
- Growth opportunities in this business are limited given companies are assigned quotas from the search engines. There may be room to increase the quotas in the event the search engines reduce the number of companies they use, however the upside is still limited.

Business Model



- Revenues from this segment declined 3.8% over FY'13 to $1.69M, however margins improved significantly resulting in a 288% lift in profit before tax.

FOOTAR

- Footar provides an advertising display space along the bottom of a website. As opposed to the AdFeed service, Footar provides a visual based product.
- Publishers/website owners will advertise companies/products/events on their website using the Footar advertising capabilities for a fee.
- Footar advertising capabilities is currently used on over 200 websites. Advertisers pay on a CPM (cost per mille impressions) basis, meaning advertisers pay per 1,000 visits to the site which prompt the advertisement to be displayed. As such, revenues for the business are highly dependent on website traffic.
- A focus for this product moving forward will be expanding the number of relationships with publishers who have attractive website traffic as well as broadening the customer (advertiser) base.

Business Model

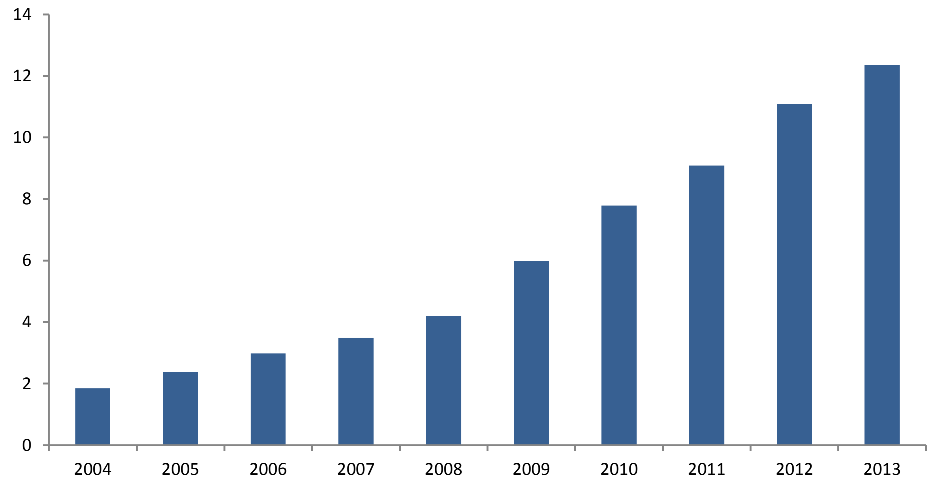
- The Footar product improved over FY'13 with revenues increasing 26% to $1.1M but more importantly was profitable, unlike the previous financial year.
- Throughout FY'13, 97% of revenue was generated from a single customer, which was of concern. However, the concentrated nature of the customer base has been alleviated by the company expanding to four customers since the financial year end. It's important to note that the company's customers are advertising aggregators, therefore the customers in turn have a portfolio of clients for which they are providing advertising services. It is unknown how many clients each of the customers has however its assumed to be in the hundreds at any point in time.

INDUSTRY ANALYSIS

AUSTRALIAN ONLINE SHOPPING INDUSTRY

- The Australian online shopping industry makes up for only a small percentage of retail spend with online spend accounting for just 6.3% of total retail spend. However, online shopping by Australians is growing and is expected to grow at a rapid rate in coming years, continuing to take market share from walk in stores.
- While the amount of dollars spent via online shopping is increasing, a survey conducted by PWC in 2012 determined that almost half of online shoppers in Australia purchased products from overseas sites due to the lower cost and availability of products. As a result, Australian online stores have to compete not only with domestic walk in shops and brands but international stores.
- In 2013, online shopping expenditure by Australian's was estimated to be AUD$12.4B with IbisWorld forecasting growth to ~AUD$19.8B by 2018. Australia has typically lagged other developed nations such as the UK and the US with online shopping but this trend is expected to change with more retailers looking to revamp their online capabilities.

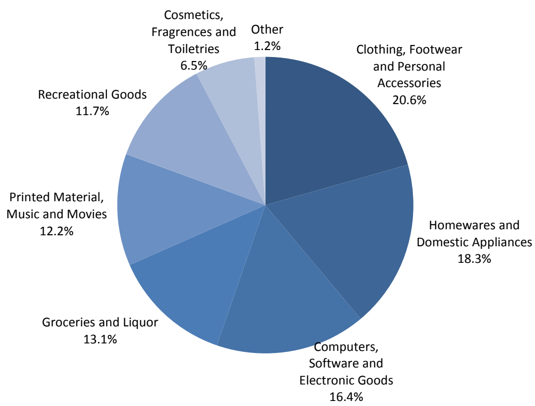
Online Shopping Revenue Growth ($B)



Source: Ibis World

- Fashion items were the most purchased goods in 2013, with homewares and domestic appliances and software and electronic goods being the second and third most purchased items, as detailed in the below chart. SHP's businesses cover the domestic appliances and software and electronic goods categories, so is operating in high demand markets, however, this area of the market is very competitive with a number of online retailers offering these products. It will be an integral part of SHP's strategy to retain customers as well as attract new shoppers. Given the low margins associated with electronic products, volume will be the key to the success of the online shopping division.

Category Breakdown by Revenue (2013)



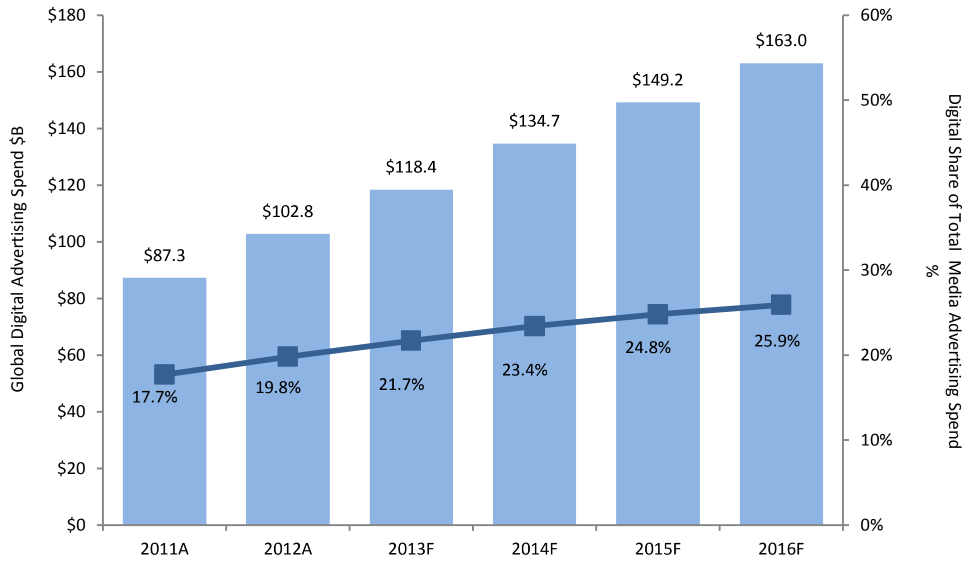
Source: IbisWorld

- The industry is highly competitive due to low barriers to entry. Over the five years to 2013, IbisWorld estimates that the number of new entrants grew at an annualised rate of 13.2%.
- The online shopping industry is expected to grow, albeit at more moderate rates, with growth driven by the continued improvement in computer literacy, improved internet speeds, and improved security.

ONLINE ADVERTISING INDUSTRY

- Global advertising spend was in excess of US$500B in 2012 and is expected to grow to over US$600B in 2015. Global digital advertising spend is growing, with eMarketer forecasting that digital advertising spend will continue to take market share from traditional forms of advertising such as television, radio and print media. In 2012, digital advertising spend accounted for ~20% of total advertising spend, with this figure expected to increase to in excess of 25% in 2016.
- For the purposes of this discussion, digital advertising includes advertising that appears on computers (both desktop and laptop), mobile phones and tablets, however excludes SMS, MMS and P2P messaging based advertising.

Global Digital Advertising Spend



Source: eMarketer/Independent Investment Research

- While the online advertising industry is growing at a rapid rate, the industry is highly competitive. One of the fastest growing areas of digital advertising is in the mobile advertising space. Whilst we view this as an area of opportunity for the online advertising division, the company will not be seeking to branch its services into mobile advertising.

PEER COMPARISON

- There are the two direct online shopping comparables listed on the ASX, Mnemon Limited (ASX: MNZ) and Ibuy Group Limited (ASX: IBY).
- MNZ is an e-commerce and online retailing group that completed the acquisition of DealsDirect Group Pty Limited in January 2014. DealsDirect run the online department store www.dealsdirect.com.au. DealsDirect had turnover in excess if $60M in FY'11, FY'12 and FY'13. The company has over 10,000 items for sale and in excess of 1 million subscribers. MNZ acquired DealsDirect for $15M through which shareholders were compensated by way of 12.5M fully paid ordinary shares in MNZ.
- IBY was listed in the ASX in December 2013 and is an online retailer with a focus on flash sales throughout Hong Kong, Singapore and Malaysia. The company runs four websites: (1) BeeCrazy.hk; (2) Deal.com.sg; (3) Mydeal.com.my; and (4) Dealmates.com. Flash sales involves the sale of goods and services at discounted prices for a limited period of time. The company raised A$37M through the issued of new shares and $7M via convertible notes.

ASX-Listed Comparables (as at 31 January 2014)				
Company	Share Price ($)*	Market Cap ($M)	Number of Shares on Issue	Cash at Bank ($M)
MNZ	1.25	20.5	16.4	6.2**
IBY	0.37	129.3	359.3	11.5
SHP	0.02	4.8	240.0	0.89

* Gross proceeds from capital raising.

- MNZ is a direct competitor to SHP given it operates in the same market, while IBY operates in selected Asian markets. However, DealsDirect is a large player in the online retail market with much greater turnover than any of the businesses acquired by SHP. Given we have no current information about the revenue of the newly acquired online shopping businesses by SHP it is difficult to make any multiple comparisons.

INVESTMENT CASE

- The company is currently in a growth phase, expanding into the new market of online shopping. There is organic growth potential in the online advertising division, however given the nature of the businesses, there is limited upside. We envisage growth will primarily be attributable to the online shopping division.
- The online shopping acquisitions have the potential to double the revenues of the company in FY'14, assuming the businesses customer base has not been effected too greatly through the distressed business conditions that resulted in the sale of the assets. Two of the three websites purchased had to be relaunched due to the closure of the websites while in administration. As such, it may take some time for the websites to regain traction in the market place.
- During the initial stages of the acquisition, the company was able to retain the services of the vendors from the online shopping acquisitions to assist with the transition of the supplier relationships.
- Success of the company will be a result of the managements ability to manage the cost base while generating sufficient volumes in both the online shopping and advertising divisions. The ability of the company to utilise existing technologies and create synergies between the divisions as well as the assets will be imperative to manage margins.

CAPITAL STRUCTURE

- As at 16 January 2014, the company had 240M ordinary shares, 161.9M listed options and 11.6M unlisted options on issue. The listed options (SHPO) have an exercise price of $0.015 on or before 30 June 2014. Given the current share price is above the exercise price we have assumed the options will be exercised to provide a diluted market cap of $8.1M, based on the share price of $0.021 at 5 December 2013. We have not included the unlisted options in the diluted market cap calculation given a significant price rise required for the options to be in-the-money.
- The top shareholders at the date of this report are:
  - MP3 Australia Pty Ltd: 16.9%
  - Planet W Pty Ltd: 14.0%
  - Chris Retzos: 8.5%
- Management and the Board currently hold 34.7% of ordinary shares on issue.

RISKS

- **Supply Chain Disruptions:** The company currently primarily employs "drop shipping" in the online shopping division. While this reduces the amount of inventory required to be purchased and held by the company, the delivery of products is largely out of the control of the company and as such problems/disruptions may occur which in turn may damage the customer experience and deter repeat business. The company can manage this risk by developing good relationships with suppliers, however there are no guarantees. We note, that the company is beginning to migrate to holding inventory for those products which are experiencing regular turnover.
- **Scale:** Margins in the sale of some products in the online shopping division, such as electronic devices, are low. As such, the success of the online shopping division will be the ability of the management team to achieve meaningful scale/volumes. This will likely come from further acquisitions. In addition to the scale, the management team will have to manage the cost base to ensure that the cost structure does not erode margins.
- **Subdued Consumer Spending:** As with all retailers, consumer spending will impact the performance of the company. A decline in consumer spending will likely adversely impact the online shopping division. However, given the online stores will be seeking to compete on price there is the potential for the online shopping business to pick up customers which ordinarily may have purchased from other providers or through other avenues.

- **Competition:** The company operates in competitive markets. There is the risk that the company's products may not be able to compete with other providers in future.
- **Ability to Retain Key Clients:** The advertising business depends on the ability of management to secure contracts to license and supply advertising products and services. The company's relationship with customers is governed by formal and informal contractual arrangements. If the company is unable to retain or source contracts, revenue could be adversely affected. The company's ability to meet budgeted expectations is essential to retaining clientele.
- **Website Traffic:** Revenues from the online advertising division are dependent on website traffic. In the event website traffic is down, this will have an adverse impact on revenues. The ability of the management team to expand their publisher network with high traffic websites will assist in maintaining steady revenues.

BOARD OF DIRECTORS & MANAGEMENT

- **Andrew Plympton, Non-Executive Chairman:** Mr. Plympton was appointed to the board in February 2010. Mr. Plympton has held a number of senior executive and board roles for insurance brokers/managers and underwriting agencies. Mr. Plympton currently holds the position of Chairman at Entellect Limited (ASX: ESN) ad is a director at Newsat Limited (ASX: NWT) and Energy Mad Limited (MAD). Mr. Plympton is also a Commissioner of the Australian Sports Commission, Executive Member and director of the Australian Olympic Committee and Australian Olympic Foundation Limited.
- **Simon Crean, Chief Executive Officer:** Mr. Crean was appointed CEO in September 2013. Mr. Crean has extensive experience in the e-commerce industry, previously working with Looksmart, Ericsson, Destra, Mercury Mobility and Effective Measure at a senior executive level.
- **Domenic Carosa, Non-Executive Director:** Mr. Carosa joined the board in June 2013. Mr. Carosa is co-founder and Chairman of Future Capital, an early stage internet investment fund, and CEO of Dominet, a boutique investment/consultancy group. Mr. Carosa has over 20 years experience in business and technology, co-founding Destra Corporation Ltd. an ASX-listed media and entertainment company.
- **Mark Goulopoulos , Non-Executive Director:** Mr. Goulopoulos joined the board in November 2012. Mr. Goulopoulos is an Associate Director of Private Clients at Patersons Securities. Mr. Goulopoulos has over 10 years experience as an investment advisor and specialises in strategic investment advice for high net worth clients, small international hedge funds and family offices. Mr. Goulopoulos has had a focus on small cap stocks and has been involved in the origination, arrangement and distribution of transactions in equity markets. Mr. Goulopoulos has also co-founded companies with a focus on e-commerce and mobile applications.
- **Sophie Karzis, Non-Executive Director & Company Secretary:** Ms. Karzis is a practising lawyer with over 20 years experience in corporate law. Ms. Karzis is a company secretary and general counsel to a number of public and private companies and is currently the Principal of Corporate Counsel.
- **Damian London, Non-Executive Director:** Mr. London was the co-founder of Planet W and joined the company when the Planet W assets were acquired in 2010. Mr. London has over 16 years experience in management, software and web development, search engine marketing and online advertising. Mr. London has co-founded a number of online advertising and marketing companies over the years, including Ansearch, Planet W, Project Search and Hot Shot Media. Mr. London resigned as an Executive Director and CEO in August 2013, retaining a position on the board as a non-executive director.

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