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TOTAL FACE GROUP LIMITED (TFG) Sept quarter cash flow report

Leading consolidator in the fragmented non-invasive aesthetic market poised for strong growth

DIRECTORS

Paul Fielding, Executive Chairman
Joanne Hannah, Director and CEO
Dr Vilma Di Maria, Non-Executive Director
John Conidi, Non-Executive Director
Dr Naveen Somia, Non-Executive Director

MARKET DATA

ASX Code:	TFG
Current Price:	$0.27
52 week Share Price Range:	$0.23- $0.42
Market Capitalisation:	$24.3 million
Enterprise Value:	$32.7 million

CAPITAL STRUCTURE

Shares on Issue (listed):	90.1 million
Shares on issue (escrowed):	31.7 million

FINANCIAL SUMMARY

$'000	FY 2016 (A)	FY 2017 (F)*	FY 2018 (F)*
Revenue	7,918	25,500	35,000
EBITDA	-133	2,800	6,500
Net Profit	-826	1,608	4,060
EPS (c)	-1.0	1.3	4.1
PER (x)	-	20.8	6.6
EV/EBITDA (x)	-	11.7	5.0

*Gordon Capital estimates excluding non-recurring items

SHAREHOLDERS

1. Paul Fielding	10.6%
2. Perpetual Ltd	6.6%
3. Regal Funds Management P/L	5.8%
4. Tiga Trading Pty Ltd.	5.7%
5. Contango Funds Management	5.5%

SENIOR ANALYST

David Spry
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November 2016

KEY POINTS

- TFG was marginally operating cash flow positive in quarter impacted by the timing of annual costs.
- Operating cash flows to accelerate in coming quarters as costs reduce on higher revenue.
- Receipts from customers increased 65% quarter on quarter.
- Completed $10m capital raising to acquire the 5 new clinics and fund CoolSculpting® expansion.
- Purchased and installed a further 13 CoolSculpting® machines taking total machines to 24.
- Launched branding "For Good Looks" in September 2016.
- Cash balance at 30 September 2016 $1.759m with no bank debt.

INVESTMENT PROPOSITION

Total Face Group (TFG) is a high growth company that provides investors with exposure to the fast growing non-surgical aesthetic market. The company has a compelling business model that underpins its organic and acquisition growth strategy. Having a strong position in a very fragmented market and a highly regarded reputation, TFG is in an excellent position to be the leader in industry consolidation.

Despite being at the early stages of development, TFG has gained the attraction of institutional investors. We are confident that TFG can deliver on its growth objectives having a very experienced board, operating and practitioner team. With the significant profit uplift expected over the next two years from the existing clinic network and with the expectation of further acquisitions, the stock looks compelling value for investors.

EVENT

TFG released its September Quarter 2016 cash flow report to the market on 28 October 2016 (refer below).

CASHFLOW		
($'000)	**Sept. Qtr.16**	**YTD 3M**
Cash Flow From Operations	**9**	**9**
Cash Flow From Investing	-9,961	-9,961
Cash Flow From Financing	9,110	9,110
Net increase (decrease) in cash	**-842**	**-842**
Cash at start of Qtr./year to date	**2,601**	**2,601**
Cash at end of Quarter	**1,759**	**1,759**

ANALYSIS AND COMMENT

Revenue continued to grow strongly in the first quarter ended 30 September 2016, with receipts from customers increasing 66% to $4.831m compared to $2.917m in the June quarter 2016. Growth continued to be aided by recent new clinic acquisitions but pleasingly the core business of cosmetic procedures achieved strong organic growth with the average spend per cosmetic injectable treatment rising 16% during the quarter. A notable performance was the Peninsula Clinic which achieved organic growth of 52% (excluding any impact from CoolSculpting® benefitting from re-location and three additional treatment rooms. CoolSculpting® treatments more than doubled reflecting increased machine numbers and the impact of marketing in particular 'CoolEvents'. TFG has taken delivery and installed 13 of the 20 new machines on order bringing total machines in use now to 24.

The roll-out of TESSA is also starting to pay dividends in terms of data capture and being able to undertake targeted marketing campaigns. During the quarter over 1,750 treatments/consultations were provided to both existing and new clients having their first appointment in a different modality. With the data captured by TESSA, TFG will be in a position to drive cross-selling opportunities between modalities increasing clinician utilisation rates and annual revenue per customer.

TFG was marginally cash flow positive in the first quarter at the operating level (9K), being impacted by the timing of a number of annual expenses such as ASX listing fees, insurance, rentals on acquired clinics, changes to payroll timing and brand launch costs. We understand that the bulk of the increased cost in the first quarter was in the timing of payroll payments. In the month of September 2016, TFG achieved a positive operating cash flow of 438K on customer receipts of $1.9m, reflecting the underlying strength of the business. Operating cash flow will accelerate in coming quarters with the significant uplift in profitability and cash generation expected from the 5 new clinics acquired in July 2016, the growth in CoolSculpting.® treatments and lower operating costs.

CoolSculpting® treatments will continue to grow on the back of further expansion within the existing clinic network and its adoption in acquired clinics coupled with increased marketing ('CoolEvents') and utilisation amongst clinicians. Ultimately, we believe the CoolSculpting® modality has the potential to contribute in excess of 20% of total group revenue compared to 11% in FY2016 and an expected 15% in FY2017.

TFG is executing well on its business model which is based around the four key elements of brand creation and recognition, clinical excellence and medical governance, organic growth and acquisitions. TFG is in a strong position to maintain above average growth over the long-term with around 30-50 clinics potentially still available for acquisition in Australia. We can also expect some margin improvement in existing and acquired clinics as brand recognition increases, internal efficiencies are derived aided by TESSA and scale benefits are realised.

The 5 new clinics along with the 20 new CoolSculpting® machines will be the major growth drivers in FY2017 and FY2018. The revenue target for FY2017 is $25.5m within the current clinic footprint. Assuming a clinic margin of 25%, we are forecasting an operating profit before corporate costs of around $6.4m, EBITDA of $2.8m and net profit after tax of $1.6m (EPS 1.3c). TFG is not expected to pay tax over the next two years as it has accumulated tax losses. For FY2018, we are targeting revenue growth of 37% to $35.0m, a clinic profit of $8.7m, EBITDA of $6.5m and net profit after tax of $4.8m (EPS 4.1c).

BUSINESS OVERVIEW

TFG operates premium non-surgical medical aesthetic clinics within Australia. The company was incorporated in April 2014 and was listed on the ASX in January 2016, following a successful IPO which raised $6m (15m shares issued at $0.40). Through acquisitions and green field developments, TFG has now established 14 clinics across Melbourne, Sydney, Canberra and Queensland with 36 highly qualified clinicians and 17 Doctors.

TFG provides client services across three key modalities: **Anti-Ageing (66%of revenue)** - anti wrinkle treatments, dermal filler treatments, lip enhancement treatments; **Skin Solutions (23% of revenue)** – medical grade skin peels, Obagi® skin care, intense pulsed light and laser; **Body Fat Reduction using CoolSculpting® (11% of revenue) -** a process when fat cells are exposed to extreme cold they die and are eliminated naturally by the body. There is no downtime or surgery associated with this procedure. Consumer products are also sold through the clinics and offer significant leveraging opportunities as new products are added.

TFG's business model and strategy is based around four key elements of brand creation and recognition, clinical excellence and medical governance, organic growth and acquisitions. TFG's consistency in messaging, branding, customer service and clinical outcomes ensures that it maintains a strong and loyal customer base and this represents a key competitive advantage. TFG's customers are aged 18 years and above with the customer profile depending on the type of treatment being given. The company has a highly experienced team of doctors, nurses and dermal therapists who build long-term relationships with customers by developing personalised treatment plans. To aid this process, in-house and external staff training programs are undertaken to ensure that treating staff are trained in the latest equipment and techniques. TFG has strong industry knowledge and supplier relationships with some of the world's leading pharmaceutical companies including Allegran, Galderma®, iNova, Lumenis and Zeltiq. These companies supply over 90% of TFG's consumables and equipment.

Growth will be driven organically and through acquisitions in what is a large and growing non-invasive aesthetic market. As brand recognition strengthens and with the implementation of TFG's end to end technology systems

(TESSA) which allows for safe and consistent client consultations and treatments, clinician utilisation rates are expected to increase resulting in higher revenue. The implementation of a single nationwide telephone number 13 FACE has reduced the cost of marketing multiple telephone numbers and enhanced brand awareness which in turn helps organic growth initiatives. Greenfield clinics are opened in under-represented regions with close scrutiny paid to the demographics and competitive landscape.

Acquisitions are the key part of TFG's future growth strategy in what is a fragmented non-invasive aesthetic market. There are a number of key criteria that TFG adheres to when assessing an acquisition: the business must be profitable; the business must enhance the geographic or client spread; the business must have a good reputation; key personnel must stay in the business for at least 12 months; the business must be able to operate from the same location; the services offered must fit with TFG; and there must be opportunities to grow the business.

BUSINESS DRIVERS AND GROWTH PROFILE

The non-invasive cosmetic industry in which TFG operates is generally classified within Plastic Surgery. In Australia, the industry is estimated to generate revenue of around $1b per annum of which 42% is addressable by TFG ($420m). With the current market penetration rate only being around 5%, there is substantial growth potential as this increases. According to the Cosmetic Physicians Society of Australia, spending on minimally or non-invasive cosmetic treatments more than doubled from an estimated $300m in 2008 to $644.7m over the five year period to 2013 (16.5% CAGR). Since 2013, spending on minimally invasive cosmetic treatments has grown to an estimated $890m in 2015.

Customers are able to access non-invasive treatments from a range of non-medical and medical practitioners. Cosmetic injectable products are classified as Schedule 4 medicines under the Therapeutic Goods Administration (TGA) which restricts purchase. This impacts to some extent the competitive landscape and the ability of new participants to enter the industry which is positive for TFG being an established player. Apart from the major franchised groups such as Laser Clinics Australia which generates annual revenue in the vicinity of $80-$100m, the industry in Australia is highly fragmented with practitioners often operating from one location with less than 10 employees. Typical operators include: those who rely on low pricing and high volume to drive revenue; plastic surgeons and dermatologists seeking diversification; beauty, skin care or day spa clinics seeking higher margins; and general practitioners supplementing traditional revenue streams. This represents a huge opportunity for TFG to participate in industry consolidation and significantly lift the returns from acquired clinics. The creation of a premium brand enables TFG to deliver a broader range of services than what could be achieved by a single clinic.

The non-invasive aesthetic market is growing at a faster rate than surgical procedures at around 10%-11% per annum and is expected to reach $12.5b by 2020. Growth is being driven by increased social acceptance and affordability with consumers undergoing procedures more frequently, the accessibility of services and the lower risk of post treatment complications. The administration of injections into the skin, face and body remains the largest product segment within the industry and is highly profitable. Non-surgical aesthetic treatments have also shown to be resilient to depressed economic conditions, which was evident during the downturns of 2008 and 2009 with industry growth remaining robust during this period. Other factors driving growth include: Customer demographics with younger clients seeking treatment; the ageing population; Australian climate; higher levels of obesity; sociological pressures including increased divorce rates; and increased trust of products and procedures.

Against this backdrop, with its strong brand and reputation and being well funded (no bank debt), TFG is capable of sustaining growth for a number of years with much depending on the pace of acquisitions and the proper execution of its strategy. Within the addressable non-invasive aesthetic market it is estimated that there are about 30-50 clinics available for potential acquisition by TFG in Australia. We estimate on average these clinics generate revenue around $2.0m per annum, resulting in a potential revenue impact of $60m-$100m to an acquirer before any revenue synergies. Assuming a sustainable operating margin of 25%, the potential profit contribution of these clinics would be in the vicinity of $15m-$25m. Previous acquisitions by TFG have been done on EBITDA multiples of 4.0x-4.5x.

Since incorporation in 2014, TFG has undertaken a number of acquisitions and has demonstrated its ability to improve performance through the addition of new services and products and has delivered significant efficiency gains with the benefits of increased scale. With the introduction TFG's proprietary end-to-end systems (TESSA) and other standardised procedures, further efficiencies are expected to be delivered in the near future. With the corporate and operating infrastructure now largely in place, there is minimal incremental fixed costs as new clinics are added which significantly enhances the potential operating leverage of acquired clinics as revenue and cost synergies are derived.

Existing and new clinics will benefit from the rollout of CoolSculpting® within the body fat reduction modality. TFG is in the process of rolling out a further 20 CoolSculpting® machines over the remainder of 2016 (13 delivered and installed so far) at a cost of $3.2m, which we estimate to have a potential revenue impact of between $6m and $18m per annum based on a minimum of 1.5 and a maximum of 4.0 cycles a day ($800 per cycle). TFG expects CoolSculpting® to be the fastest growing modality as more machines are rolled out across the network, more training of clinicians to perform treatments takes place and increased marketing initiatives including 'Cool Events' take effect. For FY2017, CoolSculpting® is expected to contribute 15% of total revenue compared to 11% in FY2016 and we expect the revenue contribution to exceed 20% over the next few years.

Current marketing campaigns being undertaken and the continued maturity of TESSA, have the potential to increase clinician utilisation rates (potential uplift 20%-25%). When combined with the impact of acquisitions and the additional CoolSculpting® machines, we are confident that TFG can achieve substantial growth in revenue and profit over the next few years providing substantial rewards for shareholders.

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