L6, 121 King William St
Adelaide SA 5000
bakeryoung.com.au
ABN 92 006 690 320 AFSL 246735

IGNITE LIMITED (ASX:IGN)

A company on the cusp of administration, rebirth, or takeover...

Ignite may be a speculative buying opportunity, however, at present the company should be watched for early signs of improvement. For now, we are looking to see if new management can execute on early initiatives. Upon seeing this, the share price has potential to re-rate significantly given the company is currently priced for failure.

For the high-risk investor, Ignite offers an opportunity to purchase stock at the company's current break-up value (net tangible assets circa A$5m, market capitalisation circa A$5m). Ignite is a highly speculative investment, so before making a decision, seeking guidance from an adviser is strongly advised.

At this stage, the jury is out on whether Ignite has a future. The company has failed to deliver a return on investment to shareholders since 31 August 2007, thus the question must be asked, what has changed and why is this time different? Whilst Ignite has divested all non- core operations, returning the company to a more traditional model, there is still a great deal to be achieved before we can have confidence in the business remaining a going concern.

It is important to understand Ignite operates in an industry that is 'all things people', where the current Chairman, (previous Interim CEO) Gary Sladden, highlights 'the company's assets leave from the car park every day'. Ignite is a recruitment business which has struggled to get the best out of its people for some time. One could assume the recruitment industry is at the mercy of the business cycle and is subject to periods of increased volatility and uncertainty. Fortunately for Ignite, the company was able to endure Covid-19 (thanks to JobKeeper) and is now operating in a healthy market where business confidence is high and opportunities for employment the best we have seen in years. Ignite specialises in IT recruitment, with 90% of its revenue coming from government contracts (mostly reoccurring). The value of these cash flows, however, is more from a cross-sell opportunity, rather than its contribution to the bottom line. Recruitment companies traditionally operate on thin margins and are labour intensive, leaving little room for error, hence the company's declining share price over several years. It is worth noting that global contingent services gross margins are far superior to domestic, 25%-30% and 12%-15% respectively. Full time employment recruitment services have better margins, however, Ignite does not, and has expressed no intention to, operate in this market.

Ignite's future is reliant upon the ability to allocate and manage capital well, whilst targeting higher margin revenue. Ignite currently generates over A$100m in revenue, however, does not turn a profit. This is quite astounding given a market capitalisation of A$5m. It would seem the market has zero confidence that 1) Ignite can be profitable, and 2) Any improvements in underlying earnings would be marginal with very little growth in subsequent years.

Under the current Chairman's 10 year tenure the company has effectively run itself into the ground. The share price has fallen from 25 to 5.9cents. The company has since restructured, divesting non-core loss making divisions, closing offices, and making all non-essential and underperforming staff redundant.

Tim Moran was appointed CEO in June 2021. Tim was previously the Asia Pacific Regional Director of SThree, where he held various senior roles since 2009. SThree is a multi-brand leading international staffing company providing specialist contract and permanent recruitment services in the

STEM (Science, Technology, Engineering and Mathematics) sector. SThree is a profitable business, read here.

As Albert Einstein famously said, 'the definition of insanity is doing the same thing over and over expecting to get a different result'. Thus, the question must be asked, does Ignite operate in an industry where profits and growth exist, or has the industry been disrupted by technology, with strong competition having eroded away economies of scale? For over a decade Ignite has failed to acknowledge the above phrase is potentially a product of their own doing, or that the recruitment services industry has a diminishing return on investment.

Australia is known for having inferior gross margins compared to global jurisdictions (certainly in contingent labour), and whilst we have not been able to see the financials of competitors (as they are mostly private), we can conclude through broader research that domestic blue collar recruitment companies unsustainably drive down margins by substituting quality for volume, thus pricing out the opportunity for industry players to collectively demand higher margins and compete on a more equal and profitable playing field.

Ignite acknowledges rather than repeat past mistakes - a new strategy must be developed. We do see a way forward, however, it will likely require many things to go right. As we see it, the following iniatives are preferable:

1. A shift of focus from government specialist recruitment clients to better margin commercial contracts.

2. The renegotiation of government specialist recruitment contracts.

3. A focus on the On Demand IT Services and the People Services division that comes with higher margins than specialist recruitment and contingent services (FY2020 contributing A$9.24m and A$2.24m of a total revenue A$126m respectively).

4. Growth by acquisition of earnings accretive companies in the IT services space allowing for a cross-selling opportunity into Ignite's core Specialist Recruitment division (see here IT wage inflation).

Despite these initiatives, all options require an injection of capital and increased costs over the short-term until the lag in revenue catches up; a hard pill to swallow for existing shareholders as the company's bottom line is likely to remain negative (given proceeds from JobKeeper have ceased). Ignite is clearly in a precarious position, having needed to secure their accounts receivable to allow the company to meet its financial obligations. This is often seen as a last effort before a company is placed into administration. Ignite at the end of Q3 FY2021 had A$5.08m available of a A$6.93 debt facility, with only enough cash to pay obligations as they fall due. It's our belief the company should raise capital through existing or new shareholders, however, most likely to the distain of existing shareholders, due to dilution. The reality is Ignite is fast running out of options and is in desperate need of a lifeline.

Overall

Gary Sladden must be commended for doing a good job restructuring the business. Ignite remains a going concern and shareholders can enjoy a sigh of relief (for the time being). As stated in Ignite's HY CY2021 report, the company performed better than in the previous 9 years, (a loss of A$300k inclusive of JobKeeper assistance). This must be taken with a pinch of salt as significant costs were stripped from the business. Despite an improved bottom line, the company is likely to operate at a loss for the foreseeable future.

Focusing on the positives, Ignite has two divisions; People Services and On Demand IT Services that previous management has been unable to develop. The good news is both these divisions can be expanded nationwide and could generate good margin expansion and revenue growth. As with most small businesses, having competent personnel to extract value and drive growth are hard to come by, which has been the Achilles heel for Ignite.

The appointment of Tim Moran brings not only a breath of fresh air, but a reputation of success driven by impeccable customer service and workplace culture. Tim's resume and career accomplishments speak for themselves, and he is well known amongst industry peers. It is for this reason we believe the ability to attract necessary senior and middle management becomes easier. On 24 June Ignite updated the market about the appointment of Nikki Grech as Executive General Manager of its talent solutions business 'People Services' and Strategic Project Leader across Ignite. We expect further high-profile personnel to join over the coming months.

As highlighted, there are opposing forces at play. Whilst the current environment for employment and recruitment is the best it has been in years, there is also difficulty in finding acceptable candidates. Domestic competition is uneconomical and unsustainable, thus Ignite accepts they must shift their previous strategy focusing not only on top line growth, but more importantly improving margins through divisions other than Specialist Recruitment.

We acknowledge Ignite has an incredible amount of work ahead which will most likely come at the expense of negative earnings for at least the next six – twelve months, and possibly longer. It is too early to be able to make a recommendation either way based on what we know. We are looking to see some traction in the aforementioned initiatives to build confidence.

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