November 18, 2019

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November 18, 2019

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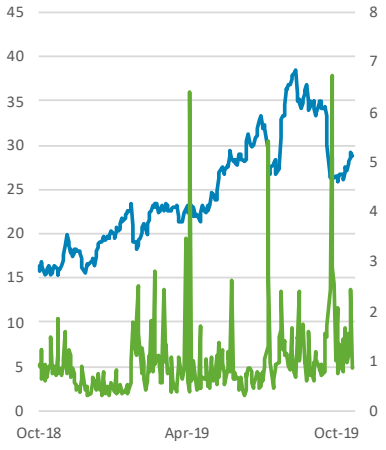
WiseTech (WTC AU, WTCHF US)

Share Price in AUD	**$28.87**
Market Cap in AUD (mln)	$9,186.20
P/E	164x
P/S	25.4x

WiseTech (WTC AU, WTCHF US) last share price in AUD (blue, left) and volume (green, right, mln shares)



Source: Bloomberg November 18, 2019

WiseTech (WTC AU, WTCHF US)

Questions for Management

"Ok, I'm Out of My Area of Expertise"

Richard White on ABC news.[1]

Richard White, whose background is in software, is adamant that WiseTech's accounts are correct but says he does not understand them. Presumably, the CFO—who has no experience in software—does understand the issues, but for reasons we fail to understand has not come out to explain them.

Investors need to ask some key questions at the annual general meeting on Tuesday.

1 https://www.abc.net.au/news/programs/the-business/2019-10-24/richard-white-speaks-to-the-business/11637794

1. Why did your corporate counsel resign after just three months on the job?
2. Why is there a continued wall of silence over Independent Director Christine Holman's decision to bring forward her departure date?
3. WiseTech says it intends to reduce its related-party transactions, so why is WiseTech renting more office space from its chairman in 2019 than in 2018?
4. WiseTech chooses simply to reiterate its assertion that "organic" growth is 33%. We stand by our 10%. Can WTC provide a detailed methodology?

Why did the corporate counsel resign after just three months on the job? And why did Non-Executive Director Christine Holman resign and then bring forward her date of departure so abruptly after we published our concerns about the company?

WiseTech's Head of Legal Katharine Lowe left the company a few weeks before our first report was published,[2] having stayed only three months. Christine Holman, the director responsible for the audit committee, resigned, effective the date of our first report. The company has failed to provide an explanation for either departure.

Why does WiseTech rent 21% of its office space from its CEO?

The CEO charges the company for 21% of all the leased office space. Richard White and his co-founder, Maree Isaacs, the director responsible for invoicing, earned about $1.5 mln in 2019 from property rents paid by WiseTech. This amounts to 21% of the company's total lease expenses of $7.3 mln. The pair earned $2.3 mln providing services to WTC in FY2019. WTC leases office space and procures data center services from companies controlled by Richard White and Maree Isaacs, and payments to these companies rose in 2019 compared with 2018.

2 https://www.smh.com.au/national/day-of-reckoning-alp-election-review-to-apportion-blame-20191106-p5381o.html

KMP transactions

Directors of the Company controlled 58.28% (2018: 63.08%) of the voting shares of the Company as at 30 June 2019. A number of KMP, or their related parties, hold positions in other companies that result in them having control or significant influence over these companies. Some of these companies transacted with the Group during the year. The terms and conditions of these transactions were no more favourable than those available, or which might reasonably be expected to be available, in similar transactions with non-KMP related companies on an arm's length basis.

The aggregate value of transactions charged/(recovered) and outstanding balances related to KMP and entities over which they have control or significant influence were as follows:

		Transaction values for the year ended 30 June		Balance outstanding as at 30 June	
Directors	**Transactions**	**2019 $000**	2018 $000	**2019 $000**	2018 $000
R White and M Isaacs	Company apartments rent [1]	–	4	–	–
R White	Company apartments rent [1]	**170**	154	–	–
R White and M Isaacs	US office lease [2]	–	66	–	–
R White	US office lease [2]	**866**	721	–	–
R White and M Isaacs	US data centre services [2]	–	65	–	–
R White	US data centre services [2]	**802**	650	–	–
R White	Staff training facility [3]	**218**	–	–	–
R White	Office services agreement [4]	**(18)**	(18)	–	(6)
R White	Sydney office lease [5]	**250**	–	**(250)**	–

The above transactions are made at normal market rates.

1 The Group has an agreement for apartment leases on properties owned by Marwood White Administrators Pty Ltd, a company controlled by R White. This agreement was transferred from RealWise Holdings Pty Ltd, a company controlled by R White and M Isaacs, on 1 December 2017.

2 The Group leases office space and procures data centre services from RealWise Chicago LLC, a company controlled by R White. The agreements for office lease and data centre services were transferred from RealWise Investments LLC, a company controlled by R White and M Isaacs, on 31 July 2017.

3 Staff training courses, run by an unrelated third party service provider, are held at a facility owned by R White. The charge for usage of the facility is embedded in the service provider fees.

4 The Group provides office accommodation and related services to RealWise Management Pty Limited, a company controlled by R White.

5 The Group utilises office space owned by R White and it is currently negotiating a long term lease on an arm's length basis.

Why bill globally from the world's most expensive tax jurisdiction?

WiseTech, in its responses to our reports, disclosed that it bills clients globally out of Australia—one of the most expensive tax jurisdictions in the world. Is that being done to sustain the "audit-light" structure it enjoys in Australia? The company reports an average tax rate of 29%, compared with an average for Microsoft of 10.2%. Most tech companies domicile services in low-tax countries like Ireland. Google, a U.S. corporation, will bill an Australian or other foreign company via Ireland to reduce tax paid.[3] Google's effective tax rate for 2018 was 12%.[4] Apple in 2018 paid an effective U.S. tax rate of 18.3%.[5] So why does WiseTech invoice customers out of Australia, which has one of the highest corporate tax rates in the world? Curiously, out of the 2019 tax charge of nearly $20 mln (excluding deferred tax adjustments), only $14 mln of cash tax was paid.

Can you clearly explain "organic revenue"?

We stand by our calculation that WTC's published reports show 10% organic

3 GOOG 2019 10-K page 80

4 GOOG 10-K page 26

5 AAPL 2018 10-K

growth, not the 33% claimed. WTC's claim relies on smoke and mirrors, like re-labeling revenue from acquired companies as "organic" when it meets certain obscure criteria.

WiseTech's calculation is unverifiable. Some of the problems:

- WTC's "organic revenue" includes revenue from acquisitions that has been "transitioned" on to the WTC platform. In other words, if a customer of an acquired company is billed by CargoWise, that customer is "organic." In 2019, the company reported that the total of this "untransitioned" revenue from all previous years was just $3.2 mln. WTC's "Untransitioned" revenue growth from previous years contributed $3.2 mln in FY2019. Based on our research and method we estimate more than $45 mln.

  In fact, WiseTech inadvertently undermined its own story in its response to our report. The company said that, in FY2019, non-CargoWise One revenue in China was 55%, or about $4.29 mln, and acquired revenue from South Africa was $5.72 mln.[6] That is a total of $10 mln from two countries. With all the acquisitions globally, this number would be several times higher. Clearly WiseTech has a flawed method for calculating acquisition revenue from prior years.

- "Organic revenue" by WTC's definition includes revenue from acquired clients if a sister company of that same client is already a CargoWise client.

- When calculating half-on-half growth of acquired revenue, WiseTech artificially inflates the numerator by comparing acquired revenue from acquisitions over the last 18 months (previous full year and current half) with revenue from a 12-month period.

Here is our calculation:

1) Revenue from acquired companies in a given year based on WTC press releases. We pro-rate that revenue based on the month the company was acquired. In FY2019, the acquired-revenue number is $49.3 mln.
2) Annual revenue, based on press releases, of companies acquired the previous year, assuming no increase. We include this previous-year acquired-revenue number because companies tell us that they typically continue as

6 "Cargowise One revenue is now 45% of China revenue" Earning call 19 Feb 2019 and WiseTech Global Shanghai Information Technology ltd 2018 revenue $7.8 mln. South African acquisitions had $9 mln in revenue when acquired and WiseTech in rebuttal of 23 October 2019 stated revenue had declined 10% per year since then.

stand-alone platforms for at least two years. That means that their clients do not pay for access to the CargoWise One platform or other WiseTech software. In FY2019, we calculate this element of acquired revenue was $44.9 mln. WiseTech states it was $42.3 mln.

3) For FY2017 and FY2018, we add in the reported revenue of Softship (SFO GR) a listed German company that was acquired in several tranches and was consolidated from FY2017. Softship revenue was reported separately until H1 2019, when it was delisted, on September 28, 2018. We included estimated Softship revenue for FY 2019 of $14.8 mln.
4) We take the company's reported top-line incremental revenue and subtract acquired revenue in each year to derive organic growth.

Please see the table below for all of the calculations and growth numbers

Table 1. J Capital Estimate of Acquired and Organic Growth

	FY 2017	FY 2018	FY 2019
A. Total Revenue	153.8	221.6	348.3
B. Revenue Growth (Current year less previous year)	51	67.8	126.7
C. Contributions of Acquisitions to Revenue (current year)	1.4	21.7	49.3
D. Contributions of Acquisitions to Revenue (prior year)	8	3.6	44.9
E. Softship Revenue	14.1	14.4	14.8
F. Total Acquisition Revenue Growth (C+D+E)	23.5	39.7	109.0
G. Total Organic Revenue Growth (B-F)	27.5	28.1	17.7
H. Acquisition Revenue Growth (F/A[previous year])	23%	26%	49%
I. Organic Revenue Growth (G/A[previous year])	27%	18%	8%

Source: Company reports, J Capital

So, can WTC lay out clearly the basis for its 33%?

What about those overstated costs?

Central to our view of overstated profits are unexplained costs of $66 mln. Employee salary and benefits are too low to account for both current and capital software expenses. Employee costs would need to be at least $50 mln higher. If WiseTech is correctly stating accounts, then $66 mln in expenses are not explained. We believe these are fake costs. CFO Andrew Cartledge, responding to a friendly analyst question, dismissed the issue by claiming we had used FY 2013 as the base year for our analysis. Nice try Andrew, but you are not fooling anyone; the analysis can be done in any year. If we are wrong, how does WTC explain those costs?

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