February 26, 2020

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February 26, 2020

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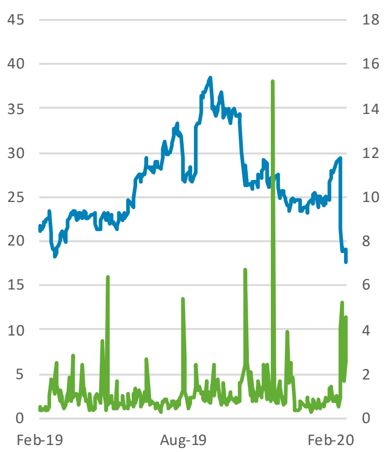
WiseTech (WTC AU, WTCHF US)

Share Price in AUD	**$17.57**
Market Cap in AUD (mln)	$5,592.8
P/E	61x
P/S	13.9x

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



Source: Bloomberg February 26, 2020

WiseTech (WTC AU, WTCHF US)

WiseTech May Be the First Corporate Death from Covid19

- **Corona ate my homework:** WTC blamed the coronavirus for a 17% downward revision to Ebitda guidance in its H1 2020 report, but behind the numbers was a shocking decline in profitability. For every lost $1 in revenue guidance, WTC lost $2 in profit. In H1 2019, WTC reported about $0.31 in Ebitda for every $1 in new revenue. This profit decline is all because of poorly performing acquisitions.
- **WiseTech caught the flu in July 2019:** WiseTech Net Profit After Tax and Adjustments (NPATA) is down 5% HoH but down 14% when we further adjust for the $6 mln ($3 mln H1 2020) free kick to profit from an accounting change to capital leases.
- **Hand in the cookie jar:** WiseTech's acquisitions are not performing and so the company is paying less in earn-outs. Contingent liabilities are being removed from the balance sheet and plumping up profits as "fair value gains" over on the income statement, without a corresponding write-down of goodwill assets.
- **When corona isn't enough:** WiseTech could not show growth in the rate of new organic revenue growth in H1 2020, so the company just straight-out made it up and claimed a 24% acceleration when in fact new organic revenue growth declined 20%. The rate of new acquired revenue growth declined by 24%.

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February 26, 2020

- **Government report supports our view of WTC:** The Australian Tax Office published WiseTech's revenue, profit, and tax payable for FY2018 on December 12, 2019. Revenue was lower by $47 mln than in WiseTech's public report, and tax was half what they claim. This almost exactly matches the estimate from our **October 16, 2019 report** for missing revenue and profit. The tax document may expose potential fraud in WTC's reports to investors. If the report is not fraudulent, the ATO shows that international acquisitions make no profits.
- **Stuffing away costs:** In H1 2020, operating expenses rose 37%, but capitalized software expenses grew 69%. That supports our contention that WTC is faking its profit by hiding expenses.

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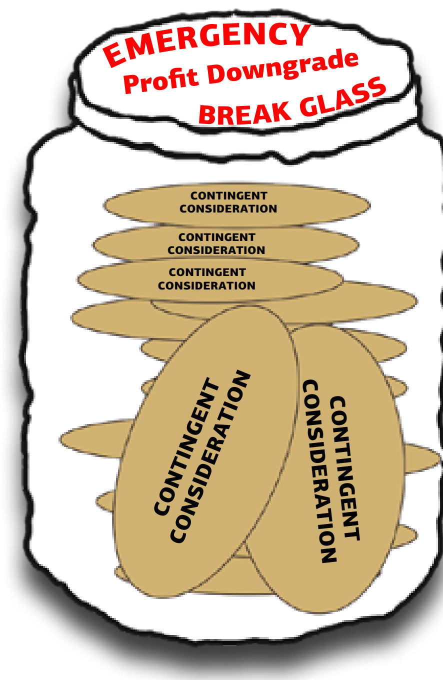
We do not buy WiseTech's claim that coronavirus is messing with company results. The recent H1 2020 report shows problems in H1 2020, before anyone in Wuhan was diagnosed with coronavirus. NPATA is down 14% HoH in H1 2020. Acquisitions are not performing, and growth in organic and acquisition revenue is flagging.

Contingent Consideration Cookie Jar

WiseTech made a large fair value adjustment to consideration liabilities. The adjustment shows, among other things, that WiseTech's acquisitions are not performing.



WiseTech is paying less in earn-outs and therefore removing contingent liabilities from the balance sheet and plumping up profits as "fair value gains." That means acquired companies are not achieving their targets and therefore not making their earn-out milestones.

Meanwhile, WTC is double dipping. The company should write down goodwill assets when they reverse these contingencies--but that would be a loss on the income statement and cancel out the "fair value gains."

WiseTech is reaching back to acquisitions made in 2018 to make these adjustments. This is clear from two disclosures: that the reduction in consideration came from non-current consideration and the amount of the reduction. None of the 29 acquisitions since 2018 had a contingent consideration as high as the $32.7 mln fair value change.

Table 1. WiseTech Fair Value Consideration Change was to Non-Current Consideration (mln A$)

	Current	Non-Current	Total
Opening June 30, 2019	69.8	157.2	226.9
Additions – H1 acquisition contingencies		20.2	
Change in fair value estimate of contingent consideration		-32.7	
Cash paid	-20.9		
Other adjustments	4.3		
Non-Current transition to Current	28.6	-28.6	
Closing Balance 31 Dec 2020	81.8	116.0	197.8

Source: Company reports, J Capital. Note positive numbers are additions and negative numbers are payouts.

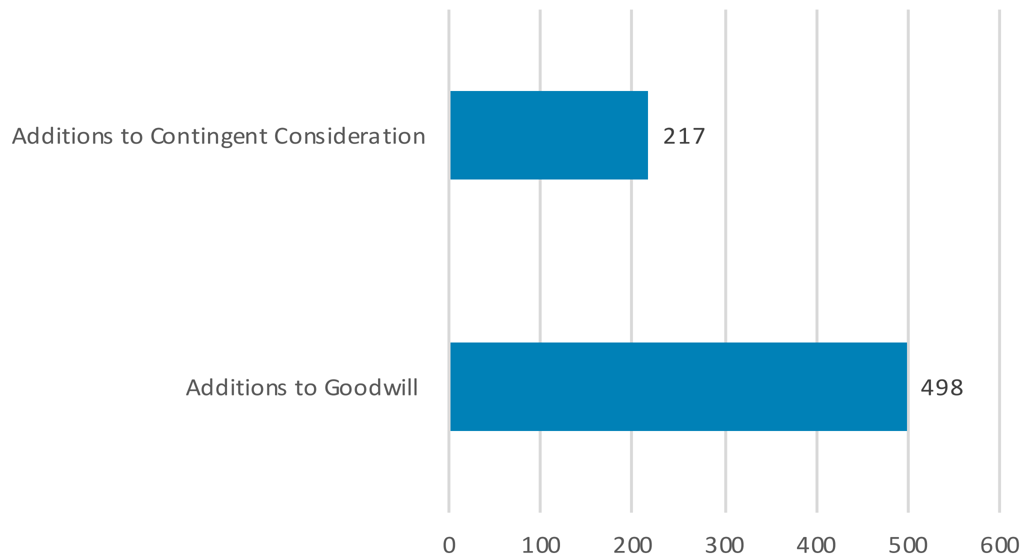
The problem for WiseTech is that it has recognized $498 mln in goodwill from the same acquisitions since 2018 for which it has recorded $217 mln in contingent consideration. These are two sides of the same coin. Contingent consideration is recorded as goodwill at the time of acquisition.[1] The contingent consideration write-down of $32.7 mln is 15% of all contingent consideration over the last two years. We believe that the goodwill should also be written down by 15%, or $74.7 mln. In the last two years there has not been any impairment of goodwill. WiseTech's February 19, 2020 explanation of the reduction in contingent consideration stated:

> *"Each period, we gain a clearer picture of the operational performance and potential of our acquired businesses. This allows us to update our assessment of the contingent consideration payable pursuant to performance conditions. "*

By the same logic, goodwill for the same acquisitions should also be written down. The auditors, KPMG, should look closely at this issue.

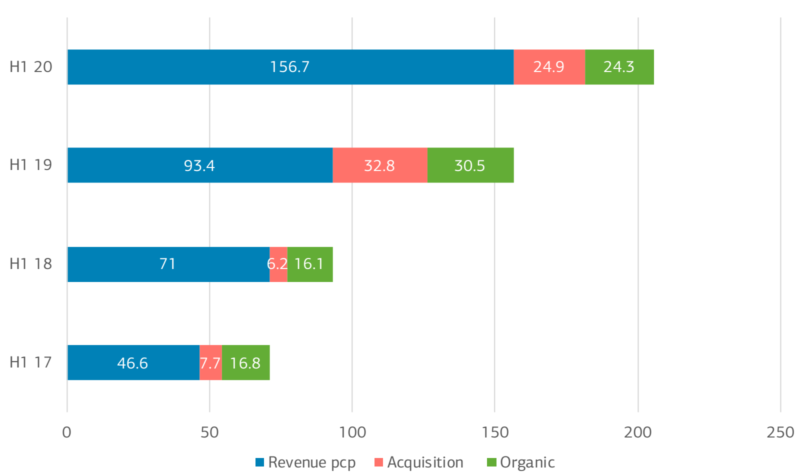
1 WiseTech acquisitions have very low amounts of assets and so the excess of total consideration over assets acquired is recorded as goodwill.

Chart 1. Acquisition additions of consideration and goodwill from Dec 2017 to Dec 2019 (mln A$)



Growth in Organic and Acquired Revenue Declines

Chart 2. WiseTech H1 Revenue Growth Organic and Acquisition (mln A$)



	Organic	Growth Rate of Growth
H1 20	24.3	-20%
H1 19	30.5	89%
H1 18	16.1	
	Acquisition	**Growth Rate of Growth**
H1 20	24.9	-24%
H1 19	32.8	429%
H1 18	6.2	

WiseTech could not show that organic revenue accelerated, so they just made it up and said it grew 24% when in fact rate of growth declined by 20%. Acquired revenue rate of growth declined by 24%. We cannot work out any alternative method of calculation that delivers a 24% growth in organic revenues.[2]

2 Organic revenue growth on revenue in the prior corresponding period would make sense but that is only gets 15.5% growth (24.3/156.7).

> *"Organic revenues from our existing and new CargoWise customers delivered $24.3m of growth on 1H19. Growth in organic revenue from existing and new CargoWise customers was 24% compared with 1H19…"* Wisetech H1 2020 page 5.

WiseTech goes onto say that organic revenue from existing clients was $25.5 mln in 1H 2019 and new clients was $5 mln. That sums to $30.5 mln and gives us a decline of 20% (24/30.5-1).

Table 2. H1 2020 Organic and Acquired Revenue and Acceleration (mln A$ and %)

WiseTech as reported H1 2020	1H 19	1H 20	Growth in Growth
Organic Revenue Increase - new and existing clients (a +b)	Not Stated	24.3	24%
Organic Revenue Increase - existing clients (a)	25.5	17	Not Stated
Organic Revenue Increase - new clients (b)	5	7.3	Not Stated
Acquired Revenue Increase	Not Stated	24.9	Not Stated
J Capital Calculations from WiseTech H1 2020 and H1 2019 reports			
Organic Revenue Increase - new and existing clients (a + b)	30.5[4]	24.3	-20%
Organic Revenue Increase - existing clients (a)	25.5	17	-33%
Organic Revenue Increase - new clients (b)	5	7.3	46%
Acquired Revenue Increase	32.8[5]	24.9	-24%

3 You can get the $30.5 mln from summing existing $25.5 mln and new $5 mln in H1 2020 report or see the same numbers in the H1 2019 report on page 5.

4 See H1 2019 report on page 5.

Taxes got Al Capone

An obscure document from the Australian Tax Office (ATO) shows that WTC told the government it had $47 mln less in revenue and $8.4 mln less in income tax in FY2018 than it told investors.

Each year, the ATO publishes the revenue, taxable income, and tax paid by public and foreign-owned companies with turnover of $100 mln or more and of Australian private companies with turnover of $200 mln or more. On December 12, 2019, the ATO released data for FY2018 for the 2,200 companies that fit this criteria. WiseTech made the list for the first time, despite annual revenues exceeding $100 mln in FY 2017. WiseTech's revenue in FY 2018 was $47.2 mln less, profit before tax $7.9 mln less and income tax expense less by $8.4 mln.

WiseTech has global operations but largely invoices clients out of Australia since FY 2016. Therefore, most of WiseTech's global activity is subject to Australian tax. This was made clear when WiseTech defended against our claim their European, Middle East and African revenue was overstated:

> *"Our revenue by geographic location and the Financial Statements clearly state that it is based on our customer's invoicing location, based on billing address. This approach was adopted in FY16 as the billing model for the business was largely centralised in corporate headquarters in Australia, thus regional centres, including the UK, became support centres ."*[5]

And this is confirmed in the statutory reports of entities such as WiseTech Global UK Ltd:

> *"For the period ending 30 June 2016, revenue is calculated as a cost plus 8% recharge to a related entity namely WiseTech Global (Australia) Pty Ltd it is a wholly owned by WiseTech Global Trading Pty Ltd which is also the immediate parent entity of WiseTech Global (UK) Limited."*[6]

So why is the tax paid in Australia reported by the ATO only half of what WiseTech reports? WiseTech may claim that newly acquired global business are not yet integrated into the Australian billing operations. Fair enough. But that is only $21.7 mln in revenue and a $4.5 mln loss. The company could also argue that Softship was a stand alone entity in FY2018 and we would estimate it had revenue of around $14 mln and profit of $1 mln. That would total $35.7 mln in revenue and a

5 WiseTech, WTC responds to misinformation in the market, 18 October 2019

6 WiseTech Global UK Ltd, Financial Year 2016 Annual Report

loss of $3.5 mln. Which makes it seem plausible until you realise WiseTech total tax paid outside of Australia is $8 mln, but the profit before tax is only $7.9 mln. Which means that the ex-Australia corporate tax rate is 101%. We know that is not possible as Australia has higher tax than all the key operating locations of WiseTech. We also know from Note 5 in the WiseTech Annual report that the adjustments for tax rates in overseas jurisdictions is minimal which implies the tax rates are essentially the same.

A listed Australian company that operates only in Australia will have identical information to the ATO report. The ASX (the company that owns the ASX stock exchange), shown in the table below, is one such example. One with large global operations, like Brambles, will be paying Australian tax only on Australian operations and potentially on consolidated profits. The ASX and Brambles are both signatories to the Voluntary Tax Transparency Code and provide reconciliations from their corporate accounts to the ATO reports. WiseTech is not a signatory and does not provide such a reconciliation.

Table 3. Listed Australian Companies Reporting vs ATO Entity Tax Information FY 2018 (mln $A)

		WTC (Global Co)			ASX (Domestic Co)			Brambles (Global Co)		
Corporate Accounting Term	**ATO Term**	Reported	ATO	Variance	Reported	ATO	Variance	Reported	ATO	Variance
Total Revenue (+Gross Interest Income)	**Total Income**	221.6	174.4	47.2	1,013	1,013	0	7,837.5	1,375.6	6,461.9
Profit before Income Tax	**Taxable Income**	57.6	49.7	7.9	642	676	-34	1,199.2	278.6	920.6
Income Tax Expense	**Income Tax Payable**	16.4	8.4	8	197	197	0	145.6	69.5	76.1
Effective Tax Rate		28%	17%	101%	31%	29%		12%	25%	8%

Source: Company Report, ATO

In a worst-case scenario for WiseTech this is complete vindication of our research. In our first report on the 16 October 2019 we made the case that WiseTech was overstating revenue in EMEA by up to $48 mln and profits of WiseTech by $33 mln. This almost exactly matches the report from the ATO. Revenue may be overstated by $47 mln and if profit are lower by $33 mln then actual profit would be $24 mln and applying the Australian Corporate tax rate of 30% then tax payable would be $7.2 mln.

The best case for WiseTech from this analysis of ATO data is that the company's overseas acquisitions are all failures and make no profits. Not a good scenario for investors. As we have seen in H1 2020 results, acquisitions are adding less revenue and profit to the company despite investing more. The past is catching up with this role up.

Pushing Costs Into "Capitalized Software"

In H1 2020, operating expenses rose 37% but capitalized software expenses grew 69%. Capitalized software costs are now 40% of software in the period, up from 34% in H1 2019. We feel vindicated in our earlier conclusion that WTC is using bogus capitalized costs to make profit look higher than it is.

Table 4. Software Expenses 1H 19 vs 1H 20

	H1 2019	H2 2020	Growth
Product design and development Total Current Expense (a)	39.3	51.3	31%
Capitalized software development costs (b)	19.9	33.6	69%
Total software development costs (a+b)	59.2	84.9	43%
Capitalized software development costs as % of total	34%	40%	

Corona ate my homework

> *"In considering adjustment to our guidance for FY20 we have prudently taken into account the potential impact of COVID-19 on manufacturing and export trade…"* Richard White, CEO H1 2020 on the revised guidance.

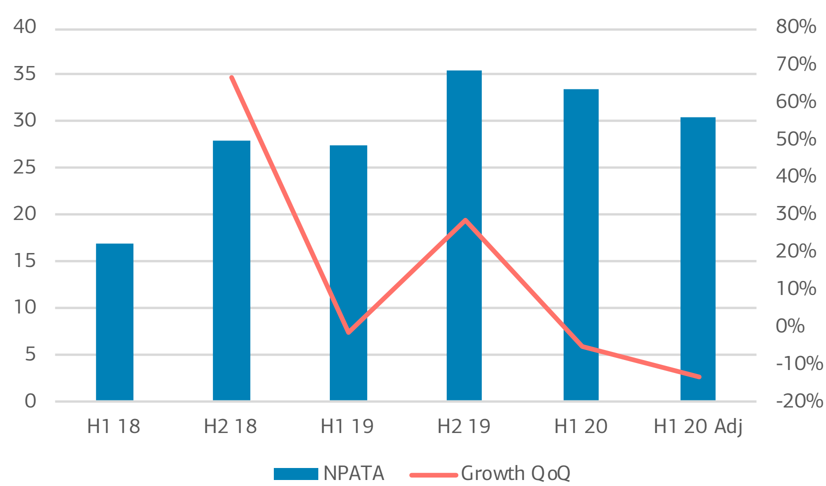
We are not buying the coronavirus excuse for WTC's revised guidance. Revised guidance has revenue 3.3% lower, but Ebitda guidance is 17.4% lower. That is a drop in profit of almost $2 for every $1 of revenue. In H1 2019, profitability was $0.31 for every $1 of revenue.

Table 5. WiseTech Guidance Update February 19, 2020 (mln A$)

	Low	High	Midpoint	Decline
Revenue Guidance	440	460	450	
Revised Revenue Guidance	420	450	435	-3.3%
Absolute change	20	10	15	
EBITDA Guidance	145	153	149	
Revised EBITDA Guidance	114	132	123	-17.4%
Absolute change	31	21	26	
Change in EBITDA for every $1 change in revenue	1.6	2.1	1.7	

Source: Company reports, J Capital

Chart 3. WiseTech Half-Year NPATA[8] and adjusted NPATA[9] Comparisons (mln A$, %)



Source: Company reports, J Capital

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7 1. Net profit after tax attributable to equity holders of the parent before acquired amortization net of tax, contingent consideration interest unwind net of tax and fair value changes on contingent consideration.

8 WiseTech changed accounting of capital leases and got a one off $6 mln benefit to profit that we have assumed is equally applied to H1 and H2 and is therefore a $3 mln free kick to profit. WiseTech note "The application of AASB 16 Leases brought into effect from 1 July 2019, is expected to add $6m to EBITDA for FY20, with no change to revenue."

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