

## At the intersection of AI and BuildTech

21st January 2020

Software stocks that enable corporates to sell more, improve quality, cut costs, save employees time and/or reduce their 'carbon footprints' are ideally placed in today's tech/ESG world. Cue Elecosoft, who said this morning that **2019 PBT would be "ahead of LY"** (£3.67m) and **"in line with expectations"** (consensus £4.1m) - despite being impacted by forex (ED est -2%, weaker SEK vs £) and macro uncertainties (eg Brexit, General Election and subdued Eurozone).

We think this is a **creditable outcome**. Not least because it underlines the **resilience of the business** - while the results are actually a touch better than our previous (bottom of the range) profit & cashflow estimates, albeit with revenues a smidgeon shy.

## Resilient business despite macro concerns

Consequently, we have tweaked our 2019 numbers (see below) to: EBIT of £4.40m (margin 17.5%) on turnover up 14% to £23.35m (3% LFL CC) with net cash closing Dec'19 at £1.50m (vs -£1.81m LY). Going forward, the **2020 PBT & EPS targets remain unchanged at £4.6m and 4.5p** respectively, notwithstanding a further small forex headwind of c.-1% (£'s recent rise vs \$/€).

Elsewhere, **our valuation inches up from 100p to 105p/share** - reflecting the **improved economic climate, new product launches** (eg AI visualisation tool), stabilisation in the SEK and **significant future up/x-selling opportunities**.

## Solid LFL growth augmented by strong cash generation

Summary Financials (£'000s)	FY18	H1'19	Est H2'19	Est FY19	Est FY20
Software licenses	5,271	3,010	2,990	6,000	6,120
Recurring SaaS & support	12,595	7,157	7,093	14,250	15,105
Services	4,354	2,544	2,556	5,100	5,202
<b>Sales</b>	<b>22,220</b>	<b>12,711</b>	<b>12,639</b>	<b>25,350</b>	<b>26,427</b>
Reported % growth rate	11.1%	20.4%	8.3%	14.1%	4.2%
Acquisition growth %	8.0%	19.5%	6.5%	13.1%	0.0%
Estimated forex headwind	-2.0%	-2.0%	-2.0%	-2.0%	-1.0%
Estimated % LFL (constant currency)	5.0%	2.1%	3.8%	3.0%	5.2%
<b>Gross Profit</b>	<b>19,536</b>	<b>11,392</b>	<b>11,296</b>	<b>22,688</b>	<b>23,652</b>
% margin	87.9%	89.6%	89.4%	89.5%	89.5%
Operating expenses (excl D&A)	-14,279	-8,446	-8,106	-16,552	-16,925
<b>Adjusted EBITDA (post SBPs)</b>	<b>5,257</b>	<b>2,946</b>	<b>3,190</b>	<b>6,136</b>	<b>6,727</b>
% margin	23.7%	23.2%	25.2%	24.2%	25.5%
Depreciation	-777	-450	-500	-950	-970
Amortisation of intangibles	-529	-358	-392	-750	-1,000
<b>Adjusted EBIT (post SBPs)</b>	<b>3,951</b>	<b>2,138</b>	<b>2,298</b>	<b>4,436</b>	<b>4,757</b>
% margin	17.8%	16.8%	18.2%	17.5%	18.0%
Net interest	-281	-179	-157	-336	-186
<b>Adjusted PBT</b>	<b>3,670</b>	<b>1,959</b>	<b>2,141</b>	<b>4,100</b>	<b>4,571</b>
Tax	-478	-301	-410	-711	-338
<b>Adjusted earnings</b>	<b>3,192</b>	<b>1,658</b>	<b>1,731</b>	<b>3,389</b>	<b>4,233</b>
<b>Adjusted Cashflow</b>	<b>4,519</b>	<b>2,519</b>	<b>2,136</b>	<b>4,655</b>	<b>4,820</b>
Cash conversion	114%	118%	93%	105%	101%
<b>Adjusted EPS (pence)</b>	<b>3.8p</b>	<b>2.0p</b>	<b>2.0p</b>	<b>4.0p</b>	<b>4.5p</b>
EPS growth %	33.3%	9.4%	2.2%	5.6%	10.9%
Dividend (pence)	0.68p	0.30p	0.45p	0.75p	0.90p
<b>Net cash / (debt) - Ex IFRS16</b>	<b>-1,814</b>	<b>-198</b>	<b>1,476</b>	<b>1,476</b>	<b>4,381</b>

Source: Equity Development. LFL sales comparatives assume all acqs were owned on 1<sup>st</sup> Jan'18.

### Company Data

EPIC	AIM: ELCO
Price	86p
52 week High/Low	87p/66p
Market cap	£70.7m
Est net cash (Dec'19)	£1.5m
ED valuation / share	105p
Share count	82.24m
Avg. daily volume	30,000

### Share Price, p



Source: Share Cast

### Description

Elecosoft is a *BuildTech*, asset/property maintenance & visualisation software specialist for the Architectural, Engineering, Construction and Operator (AECO) and digital marketing industries. Its award winning 6D solutions (>100,000 users) cover project planning, estimating, design/CAD, visualisation, site operations/maintenance and Building Information Management (BIM). BIM acts as the glue connecting all the various modules.

**Visibility is robust, with 56% of revenues recurring and >90% customer retention rates.** Landmark implementations include: The Shard, the BBC Television Centre, Hong Kong International Airport and Berlin's Reichstag Dome. **63% of the business is generated from outside the UK**, and there are c. 228 staff.

**Next news:** Prelims in March 2020

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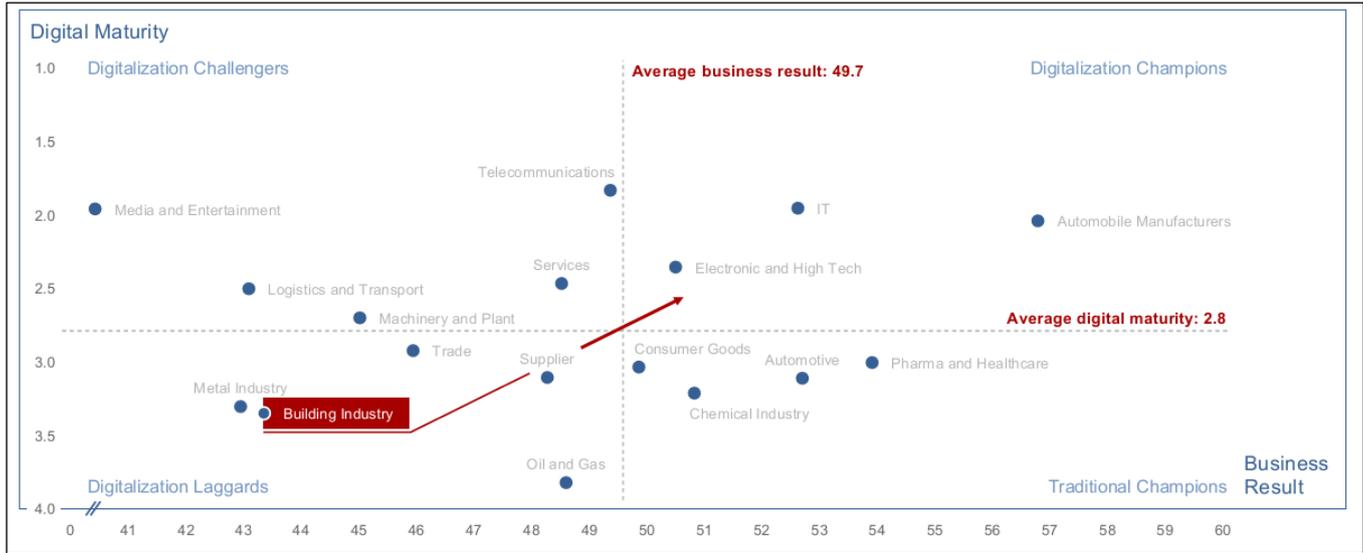
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\*a shareholder in Elecosoft

## Decade long runway in a multi \$bn market

Big picture too, the long term **fundamentals continue to be strong**, with the **\$8bn global BuildTech industry anticipated to expand at between 11%-13% CAGR** for the foreseeable future.

### Substantial opportunity to digitise Architecture, Engineering & Construction (AEC)

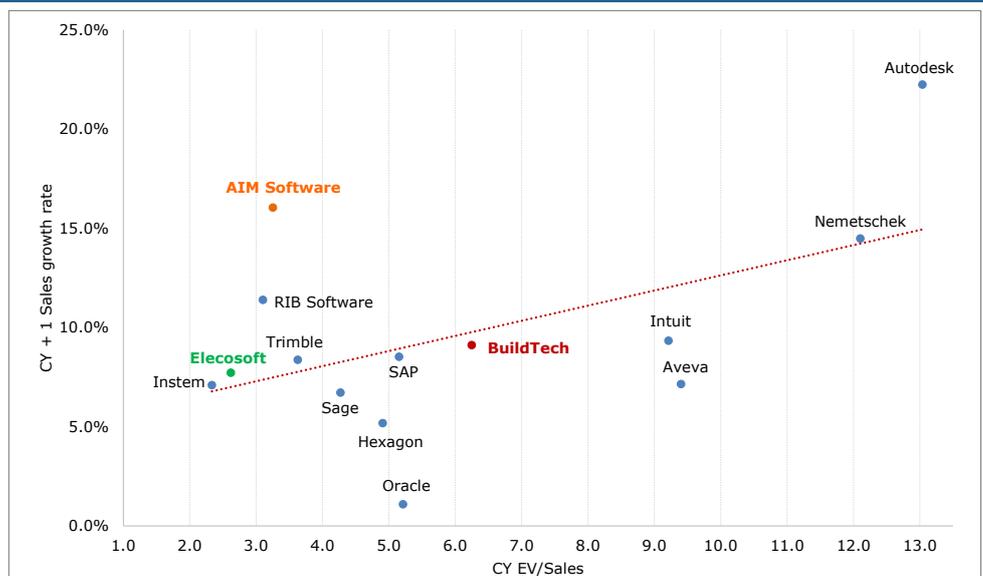


Source: Nemetschek

## Scalable model delivering near 90% gross margins

Meaning that if Elecosoft can achieve similar growth rates (ED est 2020 5.2% LFL vs 3% 2019), then we see no reason why the shares can't command a 5x 2020 EV/sales multiple vs 2.6x today (see below) over the next couple of years; equivalent to 163p/share.

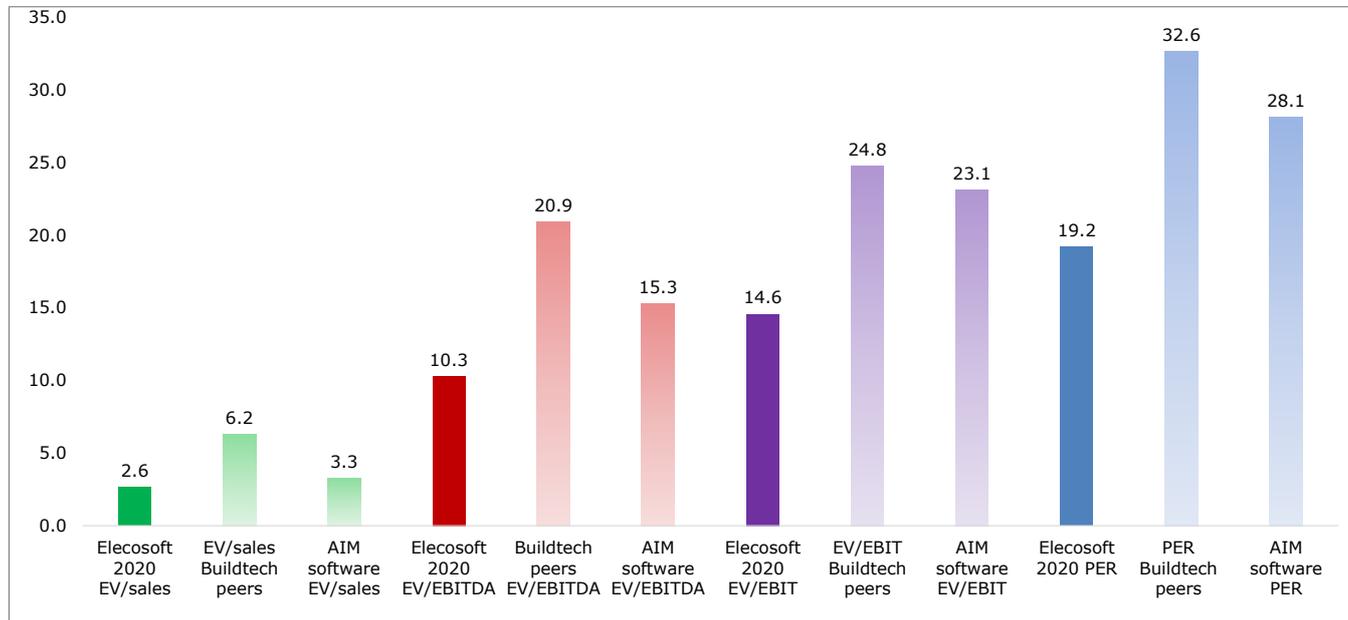
### Current year (CY) EV/sales multiples vs CY+1 growth rates



Source: Equity Development

Hence at 86p, **the stock appears undervalued**, both in absolute terms and vs *BuildTech* peers across all major benchmarks (see below).

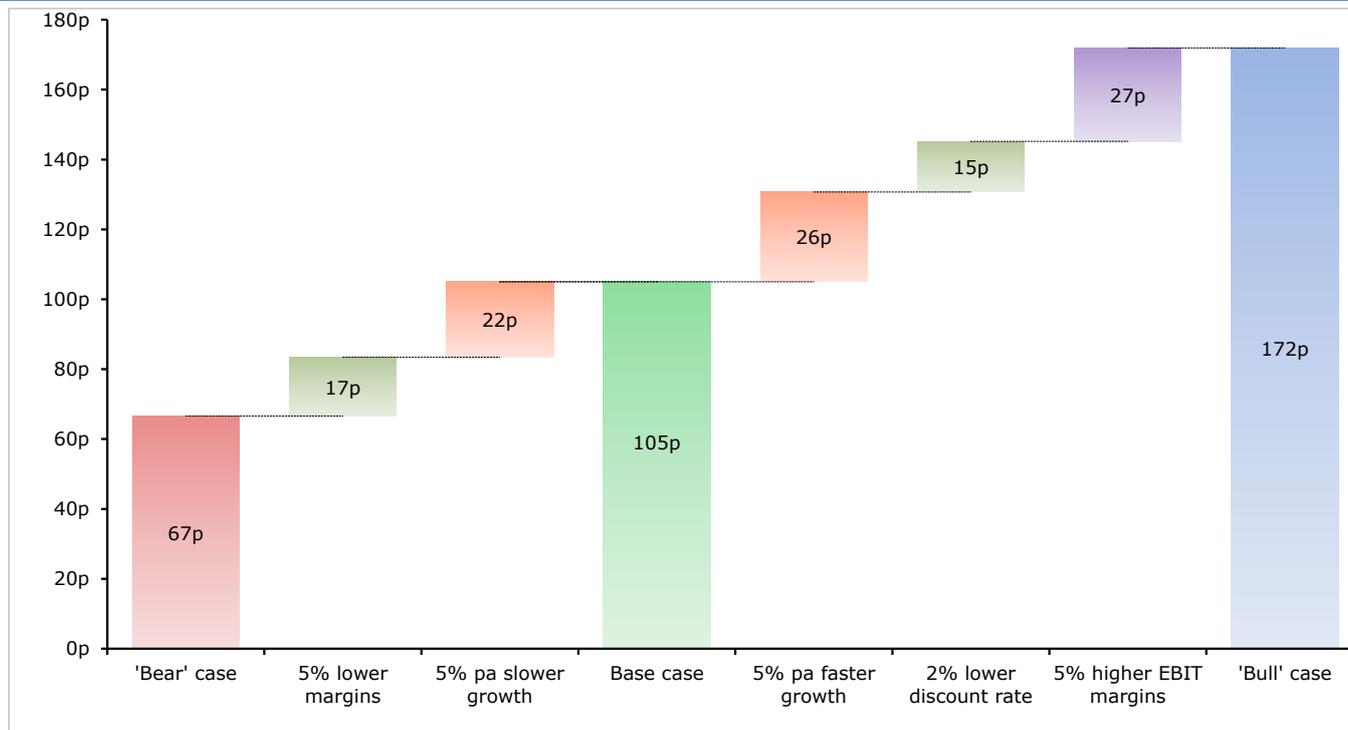
**Elecosoft 2020 multiples vs peers**



Source: Equity Development

Moreover, **the risk/reward profile appears asymmetrically tilted to the upside**, as indicated by our 'Bear' and 'Bull' case scenarios of 67p and 172p (see below). With the group's two closest rivals, Nemetschek & Autodesk, trading on multiples of >10x EV/turnover.

**Sensitivity analysis (p/share)**



Source: Equity Development

## 'You ain't seen nothing yet'

But that's not all. At the annual Consumer Electronics Show in Las Vegas a fortnight ago, many technophiles were speculating as to which areas would be next to be disrupted by Artificial Intelligence (AI). Transportation, healthcare and education immediately spring to mind.

However, one under-the-radar vertical that could be equally transformed is infrastructure, construction and real estate. Here Elecosoft is already a leading player - particularly in the UK & Northern Europe - announcing only last Thursday that it had **launched another possibly 'game-changing' AI string to its widening BuildTech bow.**

The new application enables consumers, retailers, builders & interior designers, to seamlessly upload digital photos, in order to visualise numerous flooring options at the touch of a button. In our view, a **major leap-forward**, whilst also allowing users to discard those old cumbersome sample books, which had to be constantly carted around before.

In fact, so accurate is the rendering, can you spot which of the 2 pictures of my lounge below is real vs the mockup? One being carpeted, the other covered in wood. The whole visualisation process took me less than 2 mins to complete - and can be [triallyed for yourself here](#).

## Almost a carbon copy of the original

### Option 1 : Lounge with wooden flooring



Source: Equity Development

Granted this is still early days, although encouragingly **there are already a few clients white-labelling the product**, including Karndean, marketed under their Floorstyle brand.

### Option 2 : Lounge with carpet laid



Source: Equity Development

### Potential AI 'game changer'

So what about the competitive landscape? Well, Elecosoft has spent several years creating their database of ultra-HD images, so it's going to be pretty difficult for anyone to replicate to the same level of granularity. The next steps on the roadmap being to add soft furnishings, curtains, wallpaper, sofas and cost, alongside today's flooring functionality.

Exec Chairman John Ketteley commenting: "**Elecosoft remained resilient throughout 2019 despite adverse exchange rate movements and delays and hesitations occasioned by Brexit** in the placing of orders by companies in the construction, manufacturing and retail sectors, all of which are served by Elecosoft.

*I am sure that shareholders will be particularly grateful to our employees this year for their continuing dedication and outstanding performance in such difficult trading conditions."*

## Summary financial projections

Elecosoft (Dec yearend)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
			Restated						
Software licenses	4,955	5,135	5,271	6,000	6,120	6,242	6,367	6,495	6,624
Recurring SaaS & support Services	8,622	11,018	12,595	14,250	15,105	16,918	19,624	22,764	26,407
	4,218	3,843	4,354	5,100	5,202	5,306	5,412	5,520	5,631
<b>Turnover</b>	<b>17,795</b>	<b>19,996</b>	<b>22,220</b>	<b>25,350</b>	<b>26,427</b>	<b>28,466</b>	<b>31,404</b>	<b>34,779</b>	<b>38,662</b>
% growth	16.6%	12.4%	11.1%	14.1%	4.2%	7.7%	10.3%	10.7%	11.2%
<b>Gross Profit</b>	<b>15,560</b>	<b>17,575</b>	<b>19,536</b>	<b>22,688</b>	<b>23,652</b>	<b>25,477</b>	<b>28,106</b>	<b>31,127</b>	<b>34,602</b>
% margin	87.4%	87.9%	87.9%	89.5%	89.5%	89.5%	89.5%	89.5%	89.5%
<b>Adj. EBITDA (post SBPs)</b>	<b>2,753</b>	<b>3,643</b>	<b>5,257</b>	<b>6,136</b>	<b>6,727</b>	<b>7,816</b>	<b>8,911</b>	<b>10,159</b>	<b>11,618</b>
% Margin	15.5%	18.2%	23.7%	24.2%	25.5%	27.5%	28.4%	29.2%	30.0%
<b>Adj. EBIT (post SBPs)</b>	<b>2,207</b>	<b>2,773</b>	<b>3,951</b>	<b>4,436</b>	<b>4,757</b>	<b>5,409</b>	<b>6,281</b>	<b>7,304</b>	<b>8,506</b>
% Margin	12.4%	13.9%	17.8%	17.5%	18.0%	19.0%	20.0%	21.0%	22.0%
<b>Adj. Profit before Tax</b>	<b>2,117</b>	<b>2,666</b>	<b>3,670</b>	<b>4,100</b>	<b>4,571</b>	<b>5,409</b>	<b>6,281</b>	<b>7,304</b>	<b>8,506</b>
<b>Adjusted EPS (p)</b>	<b>2.4</b>	<b>2.9</b>	<b>3.8</b>	<b>4.0</b>	<b>4.5</b>	<b>5.3</b>	<b>6.1</b>	<b>7.1</b>	<b>8.2</b>
EPS growth rate	58.2%	20.2%	33.3%	5.6%	10.9%	17.7%	15.5%	15.7%	15.9%
<b>Dividend (p)</b>	<b>0.40</b>	<b>0.60</b>	<b>0.68</b>	<b>0.75</b>	<b>0.90</b>	<b>1.05</b>	<b>1.22</b>	<b>1.41</b>	<b>1.63</b>
Yield	0.5%	0.7%	0.8%	0.9%	1.0%	1.2%	1.4%	1.6%	1.9%
% recurring revenues	48.5%	55.1%	56.7%	56.2%	57.2%	59.4%	62.5%	65.5%	68.3%
Adjusted cash conversion	69.8%	102.2%	114.4%	104.9%	101.3%	103.0%	101.8%	103.3%	103.2%
Average headcount	190	201	228	232	236	243	254	266	278
Revenues (£ks) / employee	93.7	99.5	97.5	109.3	111.9	116.9	123.6	130.9	138.9
<b>Valuation benchmarks</b>									
P/E ratio	36.0	30.0	22.5	21.3	19.2	16.3	14.1	12.2	10.5
EV/Sales	3.9	3.5	3.1	2.7	2.6	2.4	2.2	2.0	1.8
EV/EBITDA	25.2	19.0	13.2	11.3	10.3	8.9	7.8	6.8	6.0
EV/EBITA	31.4	25.0	17.5	15.6	14.6	12.8	11.0	9.5	8.1
Adjusted tax rate	-16.1%	-17.9%	-19.4%	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%
EBITDA drop through rates	37.8%	40.4%	72.6%	28.1%	54.9%	53.4%	37.3%	37.0%	37.6%
ROCE	15.5%	21.3%	15.5%	15.7%	15.2%	15.5%	16.0%	16.6%	17.1%
Dividend cover	6.0	4.8	5.6	5.4	5.0	5.0	5.0	5.0	5.0
PEG ratio	0.62	1.49	0.67	3.78	1.76	0.92	0.91	0.78	0.66
<b>Net cash/(debt) - ex IFRS16</b>	<b>-1,304</b>	<b>1,031</b>	<b>-1,814</b>	<b>1,476</b>	<b>4,381</b>	<b>7,927</b>	<b>12,111</b>	<b>17,086</b>	<b>22,868</b>
Sharecount (Ks)	74,433	76,309	77,400	82,240	82,651	83,064	83,479	83,897	84,316
<b>Shareprice (p)</b>	<b>86p</b>								

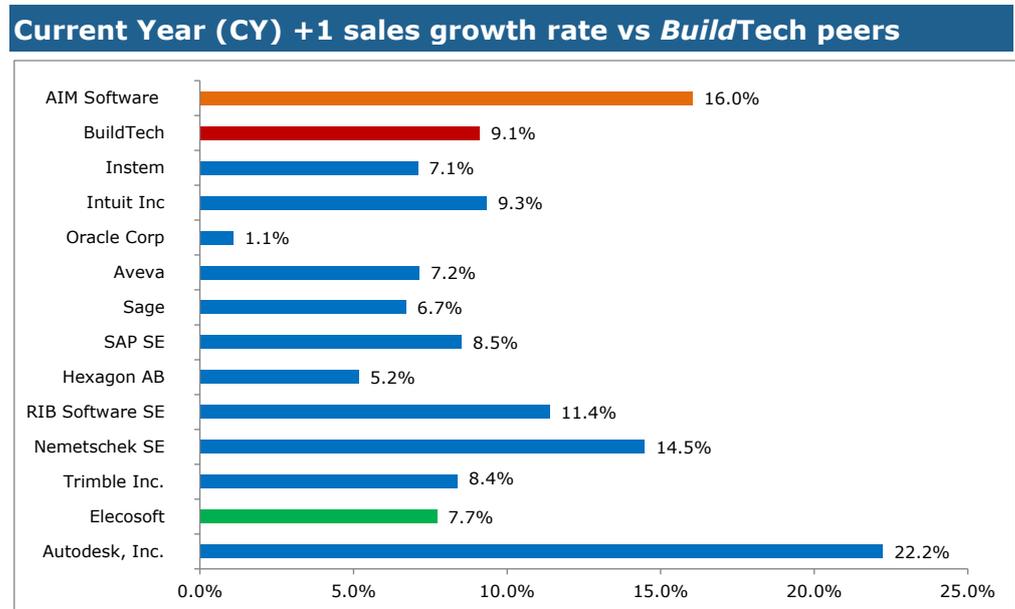
Source: Equity Development

## Key risks

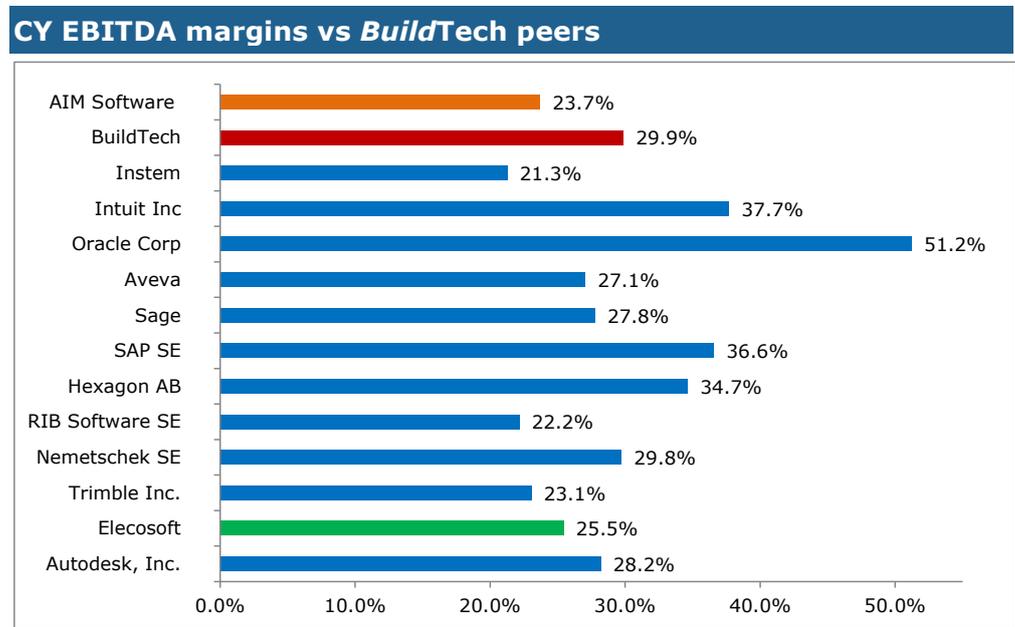
- Substantial slowdown in global GDP which could impact the worldwide property, construction and infrastructure markets.
- Anticipated growth/profitability may take longer than envisaged, cost more or not be fully realised.
- Larger license deals can lead to lumpy revenues, but this is being equally balanced by recurring revenues from SaaS, support & maintenance contracts (57% H1'18).
- Foreign exchange. However, this is primarily a translation risk with 63% of Elecosoft's turnover being generated outside the UK.
- Regulatory and tax changes. Generic risks of retention/recruitment of key staff, etc.
- Competition may intensify due to new/existing players. Indeed being relatively small, Elecosoft could get squeezed by larger rivals, partners and customers.

- As with many small cap AIM stocks, daily trading volumes can occasionally decline, particularly during seasonally quieter periods and/or between newsflow.

## Appendices - BuildTech industry KPIs & multiples

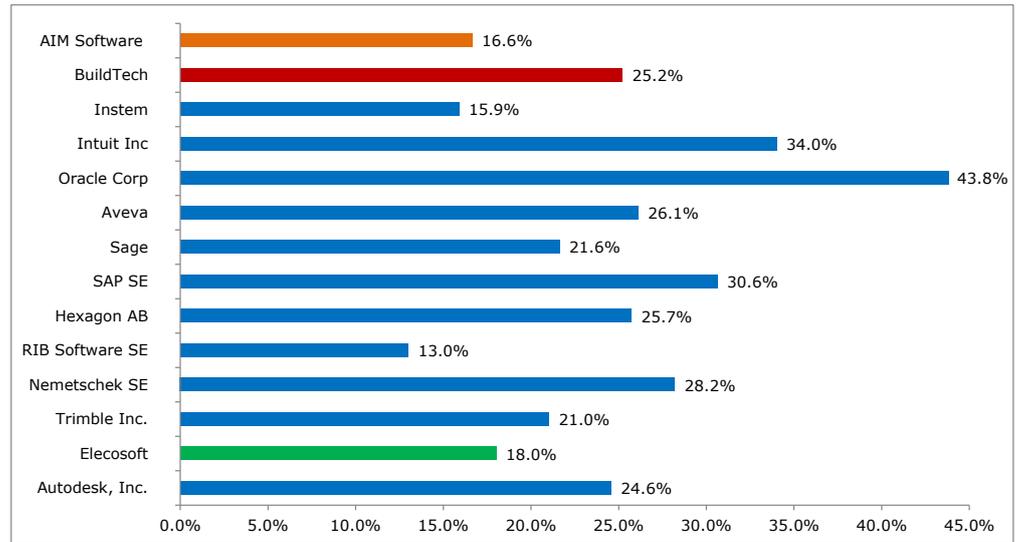


Source: Equity Development : CY = 2020, arithmetic average for sector



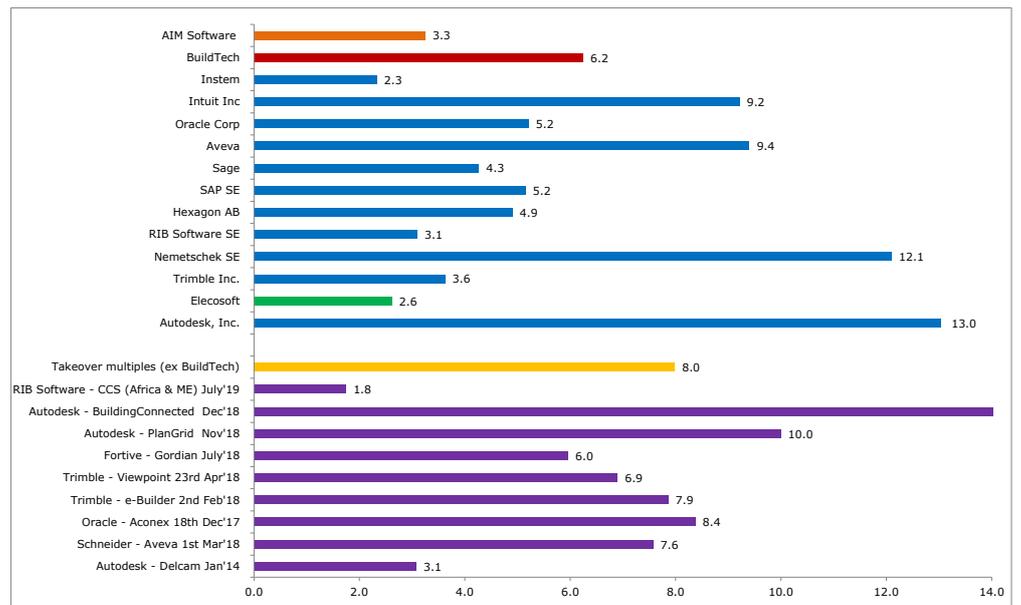
Source: Equity Development, arithmetic average for sector

### CY EBIT margins vs *BuildTech* peers



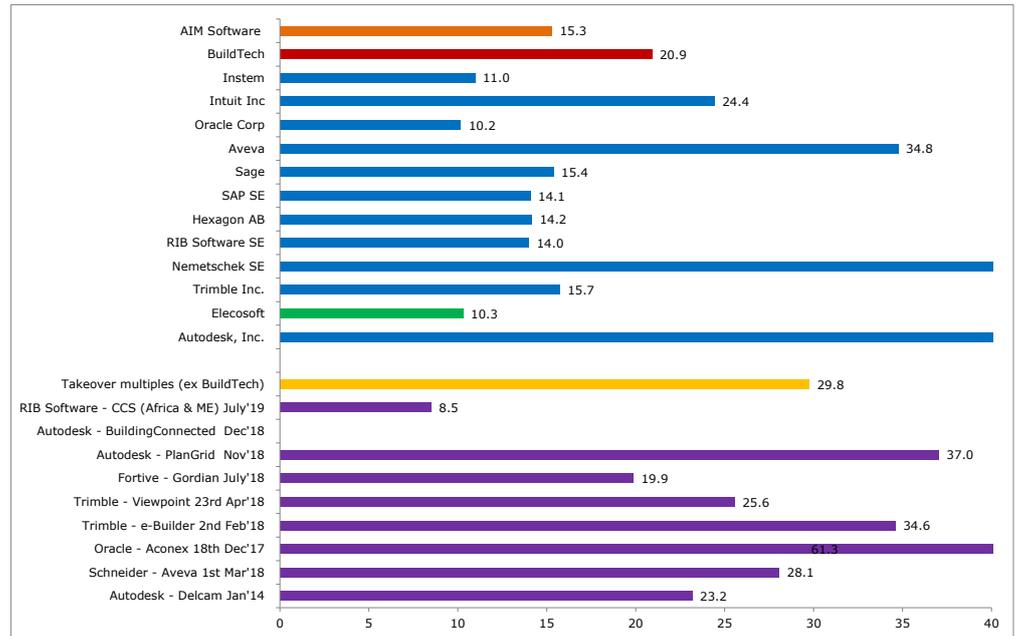
Source: Equity Development, arithmetic average for sector

### CY EV/sales multiples vs *BuildTech* peers



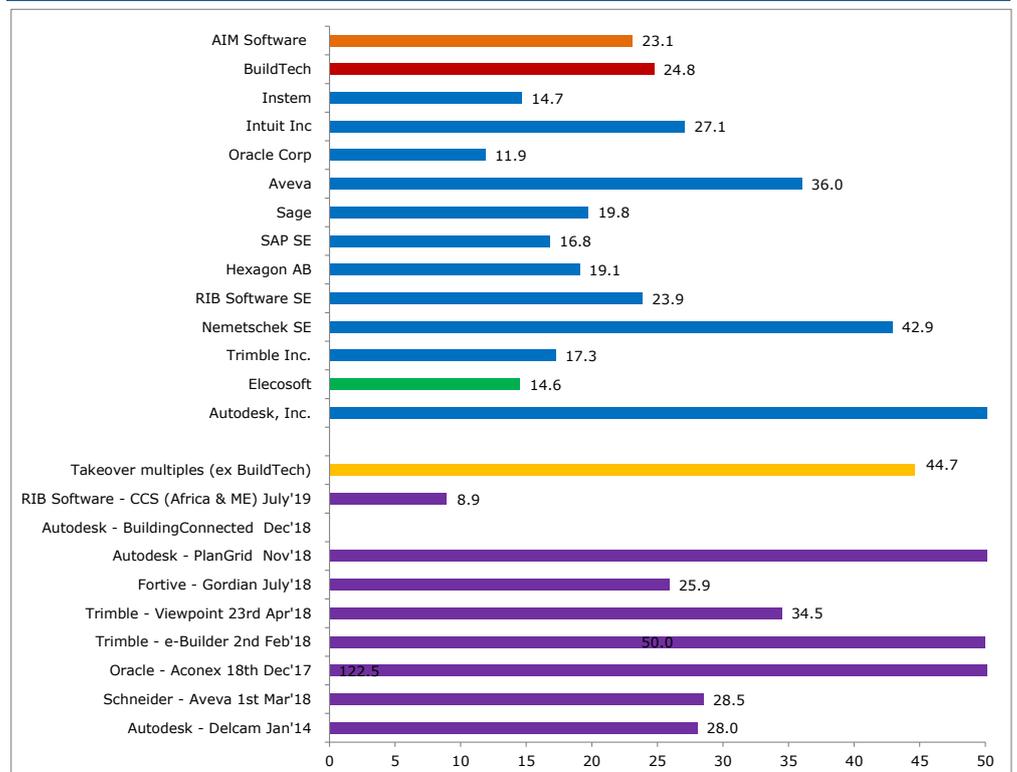
Source: Equity Development : CY = Current Year, arithmetic average for sector

### CY EV/EBITDA multiples vs BuildTech peers



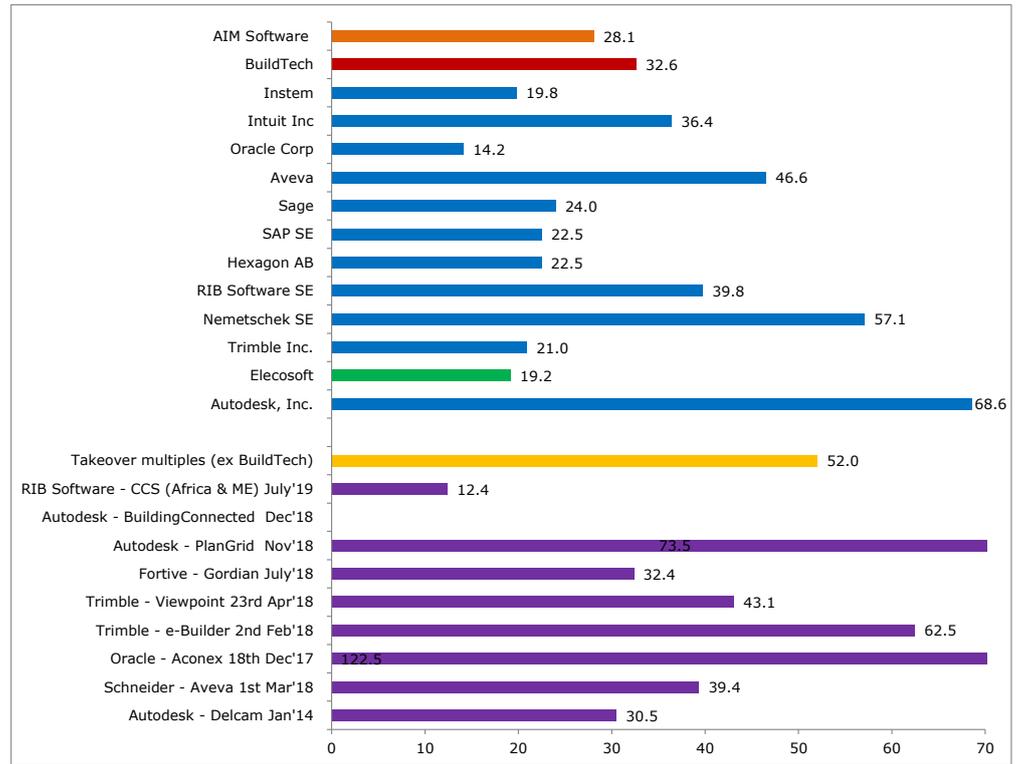
Source: Equity Development : CY = Current Year, arithmetic average for sector

### CY EV/EBIT multiples vs BuildTech peers



Source: Equity Development : CY = Current Year, arithmetic average for sector

### CY PER multiples vs *BuildTech* peers



Source: Equity Development : CY = Current Year, arithmetic average for sector

### Market capitalisation of peers

	Shareprice	Mrk Cap (Millions)	CY net cash / (debt) Millions	Enterprise Value (Millions)
Elecosoft	86p	£70.7	£1.5	£69.2
Trimble Inc.	\$44.0	\$11,088	-\$1,130	\$12,218
Autodesk, Inc.	\$192.0	\$42,432	-\$250	\$42,682
Nemetschek SE	€ 68.0	\$7,854	\$84	\$7,770
RIB Software SE	€ 19.5	\$1,009	\$137	\$872
Hexagon AB	€ 51.1	\$18,718	-\$1,277	\$19,995
SAP SE	€ 125.0	\$149,375	-\$4,840	\$154,215
Sage	725p	£7,801	-£412	£8,213
Aveva	£50.15	£8,089	£200	£7,889
Oracle Corp	\$55.0	\$178,200	-\$29,056	\$207,256
Intuit Inc	\$275.0	\$72,875	\$3,495	\$69,380
Instem	460p	£75.0	£5.9	£69.1

Source: Equity Development



## Investor Access

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