

€3.45m acqn of VR/AR visualisation expert

6th November 2018

How do the world’s best interior designers create their perfect homes? Talent plays a big factor, however they also use top notch visualisation software to quickly & easily modify a property’s layout, aesthetics and ambiance.

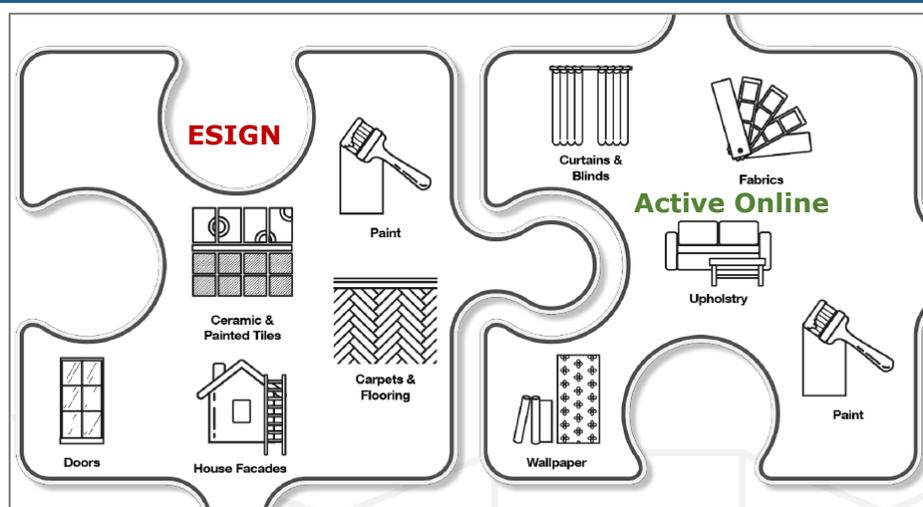
Enter [Active Online GmbH](#) based in Wesel, NW Germany and employing 29 staff. Its “**cutting-edge**” software allows consumers & homeowners to do exactly this. Swapping out the furniture, curtains & flooring, alongside changing the décor, wall colours, light fittings, fabrics & windows. All at the touch of a button in **rich HD/3D graphics**. Providing a **fully immersive 360-degree view, Virtual & Augmented Reality** (see next page), **cloud data management** and **advanced apps** to enable an almost limitless range of homeware products to be imported via standard QR codes. The technology is deployed by c.700 organisations (see later) in order to **enhance their sales processes and end-user engagement**.

Active Online and ESIGN are an ideal fit....

But that’s not all. We believe the system has **great potential outside of AO’s core ‘soft fabrics, floor coverings and interior design’ verticals** – especially across the wider *BuildTech* & merchandising communities. So much so that this morning, **Elecosoft said it had acquired the firm for an initial €3.45m** (or £3.03m) – comprising €2.95m cash and €0.5m of newly issued ELCO stock at 73.55p (total 597k shares).

The equity portion is being split equally between the 2 founder directors, who plan to stay with the enlarged group and be bound by a 36 month lock-up. A further €0.4m (performance related) bonus is also payable to these accomplished individuals, dependent on the attainment of specific targets over the next 3 years. Indicating to us, they recognise the **substantial upside available** – and what we feel is another ‘**marriage made in heaven**’, following the Shire Systems (Jul’18) & ICON (Oct’16) deals.

Stronger together



Source: Company

Company Data

EPIC	AIM: ELCO
Price (last close)	73p
52 week Hi/Lo	93p/41p
Mkt cap (post placing)	£60m
ED valuation / share	115p
Avg. daily volume	40,000

Share Price, p



Source: Web Financial

Description

Elecosoft is a BuildTech pioneer, developing on-premise and Cloud/SaaS software 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 oil providing data/info to the various interconnecting modules.

There are ~201 staff: of which 50 are software engineers, 59 client support and 55 sales/marketing. **Visibility is robust** with **55% of H1’18 revenues recurring and >90% customer retention rates**. Landmark implementations are: The Shard, the BBC Television Centre, Hong Kong International Airport and Berlin’s Reichstag Dome. **94% of H1’18 turnover was sold directly**, with the rest generated via channel partners.

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... offering 'Best-of-Breed' software solutions

Not only from **cost synergies**, where we understand ELCO can reduce its 3rd party 'image scanning' bills by circa €150k pa, utilising AO's in-house facilities. But more importantly from integrating the business with its own rival interactive visualisation division ESIGN (10% sales, located 270km away in Hanover) – coupled with X-selling the solutions into each other's extensive client lists (see next page).

This joint capability will enable users to rapidly convert digital photos into HD/3D virtual models. Allowing both the general public to see exactly how their own possessions might look inside a new property - and retailers to sell related fixtures, fittings, sofas and all manner of other goods/services from an extensive online brochure. Boosting the latter's revenues and reducing returns in the event, say an appliance doesn't fit.

Novices may soon be able to design like the 'Pros'

Plus, if this digital catalogue is fed with cost, margin & other info, then shops could theoretically alter their prices in real-time to maximise turnover, profits or any other KPI. A **substantial addressable market** that is only now being tapped.

Further out, it may be possible to **incorporate artificial intelligence**, so that even complete novices would have the power at their finger-tips to fashion designs comparable to those mocked up by the professionals.

Initial 3D/ HD rendering of actual room from digital photo



Source: Active Online

Room transformed using interactive software



Source: Active Online

Attractive purchase price & EPS enhancing in year 1

In terms of the numbers, Active Online achieved turnover, EBITDA & PBT of €2.5m (+17% vs LY), €240k & €124k respectively for the y/e December 2017. Meaning that even at the maximum €3.85m, the purchase consideration is equivalent to a modest **1.54x EV/sales multiple** vs 4.8x for sector. 21% of turnover is recurring in nature (re data management) with a further 32% repeatable from digitising material and image editing.

All told, we believe this is an **attractively priced, earnings accretive** (in year 1) **and value enhancing deal** – especially for a profitable software expert at the forefront of *BuildTech* visualisation.

Excellent endorsements from Active Online’s extensive client base (circa 700)



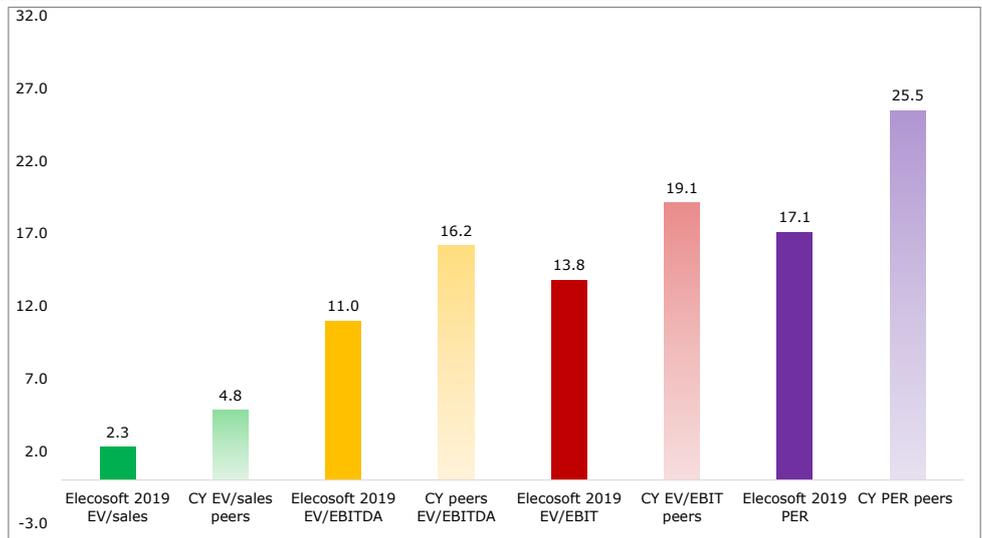
Source: Active Online

Deal financed from internal cash resources

With regards to funding, **the transaction is being financed from existing cash resources**. Albeit **separately** 3,214,285 new shares have been placed at 70p each, raising £2.25m (gross) to help accelerate the integration, and for general technology/corporate development purposes.

Going forward, our **2019 turnover, PBT & EPS estimates have been upgraded to £27.2m, £4.3m & 4.3p** respectively vs £24.9m, £4.0m & 4.1p before. Likewise, **we have nudged up the valuation from 110p to 115p/share**. Or >55% higher than today's 73p, which **we feel offers significant upside** - representing steep discounts vs peers (see below) across all key metrics.

Elecosoft 2019 multiples vs peers

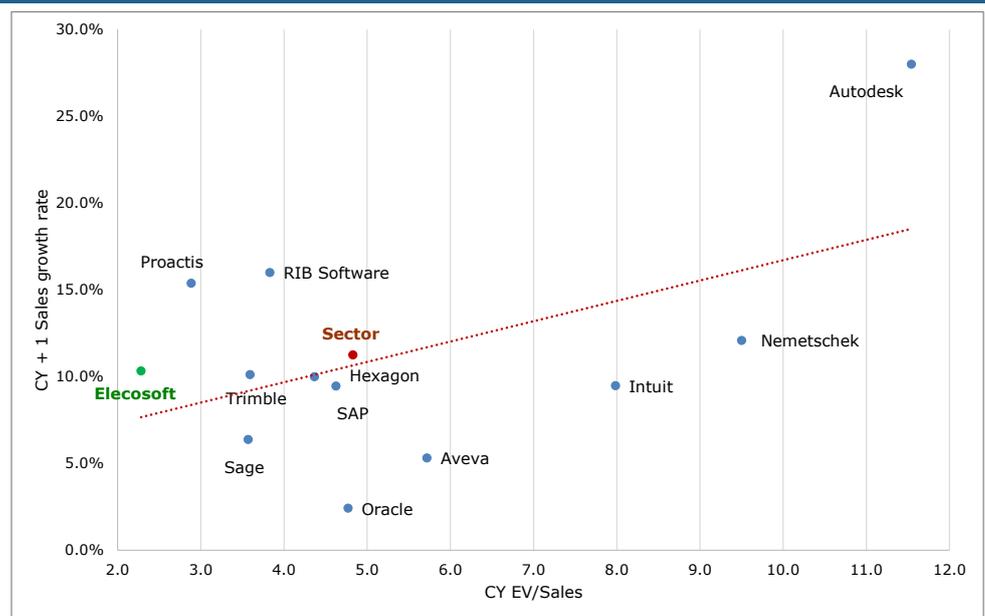


Source: Equity Development – closing prices as at 5th November 2018

Possible sharp upwards re-rating as growth takes-off

Better still, investors might not have long to wait too long either for the price gap to close. Indeed, once the City gets a wind that growth is accelerating, the stock could re-rate sharply (see below).

Current year EV/sales multiples vs CY+1 revenue growth

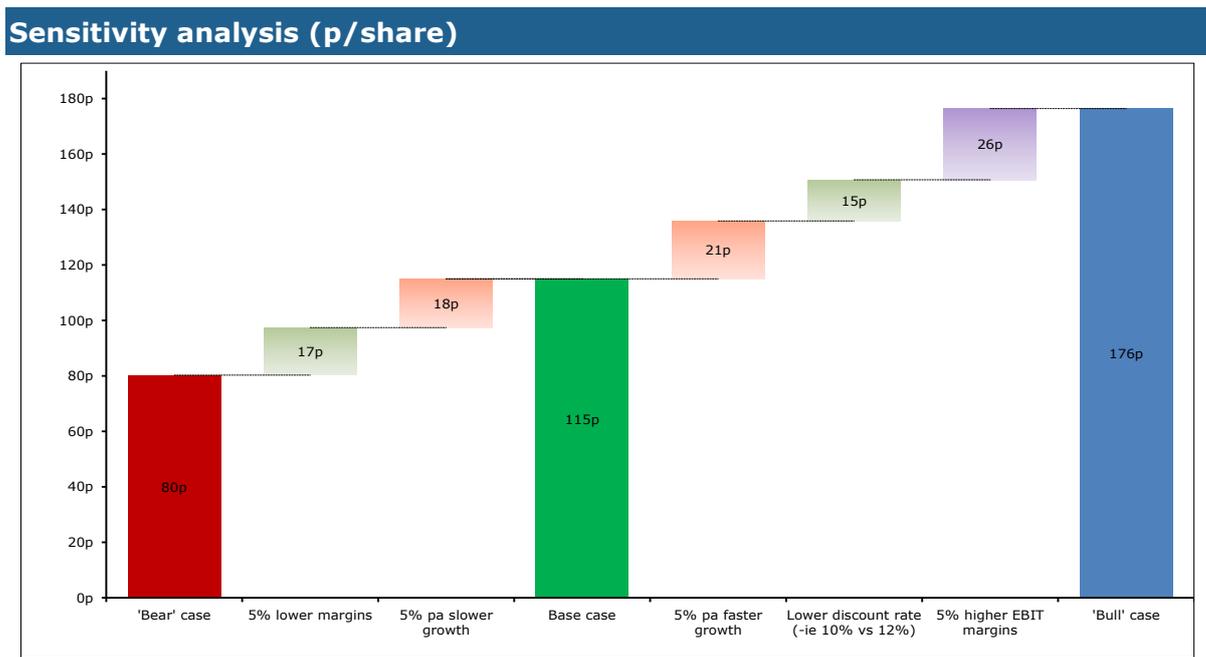


Source: Equity Development, various sites – closing prices as at 5th November 2018

Favourable 'risk vs reward' profile

Fine, but is there anything that could put a spanner in the works? Well, apart from the normal macro risks of a deep/prolonged recession, BREXIT, escalating trade tensions (US vs China/EU), tougher competition, etc – **we see little on the horizon for investors to be unduly concerned about.**

That said if pushed, there is the lumpiness of license sales to consider. Yet equally, **we estimate that recurring revenues (incl SaaS) now contribute >55% of the group** - providing robust visibility. From a risk perspective too, there appears to be minimal downside as indicated by our 'Bear' and 'Bull' case scenarios of 80p & 176p respectively (see below).



Source: Equity Development.

Current trading in line with expectations

Elsewhere, this morning's upbeat announcement reported that the business "**continues to trade in line with its expectations, and its assessment of outlook & the market remains unchanged.**"

Executive Chairman, John Kettleley adding: " *We look forward very much to working with our new colleagues at Active Online. When we make acquisitions, we look closely at the quality and flair of the management and people involved, at the technology and quality of the software, and at the potential opportunities for collaboration with companies in the Elecosoft Group. **Active Online will bring with it an outstanding team of software developers; and AR and VR capabilities together with synergistic opportunities to develop new internet visualisation tools for the interior market worldwide.***

*The proceeds of the placing will provide the means to accelerate the integration of Active Online and ESIGN and the continued enhancement and development of our software technologies. **The Acquisition is expected to be earnings enhancing within its first full financial year.***

Summary financial projections

Elecosoft (Dec yearend)	2014 Act £'000s	2015 Act £'000s	2016 Act £'000s	2017 Act £'000s	2018 Est £'000s	2019 Est £'000s	2020 Est £'000s	2021 Est £'000s	2022 Est £'000s	2023 Est £'000s	2024 Est £'000s
Software licenses	4,008	4,536	4,955	5,135	5,300	5,671	6,068	6,493	6,947	7,434	7,954
Recurring SaaS & support	7,351	7,278	8,622	11,018	12,000	13,236	14,957	16,901	19,098	21,581	24,386
Services	3,813	3,446	4,218	3,843	3,750	3,863	3,978	4,098	4,221	4,347	4,478
Shire & active online					1,250	4,400	4,972	5,618	6,349	7,174	8,107
Turnover	15,172	15,260	17,795	19,996	22,300	27,170	29,975	33,110	36,615	40,536	44,925
% growth	-7.0%	0.6%	16.6%	12.4%	11.5%	21.8%	10.3%	10.5%	10.6%	10.7%	10.8%
Gross Profit	13,314	13,572	15,560	17,575	19,624	23,909	26,378	29,137	32,221	35,672	39,534
% margin	87.8%	88.9%	87.4%	87.9%	88.0%	88.0%	88.0%	88.0%	88.0%	88.0%	88.0%
Adj. EBITDA (post SBPs)	1,465	1,795	2,753	3,643	4,735	5,645	6,685	7,966	9,532	11,040	12,777
% Margin	9.7%	11.8%	15.5%	18.2%	21.2%	20.8%	22.3%	24.1%	26.0%	27.2%	28.4%
Adj. EBIT (post SBPs)	1,266	1,506	2,207	2,773	3,659	4,499	5,264	6,228	7,345	8,638	10,135
% Margin	8.3%	9.9%	12.4%	13.9%	16.4%	16.6%	17.6%	18.8%	20.1%	21.3%	22.6%
Adj. Profit before Tax	1,046	1,386	2,117	2,666	3,459	4,299	5,214	6,228	7,345	8,638	10,135
Adjusted EPS (p)	1.3	1.5	2.4	2.9	3.6	4.3	5.1	6.0	7.0	8.1	9.5
EPS growth rate		20.1%	58.2%	20.2%	26.6%	17.6%	18.6%	18.3%	16.8%	16.4%	16.2%
Dividend (p)	0.0	0.0	0.4	0.6	0.8	1.1	1.3	1.5	1.7	2.0	2.4
Yield			0.5%	0.8%	1.2%	1.5%	1.7%	2.0%	2.4%	2.8%	3.2%
% recurring revenues				55.1%	56.9%	57.6%	59.0%	60.4%	61.7%	63.0%	64.2%
Adjusted cash conversion				102.2%	94.8%	87.4%	93.2%	96.9%	99.8%	101.3%	101.3%
Valuation benchmarks											
P/E ratio	58.1	48.4	30.6	25.5	20.1	17.1	14.4	12.2	10.4	9.0	7.7
EV/Sales	4.1	4.1	3.5	3.1	2.8	2.3	2.1	1.9	1.7	1.5	1.4
EV/EBITDA	42.3	34.6	22.5	17.0	13.1	11.0	9.3	7.8	6.5	5.6	4.9
EV / EBITA	49.0	41.2	28.1	22.4	17.0	13.8	11.8	10.0	8.4	7.2	6.1
Adjusted tax rate	-20.0%	-19.5%	-16.1%	-17.9%	-17.5%	-18.0%	-19.0%	-19.0%	-19.0%	-19.0%	-19.0%
EBITDA drop through rates			37.8%	40.4%	47.4%	18.7%	37.1%	40.9%	44.7%	38.5%	39.6%
Dividend cover			6.0	4.8	4.3	4.0	4.0	4.0	4.0	4.0	4.0
PEG ratio		2.41	0.53	1.26	0.76	0.97	0.78	0.67	0.62	0.55	0.48
Net cash/(debt)	-2,035	-803	-1,304	1,031	-2,300	-345	2,343	5,814	10,264	15,624	21,916
Sharecount (Ks)	66,611	73,971	74,433	76,309	78,644	82,638	83,464	84,299	85,142	85,993	86,853
Shareprice (p)	73.0										

Source: Company historic data, Equity Development estimates

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, albeit this is being equally balanced by recurring revenues from SaaS, support & maintenance contracts (55% H1'18).
- Foreign exchange. However, this is primarily a translation risk with ~66% of Elecosoft's turnover being generated outside the UK.
- Regulatory and tax changes.
- Competition may intensify due to new/existing players. Albeit this goes with the territory in the smallcap arena.
- Being relatively small, Elecosoft could get squeezed by larger rivals, partners and customers.
- Generic risks of retention/recruitment of key staff, etc.
- Potential (yet small) impact from implementing the new "IFRS15 sales recognition" accounting standard from 1st Jan'18.
- As with many small cap AIM stocks, daily trading volumes can occasionally decline, particularly during seasonally quieter periods and/or between newsflow.



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