

How to profit from the surge in *BuildTech*

2nd August 2018

How can an outside investor gauge the quality of a company's software? Speak to experts, test the product, ask clients and/or review industry awards/journals. Elecosoft scores highly on all of these counts - yet to us what really stands out is its **customer base**.

For instance, **PowerProject is being (or has been) deployed on many of the UK's most iconic buildings**, such as London's tallest - the Shard, together with the multi-£billion regeneration schemes at Battersea Power Station, the BBC Television Centre & Southbank Place. Internationally too, it's helped construct Hong Kong's International Airport, Berlin's Reichstag Dome and Dubai's Jumeirah Park.

Customers keep coming back for more

All told, ELCO's software is used by >90% of the UK's top 100 construction firms & 7/10 biggest retailers; 40 of the top 50 Swedish & 14 of the largest German construction groups; 70% of the EU's flooring manufacturers and 15% of 400 largest US contractors. Generating **retention rates of >90%** and **almost 60% recurring revenues** (Support, maintenance & SaaS).

Not bad by anyone's standards. Indicating that **the software is not only best-of-breed, but also that clients love it.** Going forward, **a key objective will be to continue capitalising on this competitive advantage.** X-selling the full suite of design, visualisation, construction, building information (BIM) and property maintenance applications. Along with expanding abroad outside of the EU (>90% sales) and into adjacent verticals (e.g. retail).

On track and biased towards the upside

The good news from **this morning's positive trading update**, is that **the Board are well on track. H1'18 revenues climbed 7% LFL in constant currency** (5% post forex headwind) to circa £10.5m (LY £10.0m) with **adjusted PBT jumping 45% to £1.45m** (LY £1.0m), on the back of favourable operating leverage and continued tight cost control.

Consequently, **we reiterate our FY18 sales and EBIT forecasts of £22m and £3.6m respectively.** Albeit, note that these are tilted towards the upside, especially given recent £ weakness vs the €/\$. Likewise, **H1 cash generation was strong**, ending June with net funds of £2.6m compared to £1m at the start of the period – equivalent to **cash conversion of >105%**. Plus, even after last month's strategic acquisition of Shire Systems for £5.1m (cash/debt free basis), we expect net debt to close Dec'18 at a modest £2.8m, or 0.62x EBITDA.

Similarly, while **our top level 90p/share valuation remains unchanged**, we once again emphasise that there is possible upside here too. In fact, despite this year's re-rating, the stock appears cheap vs peers, who trade on higher EV/sales, EV/EBIT and PE multiples (see below).

Company Data

EPIC	AIM: ELCO
Price (last close)	81p
52 week Hi/Lo	91p/41p
Market cap	£63m
ED valuation	90p/share
Avg. daily volume	50k

Share Price, p



Source: Web Financial

Description

Elecosoft is a **developer of 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 essential lubricant to oil all the connecting parts.**

There are 201 staff: 50 are software engineers, 59 are in client support and 55 sales/marketing. **Visibility is robust with 49% of 2017 revenues recurring maintenance, ~10% SaaS and 90%+ customer retention rates.** Landmark implementations are: The Shard, the BBC Television Centre, Hong Kong International Airport and Berlin's Reichstag Dome.

Next News: Interims in September

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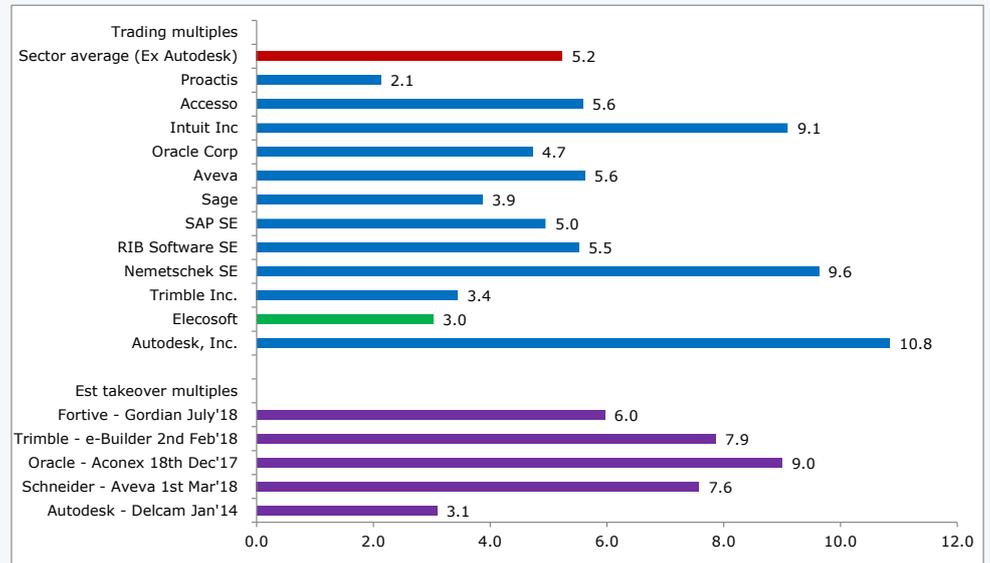
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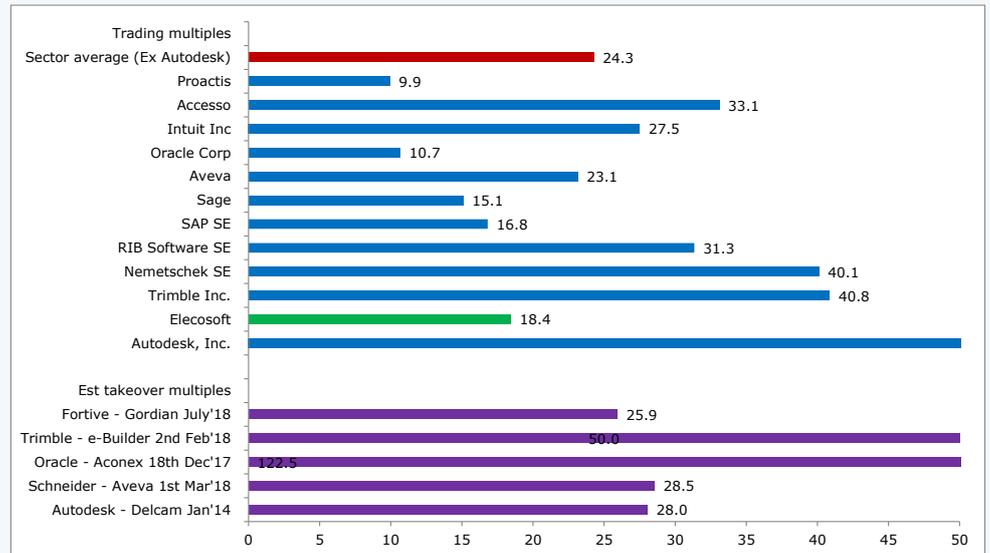
Stock trades at a discount to peers

Current year (CY) EV/sales multiples vs peers



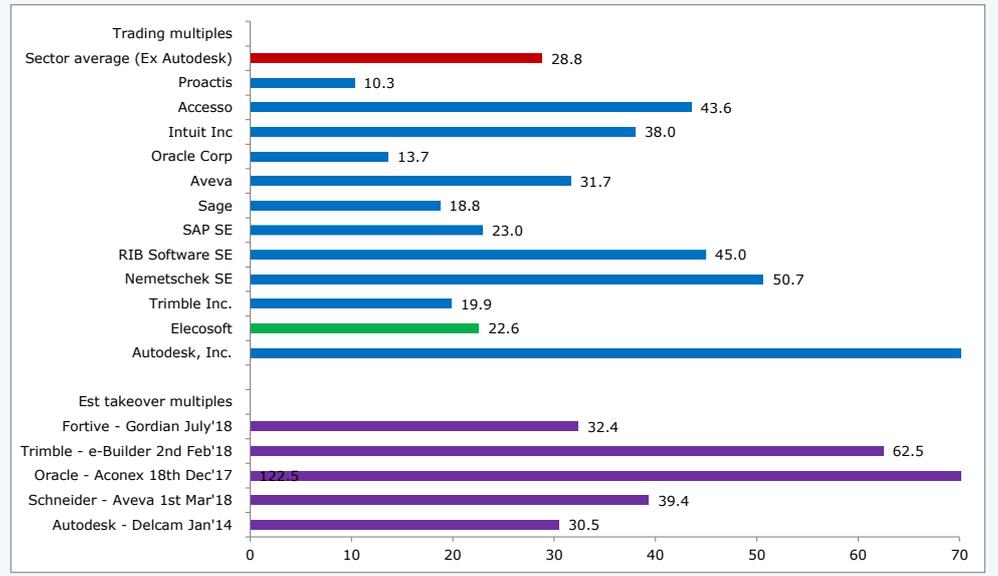
Source: Equity Development, various sites – closing prices as at 1st August 2018

CY EV/EBIT vs peers and M&A multiples



Source: Equity Development, various sites – closing prices as at 1st August 2018

CY PERs vs peers and M&A multiples



Source: Equity Development, various sites – closing prices as at 1st August 2018

Onwards and upwards

Executive Chairman John Ketteley adding "**H1'18 has seen Elecosoft continue strongly its positive forward momentum, delivering solid revenue growth, significant profit growth, and strong cash generation leaving the Company on course to meet the Board's expectations for the full year.** It was a period during which was concluded the acquisition of Shire Systems.

Shire Systems is a leading UK developer of software for managing and maintaining building and related plant and equipment and represents a significant extension of Elecosoft's specialist international construction software portfolio into the post-construction phase of a building's management. I am delighted to welcome our new colleagues at Shire Systems as they join the Elecosoft group."

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 (Incl SaaS)	4,008	4,536	4,955	5,775	6,079	6,626	7,422	8,312	9,310	10,427	11,678
Support and maintenance	7,351	7,278	8,622	9,856	10,375	11,309	12,666	14,186	15,889	17,795	19,931
Services	3,813	3,446	4,218	4,365	4,595	4,837	5,092	5,360	5,643	5,940	6,253
Shire - maintenance/FM software					950	2,090	2,341	2,622	2,936	3,289	3,683
Turnover	15,172	15,260	17,795	19,996	22,000	24,863	27,521	30,481	33,778	37,451	41,545
% growth	-7.0%	0.6%	16.6%	12.4%	10.0%	13.0%	10.7%	10.8%	10.8%	10.9%	10.9%
Gross Profit	13,314	13,572	15,560	17,575	19,236	21,740	24,064	26,652	29,535	32,747	36,327
% margin	87.8%	88.9%	87.4%	87.9%	87.4%	87.4%	87.4%	87.4%	87.4%	87.4%	87.4%
Adj. EBITDA (post SBPs)	1,465	1,795	2,753	3,643	4,567	5,392	6,243	7,220	8,338	9,620	11,087
% Margin	9.7%	11.8%	15.5%	18.2%	20.8%	21.7%	22.7%	23.7%	24.7%	25.7%	26.7%
Adj. EBIT (post SBPs)	1,266	1,506	2,207	2,773	3,610	4,310	5,046	5,893	6,869	7,990	9,279
% Margin	8.3%	9.9%	12.4%	13.9%	16.4%	17.3%	18.3%	19.3%	20.3%	21.3%	22.3%
Adj. Profit before Tax	1,046	1,386	2,117	2,666	3,400	4,000	4,786	5,683	6,709	7,990	9,279
Adjusted EPS (p)	1.3	1.5	2.4	2.9	3.6	4.2	4.9	5.8	6.8	8.1	9.3
EPS growth rate		20.1%	58.2%	20.2%	25.0%	16.3%	17.6%	18.2%	17.5%	18.5%	15.6%
Dividend (p)	0.0	0.0	0.4	0.6	0.9	1.0	1.2	1.4	1.7	2.0	2.3
Yield			0.5%	0.7%	1.1%	1.3%	1.5%	1.8%	2.1%	2.5%	2.9%
Recurring maintenance % sales	48.5%	47.7%	48.5%	49.3%	47.2%	45.5%	46.0%	46.5%	47.0%	47.5%	48.0%
Adjusted cash conversion		55.0%	69.8%	102.2%	85.0%	83.1%	84.3%	85.5%	86.4%	87.3%	88.1%
Valuation benchmarks											
P/E ratio	64.5	53.7	33.9	28.2	22.6	19.4	16.5	14.0	11.9	10.0	8.7
EV/Sales	4.4	4.4	3.7	3.3	3.0	2.7	2.4	2.2	2.0	1.8	1.6
EV/EBITDA	45.4	37.1	24.2	18.3	14.6	12.3	10.7	9.2	8.0	6.9	6.0
EV / EBITA	52.6	44.2	30.2	24.0	18.4	15.4	13.2	11.3	9.7	8.3	7.2
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%	46.1%	28.8%	32.0%	33.0%	33.9%	34.9%	35.8%
Dividend cover			6.0	4.8	4.0	4.0	4.0	4.0	4.0	4.0	4.0
PEG ratio		2.67	0.58	1.40	0.90	1.19	0.94	0.77	0.68	0.54	0.56
Net cash/(debt)	-2,035	-803	-1,304	1,031	-2,800	-1,132	919	3,445	6,516	10,281	14,736
Sharecount (Ks)	66,611	73,971	74,433	76,309	78,244	78,635	79,029	79,424	79,821	80,220	80,621
Shareprice (p)	81.0										

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 support/maintenance (49% 2017) and another ~10% from SaaS contracts.
- 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.
- 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 "FRS15 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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