

Shire acquisition "is amazing"

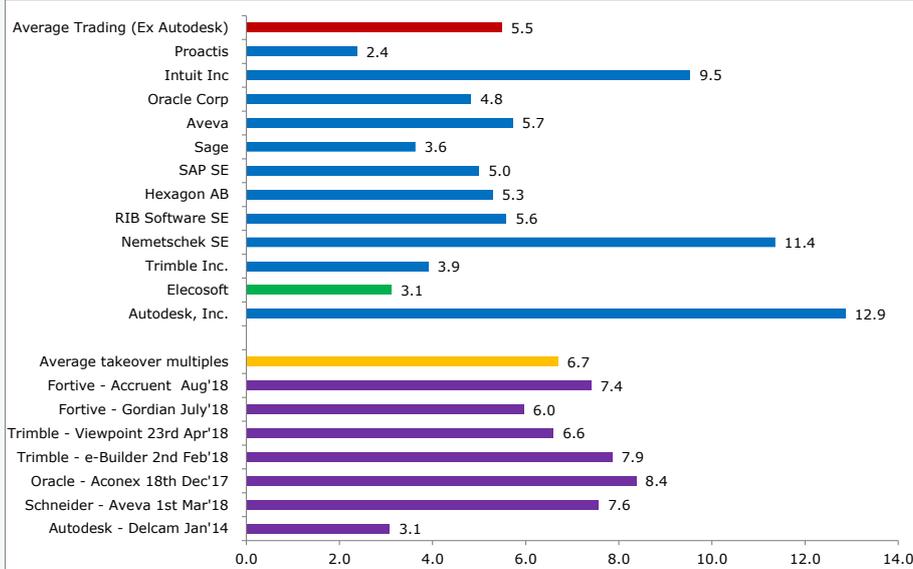
12th September 2018

Every so often even traditional, old-fashioned industries are transformed by new disruptive technology. One of the latest being the \$10 trillion Architecture, Engineering & Construction (AEC) market, where cutting edge **BuildTech software** is digitising the entire property/infrastructure life cycle (say 75 years). Covering initial design, build and commissioning, right through to maintenance, repair, upgrade and final demolition. Strangely though, this seems to have been somewhat overlooked by UK investors, despite the sector expanding at a healthy 11% clip and being worth c. \$6bn pa (*source: Nemetschek*).

ELCO trades at an undeserved discount to peers

This apparent indifference however is not shared abroad, where overseas **BuildTech stocks trade on EV/turnover multiples of >5x** (see below). In our view, correctly reflecting the software's outstanding value to end-users.

Current year (CY) EV/turnover multiples vs peers



Source: Equity Development – closing prices as at 11th September 2018

Valuation gap should close in due course

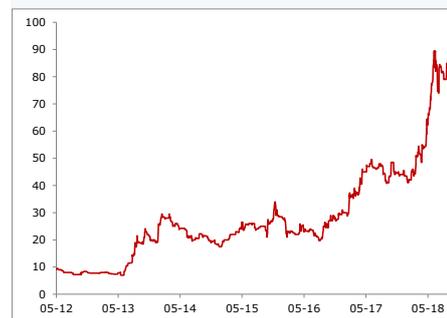
What's more, it should only be a matter of time before ratings of similar UK listed peers like Elecosoft catchup. Particularly if **the company continues to deliver impressive results**, as it did once again this morning.

Here, **H1'18 adjusted EBIT and operating cashflow climbed 33.5% (to £1,755k) and 35.8% (£2,287k)** respectively on revenues of £10,554k, up 7% LFL (constant currency vs 5.4% reported). Similarly, **underlying EPS rose 38% to 1.8p, the dividend was hiked 40% to 0.28p**, EBIT margins widened to 16.6% (13.1% LY) and **cash conversion** came in at a **better than expected 107%** (LTM). All aided by **favourable operating leverage** and **46% EBITDA drop-through rates**.

Company Data

EPIC	AIM: ELCO
Price (last close)	85p
52 week Hi/Lo	93p/41p
Market cap	£78m
ED valuation / share	110p
Avg. daily volume	35k

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 oil providing data/info to the various interconnecting modules.

There are 201 staff: 50 are software engineers, 59 are in 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 direct**, with the rest generated via channel partners.

Next News: TBC

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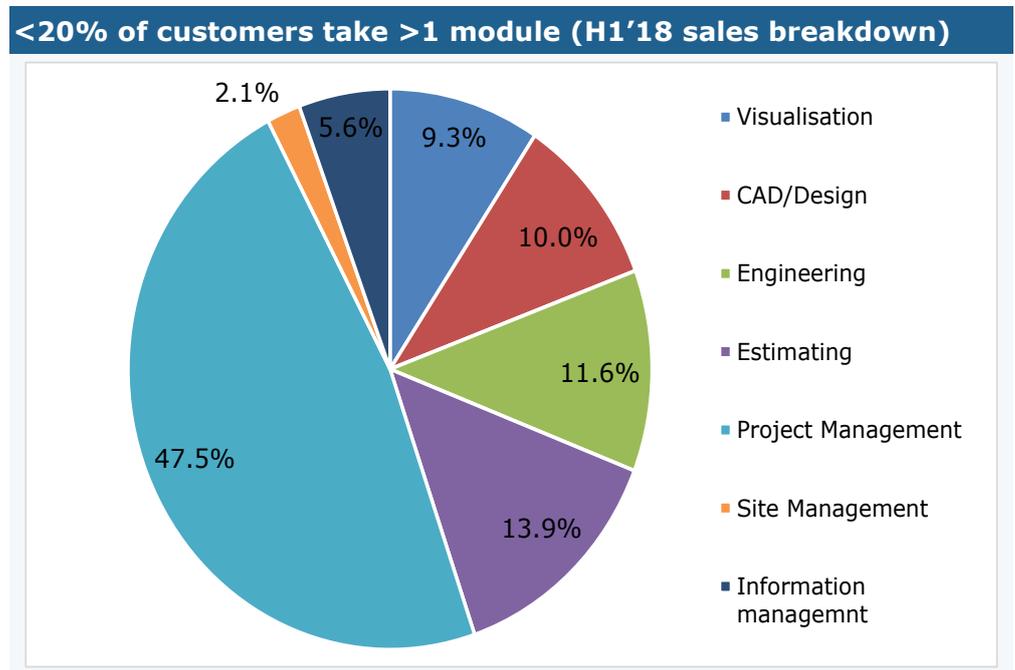
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Substantial synergies from Shire integration

Additionally, **this organic growth will be enhanced going forward** by the **transformational acquisition of Shire Systems** on 4th July for £5.1m (cash/debt free) - equivalent to modest 2018 EV/revenue, EV/EBIT and PE multiples of 2.5x, 6.5x and 8.0x. Executive Chairman John Kettleley, who is usually pretty reserved, adding that **Shire is absolutely "amazing"**.

Likewise to us, the transaction offers considerable upside. Not only by dovetailing Shire's top notch computerised maintenance management software (CMMS) with ELCO's flagship Powerproject and ICON applications. But also X-selling to its 800 customer base, who span a diverse range of verticals. Enabling landlords to manage their property/asset portfolios far more efficiently, having already captured most of the structural data during design/build.



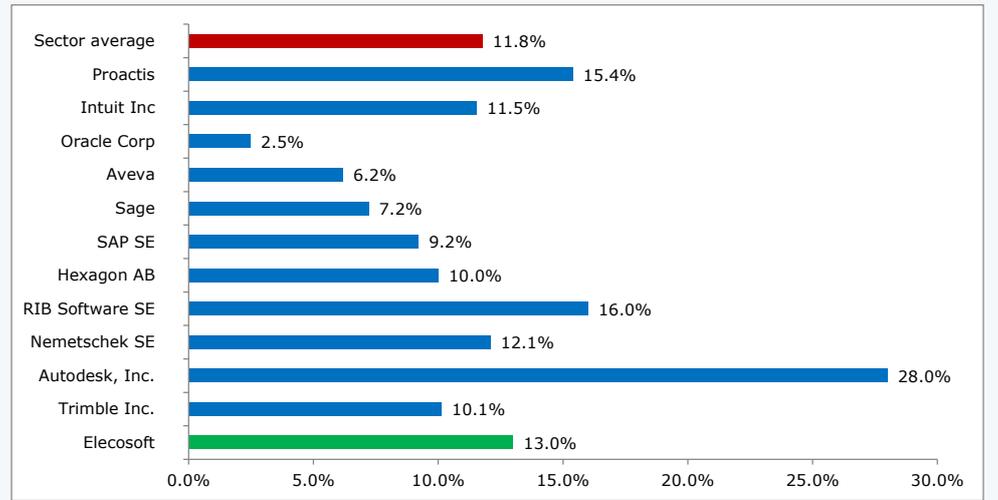
Source: Equity Development

Positive operating leverage

Ultimately, **the deal could generate synergies many times higher than the £5.1m price**. Clearly this won't happen overnight, albeit by offering **total cradle-to-grave solutions**, we believe Elecosoft should be able to **churn out double digit top line growth, 20%+ adjusted EBIT margins and 90%+ cash conversion** across the cycle.

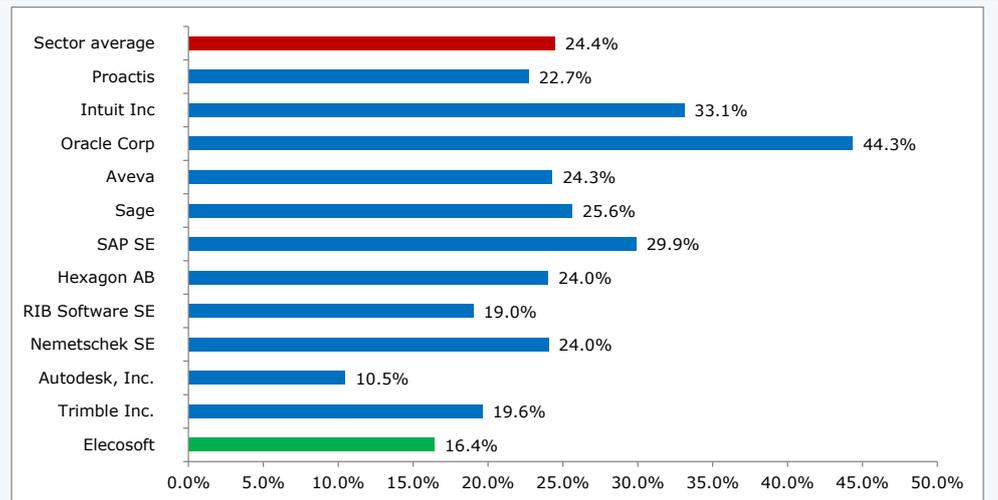
Indeed, many of Elecosoft's peers are already banging out these type of return.

Current year (CY) + 1 turnover growth rates vs peers



Source: Equity Development

CY adjusted EBIT margins vs peers



Source: Equity Development

New products coming on stream thick and fast

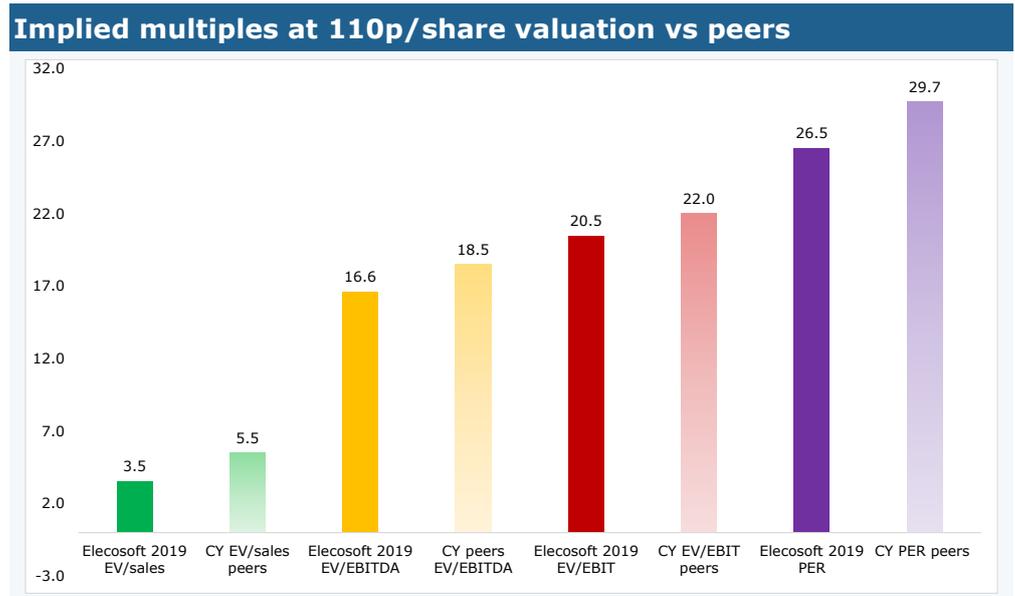
Let’s not forget too that Elecosoft is presently investing **heavily in new products**. In 2017 **£2.75m was spent** (14% of sales vs 15% 2016) **on R&D** (£1.7m) and **capitalised development** (£1.05m vs £623k amortised). For H1’18 this represented another hefty 13%, or £1.4m - primarily undertaken by ELCO’s **50 software engineers** and **59 client support staff**, situated in Sweden, UK and Germany.

Updates of Staircon Online Designer and Timber Framing were issued in the period (reported under Engineering). Whilst the beta-version of its new site management software, Memmo, was also finalised, alongside show-casing the latest editions of Powerproject and Bidcon at Nordbygg, Northern Europe’s largest construction exhibition in Sweden.

Upgrading our fair value from 90p to 110p/share

So what does this mean with regards to the valuation? Well, based on the astute Shire purchase and **substantial prospects ahead** – not least, cross/up-selling, expansion outside of Europe and entry into adjacent verticals – **we calculate the stock is worth 110p/share** (vs 90p before) using a range of benchmarks and 12% discount factor.

Plus, even at this level **the shares are not expensive**, both in absolute and relative terms (see below) vs peers.



Source: Equity Development – closing prices as at 11th September 2018

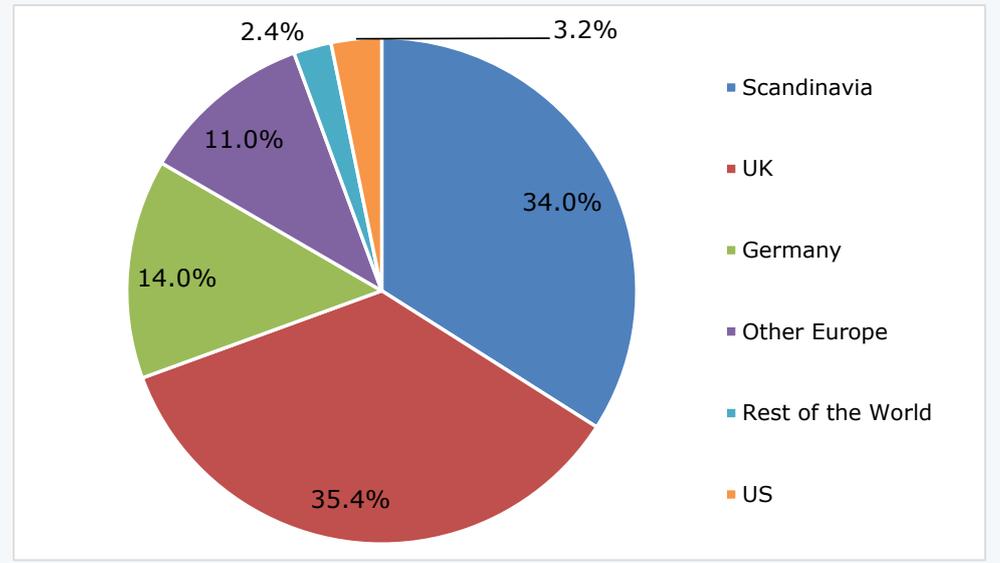
In line results and on track to meet expectations

Ok, but what else came out of this morning’s 1st half numbers?

First and foremost, **Elecosoft produced accelerating growth**, with LFL sales up 7% (constant currency) to £10,554k vs 4% in 2017, of which **55%** (or £5,792k) **was recurring in nature** – ie from SaaS, support & maintenance contracts. Hence providing **robust visibility** for this year and beyond.

Regionally, revenues jumped 12.2% in Britain to £3,732k and 90% in the RoW (principally Australia), partly offset by “challenges in the US due to slower uptake through resellers”. Nonetheless, with almost 2/3rds of the business (see below) derived from outside the UK, then any temporary impact from BREXIT should be manageable. Moreover, **this international exposure offers investors a natural hedge against possible future sterling weakness.**

H1'18 geographic sales split (£10,554k)

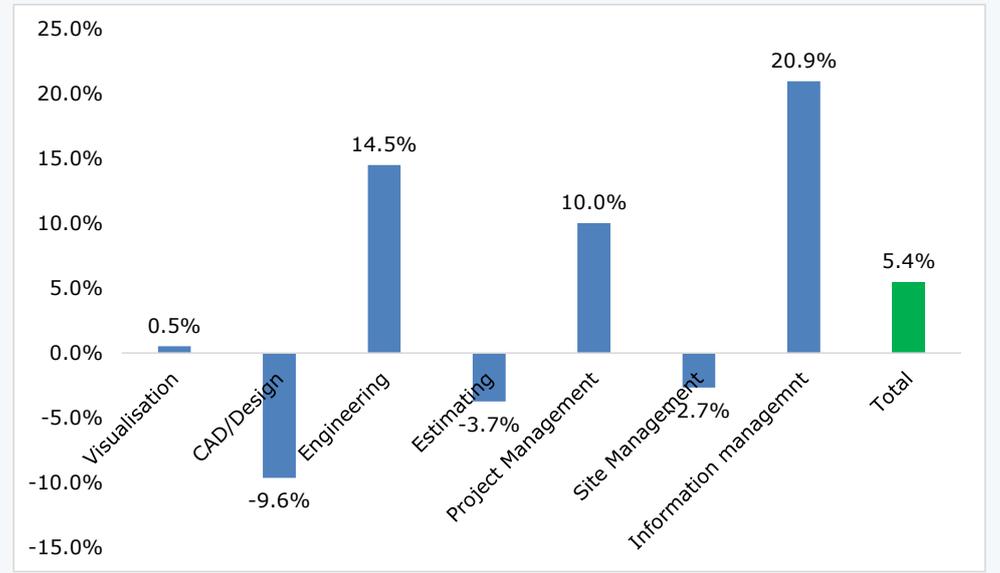


Source: Equity Development

107% cash conversion (LTM)

From a product perspective (see below), Powerproject enjoyed buoyant demand, up 10% to £5,015k, including the signature of new customer Ballast Nedam, a major €740m Dutch construction group. Equally, this was matched by notable performances from ICON (+20.9% £595k) and Engineering (+14.5% £1,225k).

H1'18 reported growth rates by product



Source: Equity Development

Robust balance sheet with £2,668k of net cash

Elsewhere, net funds closed Jun'18 at £2,668k vs £1,031k in Dec'17, boosted by positive working capital (£1,038k), despite adverse forex translation (£166k), alongside tax (£314k) and dividend payments (£110k).

Nothing untoward as FD decides to step down

Lastly, Finance Director, Simon Morgan, has decided to resign from the Board with immediate effect to pursue other interests.

Having spoken to the company, we understand **this is purely for personal reasons**, and **absolutely 100% Simon's decision**. There is **considerable bench strength beneath him**, and Benjamin Moralee (ACA) - who has been acting as Interim Deputy FD since March 2018 - will step up as a **very capable replacement**. Ben has extensive experience having previously held senior positions at Figleaves (part of N Brown) and Serena Software Europe (part of Micro Focus).

Mr Kettleley concluding *"Elecosoft has performed well in H1'18. **Our revenue growth has accelerated, cashflow remains strong, we have made good progress with our software development and the acquisition of Shire Systems has broadened and strengthened our product portfolio.***

*The majority of our operating profits are earned in, and employees based in Sweden, Germany, the Netherlands, Belgium and the USS. This, combined with the recurring nature of our revenues, means that **I believe we remain resilient to any potential effects of Brexit.***

We continue to see significant opportunities particularly in construction, but also in other related sectors that we currently serve, as we further develop our software to improve the timeliness, cost-efficiency and risk profiles of our customers' projects.

I would like to thank Simon Morgan for his contribution in his time with the Company and wish him the best for the future, and welcome Ben to the Board.

*In light of the H1'18 performance, **we look forward to the remainder of 2018 with confidence.***"

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 - maintenance/FM software					950	2,090	2,362	2,669	3,016	3,408	3,851
Turnover	15,172	15,260	17,795	19,996	22,000	24,860	27,365	30,160	33,282	36,769	40,669
% growth	-7.0%	0.6%	16.6%	12.4%	10.0%	13.0%	10.1%	10.2%	10.3%	10.5%	10.6%
Gross Profit	13,314	13,572	15,560	17,575	19,436	21,962	24,176	26,645	29,403	32,484	35,929
% margin	87.8%	88.9%	87.4%	87.9%	88.3%	88.3%	88.3%	88.3%	88.3%	88.3%	88.3%
Adj. EBITDA (post SBPs)	1,465	1,795	2,753	3,643	4,482	5,294	6,102	7,027	8,087	9,302	10,695
% Margin	9.7%	11.8%	15.5%	18.2%	20.4%	21.3%	22.3%	23.3%	24.3%	25.3%	26.3%
Adj. EBIT (post SBPs)	1,266	1,506	2,207	2,773	3,610	4,309	5,017	5,831	6,768	7,845	9,083
% 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	3,410	3,999	4,757	5,621	6,608	7,845	9,083
Adjusted EPS (p)	1.3	1.5	2.4	2.9	3.6	4.1	4.8	5.6	6.6	7.7	8.9
EPS growth rate		20.1%	58.2%	20.2%	25.4%	15.4%	16.3%	17.0%	16.4%	17.5%	14.6%
Dividend (p)	0.0	0.0	0.4	0.6	0.8	1.0	1.2	1.4	1.6	1.9	2.2
Yield			0.5%	0.7%	1.0%	1.2%	1.4%	1.7%	1.9%	2.3%	2.6%
% recurring revenues				55.1%	54.5%	53.2%	54.7%	56.0%	57.4%	58.7%	60.0%
Adjusted cash conversion				102.2%	94.2%	92.2%	98.7%	99.5%	95.8%	100.7%	100.9%
Valuation benchmarks											
P/E ratio	67.7	56.3	35.6	29.6	23.6	20.5	17.6	15.0	12.9	11.0	9.6
EV/Sales	4.5	4.5	3.9	3.4	3.1	2.8	2.5	2.3	2.1	1.9	1.7
EV/EBITDA	46.9	38.3	24.9	18.9	15.3	13.0	11.3	9.8	8.5	7.4	6.4
EV / EBITA	54.2	45.6	31.1	24.8	19.0	15.9	13.7	11.8	10.1	8.8	7.6
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%	41.9%	28.4%	32.2%	33.1%	34.0%	34.8%	35.7%
Dividend cover			6.0	4.8	4.3	4.0	4.0	4.0	4.0	4.0	4.0
PEG ratio		2.80	0.61	1.47	0.93	1.33	1.08	0.89	0.79	0.63	0.66
Net cash/(debt)	-2,035	-803	-1,304	1,031	-2,500	-521	2,149	5,377	8,939	13,579	18,992
Sharecount (Ks)	66,611	73,971	74,433	76,309	78,244	79,027	79,817	80,615	81,421	82,235	83,058
Shareprice (p)	85.0										

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.
- 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 "FRS 15 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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