

L/T winner in new social distancing world

7th April 2020

Given today's uncharted waters, it is nice to own resilient, profitable and cash generative stocks. Especially those like *BuildTech* software developer Elecosoft - sporting a **robust balance sheet** and generating **high recurring revenues** (ED 56%). Traits which should not only provide investors shelter from the worst of the COVID-19 storm, but also thrive once this CAT 5 hurricane subsides.

This morning, the firm said that **2019 turnover** and **adjusted PBT** were **"significantly higher"** (ED £25.3m & £4.1m) than LY. Closing the period with **net funds of £1.1m** (vs -£1.8m LY) - underpinned by **strong cash conversion** (ED 96%), despite investing in new products, and experiencing adverse forex (ED -2%, weaker SEK vs £) & other macro headwinds (Brexit, General Election & subdued Eurozone).

Scalable model delivering 89% gross margins

Solid LFL growth augmented by good cash generation

Summary Financials (£'000s)	FY18	H1'19	Est H2'19	Est FY19
Software licenses	5,271	3,010	2,990	6,000
Recurring SaaS & support	12,595	7,157	7,093	14,250
Services	4,354	2,544	2,556	5,100
Sales	22,220	12,711	12,639	25,350
<i>Reported % growth rate</i>	11.1%	20.4%	8.3%	14.1%
<i>Acquisition growth %</i>	8.0%	19.5%	6.5%	13.1%
<i>Estimated forex headwind</i>	-2.0%	-2.0%	-2.0%	-2.0%
<i>Estimated % LFL (constant currency)</i>	5.0%	2.1%	3.8%	3.0%
Gross Profit	19,536	11,392	11,296	22,688
<i>% margin</i>	87.9%	89.6%	89.4%	89.5%
Operating expenses (excl D&A)	-14,279	-8,446	-8,106	-16,552
Adjusted EBITDA (post SBPs)	5,257	2,946	3,190	6,136
<i>% margin</i>	23.7%	23.2%	25.2%	24.2%
Depreciation	-777	-450	-500	-950
Amortisation of intangibles	-529	-358	-392	-750
Adjusted EBIT (post SBPs)	3,951	2,138	2,298	4,436
<i>% margin</i>	17.8%	16.8%	18.2%	17.5%
Net interest	-281	-179	-157	-336
Adjusted PBT	3,670	1,959	2,141	4,100
Tax	-478	-301	-410	-711
Adjusted earnings	3,192	1,658	1,731	3,389
Adjusted Cashflow	4,519	2,519	1,760	4,279
<i>Cash conversion</i>	114%	118%	77%	96%
Adjusted EPS (pence)	3.8p	2.0p	2.0p	4.0p
<i>EPS growth %</i>	33.3%	9.4%	2.2%	5.6%
Dividend (pence)	0.68p	0.30p	0.00p	0.30p
Net cash / (debt) - Ex IFRS16	-1,814	-198	1,100	1,100

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

Downside resilience with 90%+ retention rates

So what about COVID-19? Well, the frustrating thing is that **Elecosoft has continued to trade "well" in 2020**, with results only marginally impacted towards the end of Q1.

Here customers and channel partners have indicated that going forward, there will be a **"degree of disruption"**, particularly with regards to face-to-face services (19% sales). However most of these activities (eg training/consultancy) have now transitioned to online delivery. In turn lifting demand and reducing costs.

Company Data

EPIC	AIM: ELCO
Price (last close)	52p
52 week High/Low	87p/45p
Market cap	£42.8m
Est net cash Dec'19	£1.1m
ED valuation / share	Withdrawn
Share count	82.24m
Avg. daily volume	65,000

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: 2019 finals in due course

Paul Hill (Analyst)*

0207 065 2690
paul.hill@equitydevelopment.co.uk

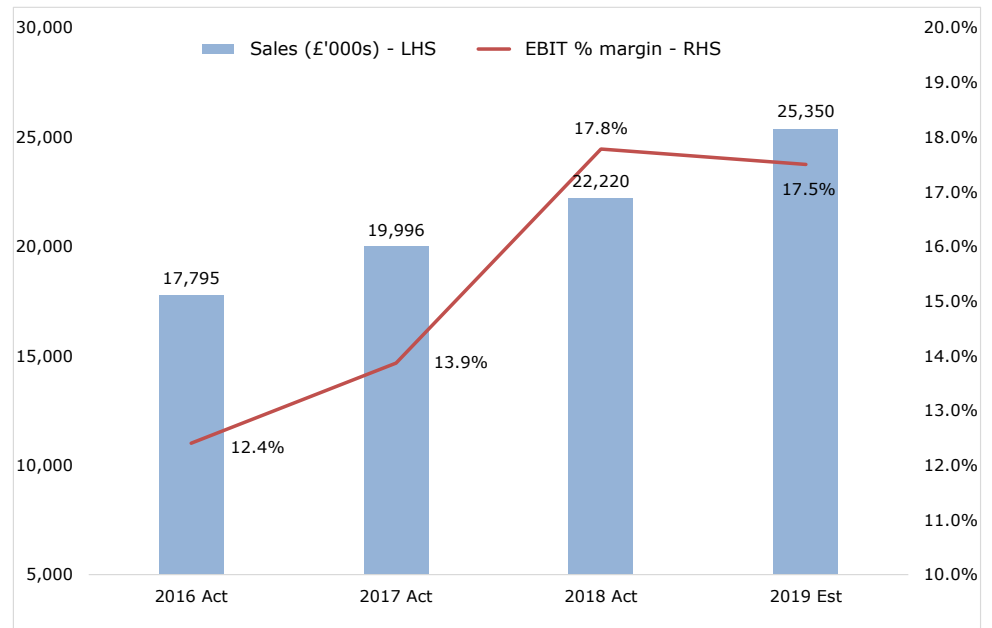
*a shareholder in Elecosoft

Well placed to withstand the current challenges

Moreover, the company has been through this type of short, sharp economic shock before - and **emerged the other side in far better shape**. We reckon this will happen again, even if near term orderflow is pushed to the right, due to deferred IT investment, industry-wide lockdowns, business interruption and the postponement of new building projects.

Elsewhere, we calculate the firm has ample liquidity, including gross cash and available banking facilities of >£7.5m as at the end of Mar'20. Whilst all staff are already home working and continue to be fully operational.

Consistent profitable growth over the past 4 years



Source: Equity Development. SBPs = share based payments.

Indeed Elecosoft's leading applications (cloud hosted) enable clients to work remotely too, sell more, improve quality, cut costs, save time and/or reduce their 'carbon footprints'. Bolstered by recent product launches, such as the new AI powered visualisation tool - which along with floor covering firm [Karndean](#), has now also been adopted by [US paint manufacturer Benjamin Moore](#) (a Berkshire Hathaway subsidiary).

End markets are vital to the nation's health

Nonetheless, sentiment across the construction, infrastructure and housebuilding sectors has been rocked by the pandemic, with the UK temporarily in limbo. Consequently, consistent with many other organisations, Elecosoft is cutting discretionary spend and conserving cash, albeit equally mindful not to harm long term capability.

Benjamin Moore adopts Elecosoft’s AI visualisation software

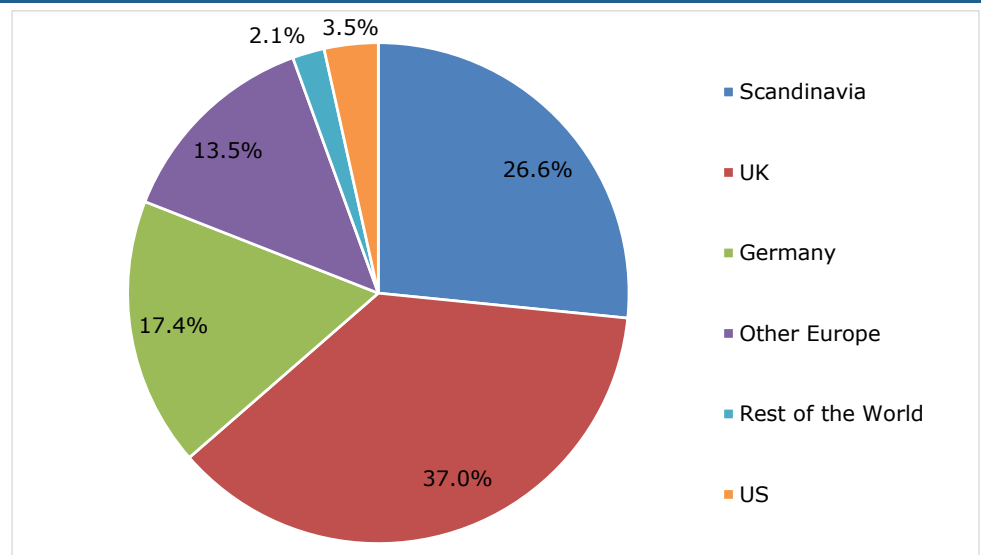


Source: Company

We have temporarily withdrawn our 2020 forecasts

Accordingly the Board has **suspended the final dividend**, and removed any indications of future performance from today’s pre-close statement. Similarly we have **withdrawn our 2020 forecasts** and beyond, until there’s greater clarity.

H1’19 sales (£12.7m) breakdown by geography



Source: Equity Development

That said, regardless of what happens over the next few months, we think **essential building/maintenance work** (tracks, roads, sewage), especially relating to **systemically important construction projects** (water, electricity, rail) **will still have to be completed**. As underlined at the UK Budget on 11th March.

What’s more, once social distancing begin to be relaxed, we think these areas will be the first to benefit (ED Est early June) in light of their mostly outdoor orientation, high employment levels, GDP multiplier effect and national importance.

Shares attractively priced

In terms of valuation, **the stock is attractively priced** for patient risk tolerant investors - trading on a trailing EV/Sales multiple of 1.6x (see below) compared to typical industry multiples pre COVID-19 crisis of between 4.0x – 6.0x.

Sure the coronavirus will impact the 2020 numbers, yet ultimately we believe the group will prosper. Enjoying high levels of recurring & overseas revenues, good retention rates, positive cash generation, a solid balance sheet and a wide & large customer base.

Range of sector valuation benchmarks pre COVID-19 crisis			
	Elecosoft Est 2019 Trailing	Typical BuildTech multiples pre COVID-19 crisis	
		Low	High
EV/Sales	1.6	4.0	6.0
EV/EBITDA	6.8	16.0	20.0
EV/EBIT	9.4	20.0	24.0
PER	12.9	25.0	30.0
EBITDA margin	24.2%	25.0%	30.0%
Adjusted cash conversion	96.5%	80.0%	110.0%

Source: Equity Development

Finally, in line with published guidance from the FCA and FRC for listed stocks, the 2019 audited accounts will be released in due course.

Key risks

- Coronavirus induced problems at some of its largest customers, which either lead to late payments and/or doubtful debts.
- 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 orderflow, but this is being equally balanced by recurring revenues from SaaS, support & maintenance contracts.
- 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.

Summary financial projections

Elecosoft (Dec yearend)	2016 Act £'000s	2017 Act £'000s	2018 Act £'000s	2019 Est £'000s
			Restated	
Software licenses	4,955	5,135	5,271	6,000
Recurring SaaS & support	8,622	11,018	12,595	14,250
Services	4,218	3,843	4,354	5,100
Turnover	17,795	19,996	22,220	25,350
<i>% growth</i>	16.6%	12.4%	11.1%	14.1%
Gross Profit	15,560	17,575	19,536	22,688
<i>% margin</i>	87.4%	87.9%	87.9%	89.5%
Adj. EBITDA (post SBPs)	2,753	3,643	5,257	6,136
<i>% Margin</i>	15.5%	18.2%	23.7%	24.2%
Adj. EBIT (post SBPs)	2,207	2,773	3,951	4,436
<i>% Margin</i>	12.4%	13.9%	17.8%	17.5%
Adj. Profit before Tax	2,117	2,666	3,670	4,100
Adjusted EPS (p)	2.4	2.9	3.8	4.0
<i>EPS growth rate</i>	58.2%	20.2%	33.3%	5.6%
Dividend (p)	0.40	0.60	0.68	0.30
<i>Yield</i>	0.8%	1.2%	1.3%	0.6%
<i>% recurring revenues</i>	48.5%	55.1%	56.7%	56.2%
<i>Adjusted cash conversion</i>	69.8%	102.2%	114.4%	96.5%
Average headcount	190	201	228	232
Revenues (£ks) / employee	93.7	99.5	97.5	109.3
Valuation benchmarks				
<i>P/E ratio</i>	21.8	18.1	13.6	12.9
<i>EV/Sales</i>	2.3	2.1	1.9	1.6
<i>EV/EBITDA</i>	15.1	11.4	7.9	6.8
<i>EV/EBITA</i>	18.9	15.0	10.5	9.4
<i>Adjusted tax rate</i>	-16.1%	-17.9%	-19.4%	-19.0%
<i>EBITDA drop through rates</i>	37.8%	40.4%	72.6%	28.1%
<i>ROCE</i>	15.5%	21.3%	15.5%	15.7%
<i>Dividend cover</i>	6.0	4.8	5.6	13.5
<i>PEG ratio</i>	0.37	0.90	0.41	2.28
Net cash/(debt) - ex IFRS16	-1,304	1,031	-1,814	1,100
Sharecount (Ks)	74,433	76,309	77,400	82,240
Shareprice (p)	52p			

Source: Equity Development



Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

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www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690