Elecosoft plc

2019 sales set to jump 19% after record year

Since the Federal Reserve's *volte face* on interest rates in December, most large cap equity indices have bounced back to near all-time peaks. The sharp rebound though hasn't yet fully filtered through into AIM, where many tech stocks remain little changed from their yearend lows. Nonetheless, we believe this situation should rebalance in 2019 as risk appetite improves, especially for quality names that continue to deliver impressive returns.

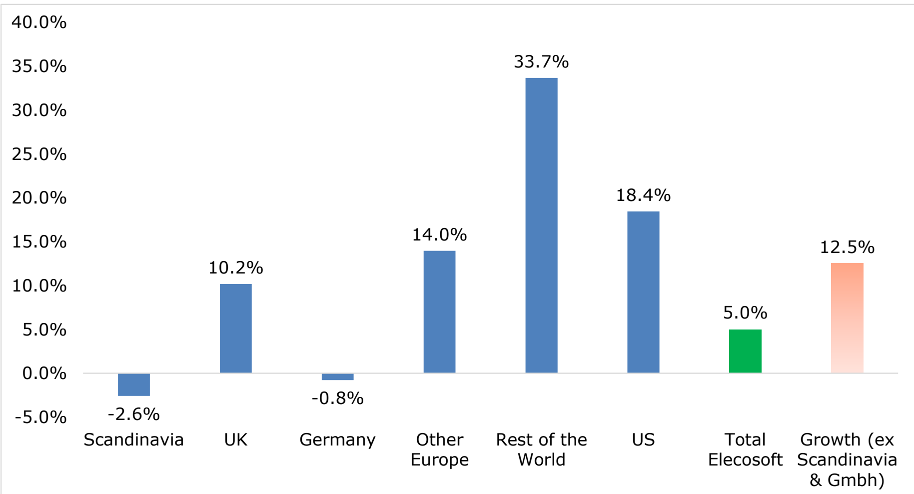
Take Elecosoft, a specialist developer of *Build*Tech, asset maintenance and visualisation software. Solutions that deliver untold benefits for construction firms, architects, contractors and landlords alike - across the entire property lifecycle (see appendices), particularly in terms of quality, project management, cost, efficiency and time.

This morning **the firm posted another record set of numbers**, characterised by a **11.1% jump in sales** to £22.2m (+5% LFL, constant currency - CC), **expanding EBIT margins** (17.6% vs 13.9% LY; split 18.4% H2 & 16.6% H1), **better than expected PBT** (+39% to £3.7m) and **robust cash generation** (101% conversion, OCF +7% to £4.5m). What's more, **57% of turnover** (+14% to £12.6m) came from **recurring maintenance, support and SaaS activities** (vs 55% LY; split 58% H2 & 55% H1) – importantly, providing **healthy forward visibility**, alongside a **durable 'economic moat'** and **resilient business model**.

Significant advances on the technology front

Geographically, **standout performances** were achieved in the **UK**, up 10% to £8.2m (ED estimated LFL, CC), **other Europe** (+14% to £2.4m), **US** (+18% to £0.8m) and **RoW** (+34%, £0.5m). Partially offset by minor LFL declines in Scandinavia (-3%, £6.8m) and Germany (-1%, £3.4m) – both of which we expect to return to positive growth in 2019. Indeed if one hypothetically stripped out these 2 regions, then we reckon the rest of the group would have clocked a notable 12.5% rise (see below).

ED estimated LFL & CC revenue growth rates by region

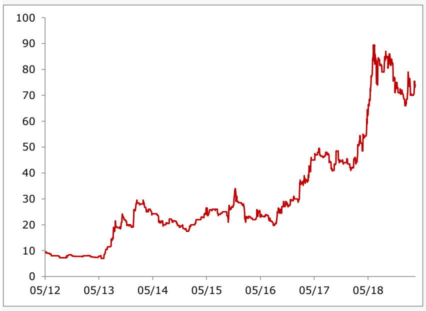


Source: Equity Development,

Company Data

EPIC	**AIM: ELCO**
Share price	72p
52 week High/Low	91p/49p
Market cap	£58.9m
Net debt (Dec'18)	£2.1m
ED valuation / share	115p
Share count	81.8m
Avg. daily volume	25,000

Share Price, p



Source: Web Financial

Description

Elecosoft is a *Build*Tech, 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 **57% of 2018 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. **94% of 2018 turnover was sold directly,** with the rest generated via channel partners. 63% **of the business is generated from outside the UK**, and there are 228 staff.

Next news: AGM 9th May 2019

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Focus to shift more towards top line expansion

Plus, these figures could probably have been even better, had not considerable management resource been engaged in completing two earnings enhancing acquisitions in H2, raising £2.25m of top-up capital (at 70p) and launching a flurry of new products.

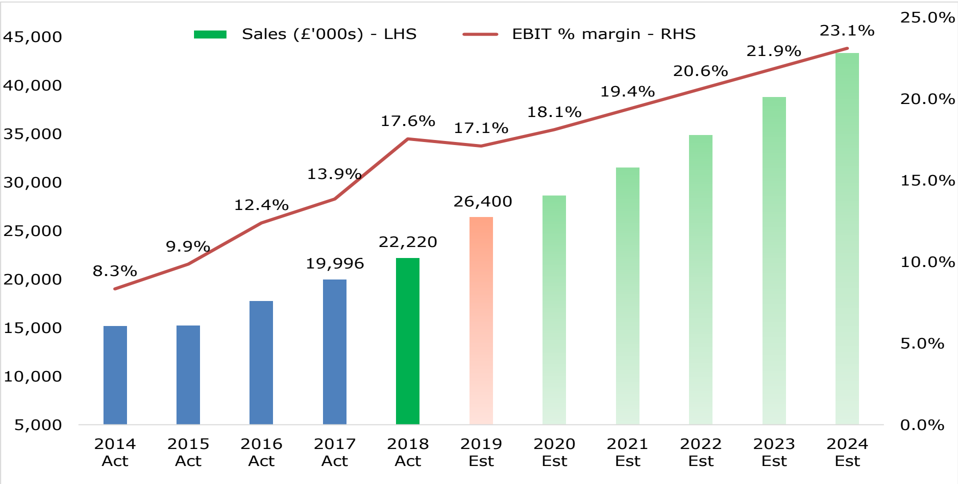
In our view, all pivotal steps in the process of enhancing and widening Elecosoft's leading software portfolio. Albeit not surprisingly in the short term, also contributing towards a temporary dip in LFLs from 7% H1 to 3% LFL in H2 – say where a few customers may have decided to wait for newer versions before upgrading.

All the same, the latest software releases have been warmly received by clients, results at both Shire Systems (£5.1m, Jul'18) and Active Online (AO for €3.45m in Nov'18) are on track, and overall **the firm has "*performed well in the first two months of 2019*"**.

2019 turnover estimates are conservatively pitched

Looking forward, **we've prudently forecast 2019 turnover to climb 18.8% to £26.4m** (see below), on the back of mid-single digit organic growth, augmented by the natural flow-through of last year's M&A.

Forecast revenue progression and margin expansion



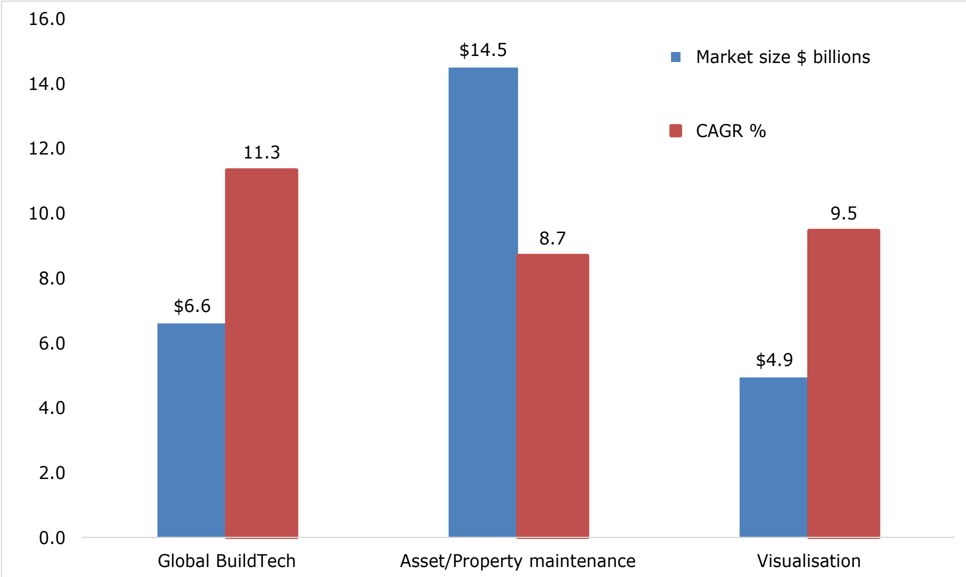
Source: Equity Development

Essential pieces of the jigsaw are in place

Investors should however be aware that **our projections are conservative** in light of the buoyant demand for *Build*Tech - a $6.6bn sector (see below) which is predicted to ramp at an annualised 11.3% to 2021 – ably supported too by the $14.5bn asset/property maintenance (8.7% pa) and $4.9bn visualisation (9.5%) verticals.

Additionally longer term, all the recent hard work in improving the product suite, has laid the foundations for a sustained period of double digit growth - underpinned by the possibility of greater marketing spend if required. Executive Chairman, John Ketteley adding " ***I believe that Elecosoft is well placed to improve further its performance and growth in 2019*** *for the benefit of our customers, our employees and our shareholders,* ***and I look forward with confidence in the year ahead."***

Est size ($Bns) & CAGR (%) of ELCO's core markets (2018)



Source: Nemetschek (Nov'18) and 360 Research (March 2019).

New customer wins include mobile operator 'EE'

But that's not all. Elsewhere Elecosoft has a **number of other major opportunities**, which management are actively progressing, namely:

- **X-selling** (see appendices) to more customers (ie 'greater share of wallet'), where presently we understand <20% of accounts take >1 module.

  For instance, dovetailing Shire's computerised maintenance management software (CMMS) with Powerproject and ICON. Hence enabling landlords to manage their property/asset portfolios far more efficiently, having already captured most (if not all) the structural data during the design/build phases. Plus, **both AO and Shire *"are already actively pursuing cross-selling of products across the Group***."

- **Up-selling** (see appendices), or servicing extra users at the same client (ie 'land & expand'). Here ICON, which manages the vital 'BIM data' that glues all the various modules together, **recently secured a flagship contract with the UK's largest mobile operator, "EE"** (part of BT).

- **Expanding internationally** to replicate ELCO's Northern European (83% sales) success overseas (eg Americas).

- **Nurturing 'channel' partners**, which currently account for just 6% of turnover vs 94% direct. For example, signing more collaboration agreements, like the one with project management solutions provider, Innovative Management Solutions in Texas, US.

- **Staying ahead of the game in terms of technology**. In fact the highly anticipated release of Powerproject V.15 is scheduled for Apr'19, together with the latest edition of Site Progress Mobile. All told in 2018, £2.8m was invested in R&D, equivalent to 13% of revenues, with £1.0m capitalised vs £0.6m amortised through the P&L.

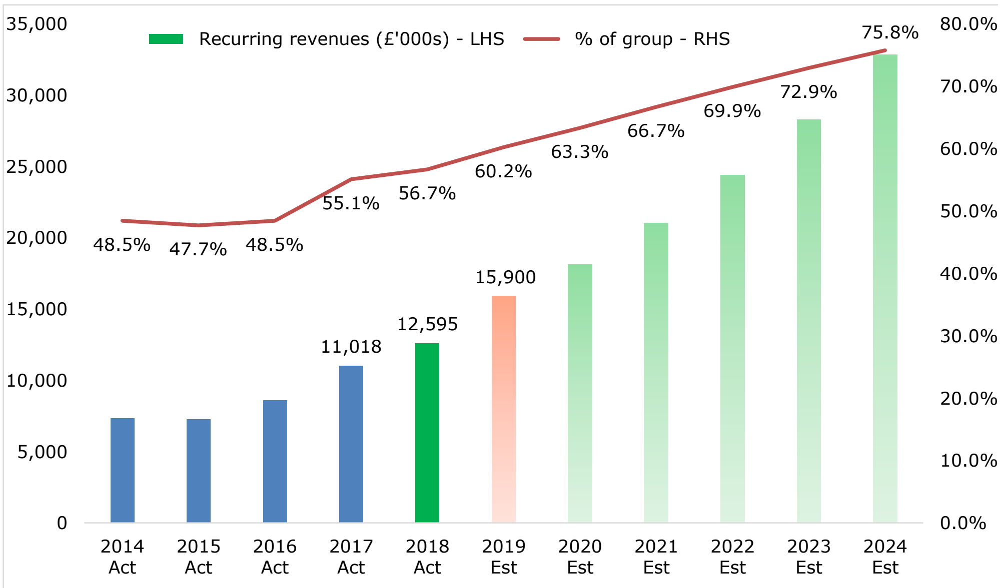
Mr Ketteley commenting "[Elecosoft has] *made* ***remarkable progress in developing market-leading construction software over the years,*** *because of the complexity and speed of innovation that is required in the development of construction software*."

- **Synergistic M&A**, but only where targets offer the desired returns, strategic fit and risk/reward balance. To us, management have an exemplary track record here, and are committed to capital discipline.

57% recurring revenues, providing robust visibility

Obviously all of this won't happen overnight, although **we envisage the benefits from the above initiatives to flow-through over the next 12–24 months**. Eventually propelling LFL growth rates to >10% by 2021, complemented by strong recurring revenues (see below), which should further drive stock price appreciation.

Recurring revenues improve visibility and earnings quality



Source: Equity Development

Strong cash generation and attractive EBIT margins

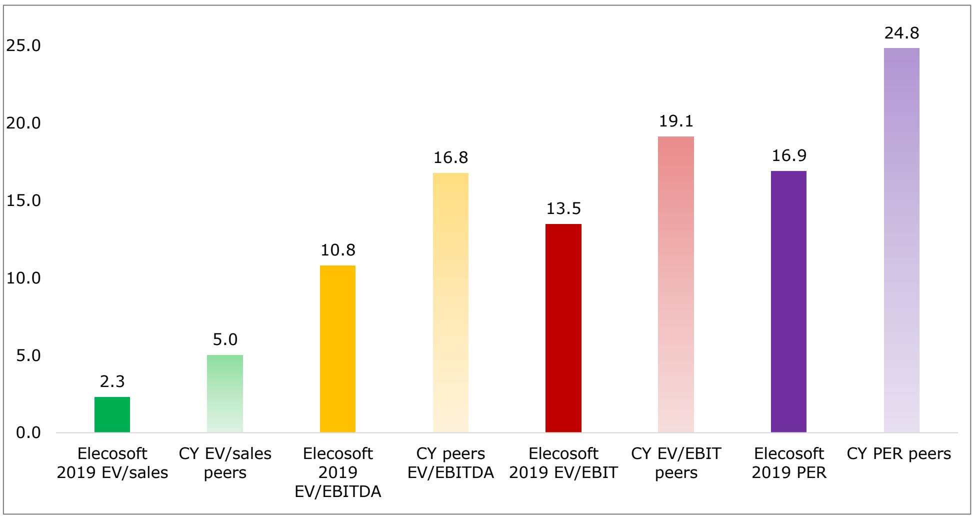
The good news for investors is that at 72p, **most** (if not all) **of this upside appears to be in the share price for free**. Moreover due to ELCO's scalability, 90%+ retention rates, **favourable operating leverage**, attractive EBITDA drop-through rates and international footprint (63% outside the UK) - **2018 adjusted EPS and closing net debt both came in slightly ahead of expectations at 3.9p (+34%) and £2.1m** respectively. The latter representing a comfortable 0.45x EBITDA and enabling the dividend (0.9% yield) to be lifted 13% to 0.68p (5.7x covered) and be paid on 31st May, with a script alternative (conversion price 74.72p) available and an ex-div date of 28th March.

Equally, if the business can ultimately achieve sustainable double digit LFLs, then we think there should be no reason why the stock can't command a sector rating of 5.0x EV/sales vs 2.3x today (see below); or worth >155p/share.

Interestingly too, recent takeovers in this space have been concluded at between 6x–8x (see appendices) - whilst the firm's 2 nearest quoted rivals, Nemetschek & Autodesk, trade on multiples of 9.7x and 10.5x.

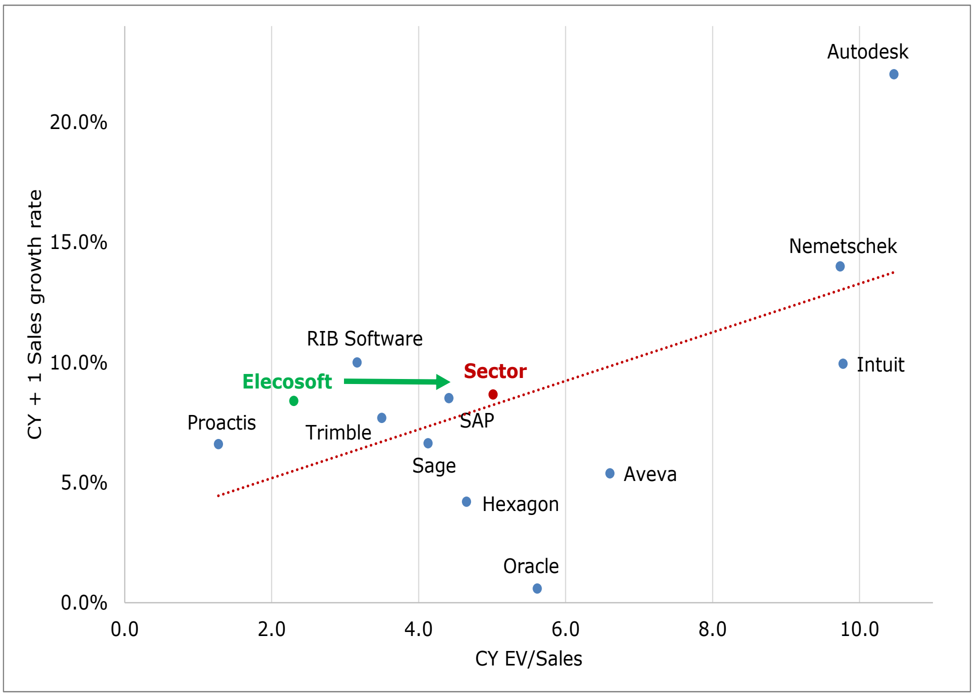
Material stock price appreciation is possible

2019 valuation benchmarks vs *Build*Tech peers



Source: Equity Development – closing prices as at 18th March 2019

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

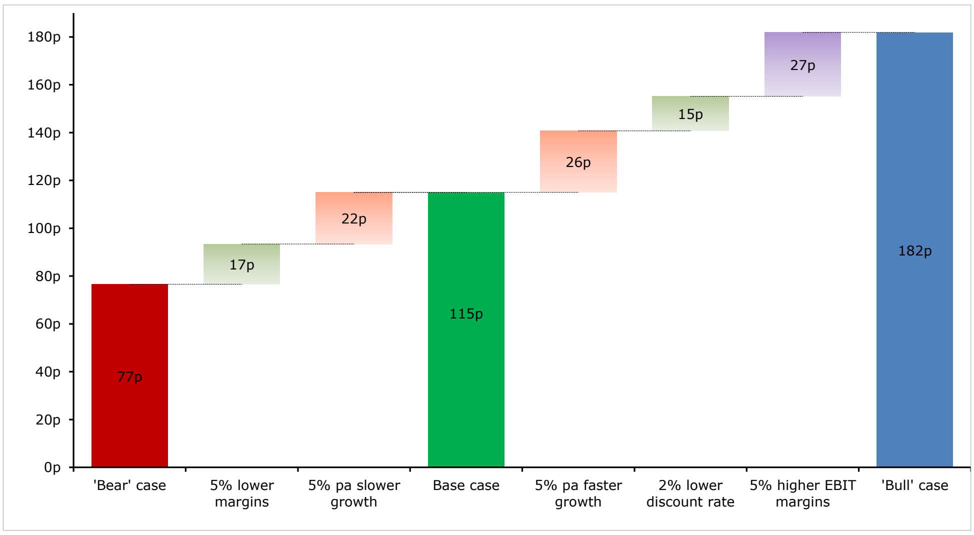


Source: Equity Development, various sites – closing prices as at 18th March 2019

Favourable 'risk vs reward' profile

From a risk perspective too – apart from the usual curveballs of a recession, Brexit, trade tensions (US vs China/EU), tougher competition, etc - there appears to be minimal downside as indicated by our 'Bear' and 'Bull' cases of 77p & 182p (see below).

Sensitivity analysis (p/share)



Source: Equity Development – closing prices as at 18th March 2019

Current trading in line with expectations

Consequently bearing all this mind, **we reiterate our adjusted EBIT forecasts for this year** (+15.8%) **and next** (+14.8%) **of £4.5m and £5.2m**, together with **the 115p/share valuation**.

Mr Ketteley concluding "***2018 was a year of continuing growth and progress for Elecosoft****, despite uncertainties attributable to the Brexit saga. However our management is conscious of the need in such conditions to apply sound financial policies, maintain a* ***strong balance sheet*** *and ensure that the fundamentals of our* ***business remain in good shape****. Elecosoft is increasingly seen as evolving into a leading international provider of construction software, with applications in various phases of construction projects, with software for property maintenance, digital storage of property data and visualisation* ***software of the highest quality for internal property applications****.*

Our co-ordinated software range has also enabled Elecosoft to ***initiate an increasingly successful strategy of cross selling in markets it serves****. Brexit may well continue to effect markets in 2019. However, given the strength of Elecosoft's finances, the international spread of its markets, and the creativity and quality of [our] market leading software portfolio,* ***I look forward to the year ahead with confidence****".*

Similarly, **we reckon all the critical pieces to the Elecosoft jigsaw are coming into place**, underpinned by the industry's equally supportive fundamentals.

Summary financial projections

Elecosoft (Dec yearend)	2014 Act £'000s	2015 Act £'000s	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
Software licenses	4,008	4,536	4,955	5,135	5,271	5,400	5,400	5,400	5,400	5,400	5,400
Recurring SaaS & support	7,351	7,278	8,622	11,018	12,595	15,900	18,126	21,026	24,390	28,293	32,820
Services	3,813	3,446	4,218	3,843	4,354	5,100	5,100	5,100	5,100	5,100	5,100
Turnover	**15,172**	**15,260**	**17,795**	**19,996**	**22,220**	**26,400**	**28,626**	**31,526**	**34,890**	**38,793**	**43,320**
% growth	*-7.0%*	*0.6%*	*16.6%*	*12.4%*	*11.1%*	*18.8%*	*8.4%*	*10.1%*	*10.7%*	*11.2%*	*11.7%*
Gross Profit	**13,314**	**13,572**	**15,560**	**17,575**	**19,536**	**23,232**	**25,191**	**27,743**	**30,704**	**34,138**	**38,121**
% margin	87.8%	88.9%	87.4%	87.9%	87.9%	88.0%	88.0%	88.0%	88.0%	88.0%	88.0%
Adj. EBITDA (post SBPs)	**1,465**	**1,795**	**2,753**	**3,643**	**4,695**	**5,649**	**6,588**	**7,823**	**9,273**	**10,776**	**12,555**
% Margin	*9.7%*	*11.8%*	*15.5%*	*18.2%*	*21.1%*	*21.4%*	*23.0%*	*24.8%*	*26.6%*	*27.8%*	*29.0%*
Adj. EBIT (post SBPs)	**1,266**	**1,506**	**2,207**	**2,773**	**3,903**	**4,521**	**5,189**	**6,108**	**7,196**	**8,486**	**10,018**
% Margin	*8.3%*	*9.9%*	*12.4%*	*13.9%*	*17.6%*	*17.1%*	*18.1%*	*19.4%*	*20.6%*	*21.9%*	*23.1%*
Adj. Profit before Tax	**1,046**	**1,386**	**2,117**	**2,666**	**3,711**	**4,321**	**5,139**	**6,108**	**7,196**	**8,486**	**10,018**
Adjusted EPS (p)	**1.3**	**1.5**	**2.4**	**2.9**	**3.9**	**4.3**	**5.0**	**6.0**	**7.0**	**8.2**	**9.6**
EPS growth rate		*20.1%*	*58.2%*	*20.2%*	*35.2%*	*9.8%*	*18.3%*	*18.3%*	*17.2%*	*17.3%*	*17.5%*
Dividend (p)	***0.0***	***0.0***	***0.40***	***0.60***	***0.68***	***0.85***	***1.01***	***1.19***	***1.40***	***1.64***	***1.93***
Yield			*0.6%*	*0.8%*	*0.9%*	*1.2%*	*1.4%*	*1.7%*	*1.9%*	*2.3%*	*2.7%*
% recurring revenues	48.5%	47.7%	48.5%	55.1%	56.7%	60.2%	63.3%	66.7%	69.9%	72.9%	75.8%
Adjusted cash conversion			69.8%	102.2%	101.4%	90.6%	97.2%	100.6%	102.1%	103.3%	103.2%
Valuation benchmarks											
P/E ratio	*57.3*	*47.7*	*30.2*	*25.1*	*18.6*	*16.9*	*14.3*	*12.1*	*10.3*	*8.8*	*7.5*
EV/Sales	*4.0*	*4.0*	*3.4*	*3.1*	*2.7*	*2.3*	*2.1*	*1.9*	*1.7*	*1.6*	*1.4*
EV/EBITDA	*41.7*	*34.0*	*22.2*	*16.7*	*13.0*	*10.8*	*9.3*	*7.8*	*6.6*	*5.7*	*4.9*
EV / EBITA	*48.2*	*40.5*	*27.6*	*22.0*	*15.6*	*13.5*	*11.8*	*10.0*	*8.5*	*7.2*	*6.1*
Adjusted tax rate	*-20.0%*	*-19.5%*	*-16.1%*	*-17.9%*	*-19.2%*	*-19.0%*	*-19.0%*	*-19.0%*	*-19.0%*	*-19.0%*	*-19.0%*
EBITDA drop through rates			*37.8%*	*40.4%*	*47.3%*	*22.8%*	*42.2%*	*42.6%*	*43.1%*	*38.5%*	*39.3%*
ROCE		*14.6%*	*15.5%*	*21.3%*	*15.1%*	*15.7%*	*16.1%*	*16.8%*	*17.5%*	*18.1%*	*18.7%*
Divdend cover			*6.0*	*4.8*	*5.7*	*5.0*	*5.0*	*5.0*	*5.0*	*5.0*	*5.0*
PEG ratio		*2.37*	*0.52*	*1.24*	*0.53*	*1.72*	*0.78*	*0.66*	*0.60*	*0.51*	*0.43*
Net cash/(debt)	**-2,035**	**-803**	**-1,304**	**1,031**	**-2,109**	**147**	**3,212**	**7,089**	**11,901**	**17,682**	**24,490**
Sharecount (Ks)	66,611	73,971	74,433	76,309	77,400	82,229	82,640	83,053	83,468	83,885	84,305
Shareprice (p)	**72.0**										

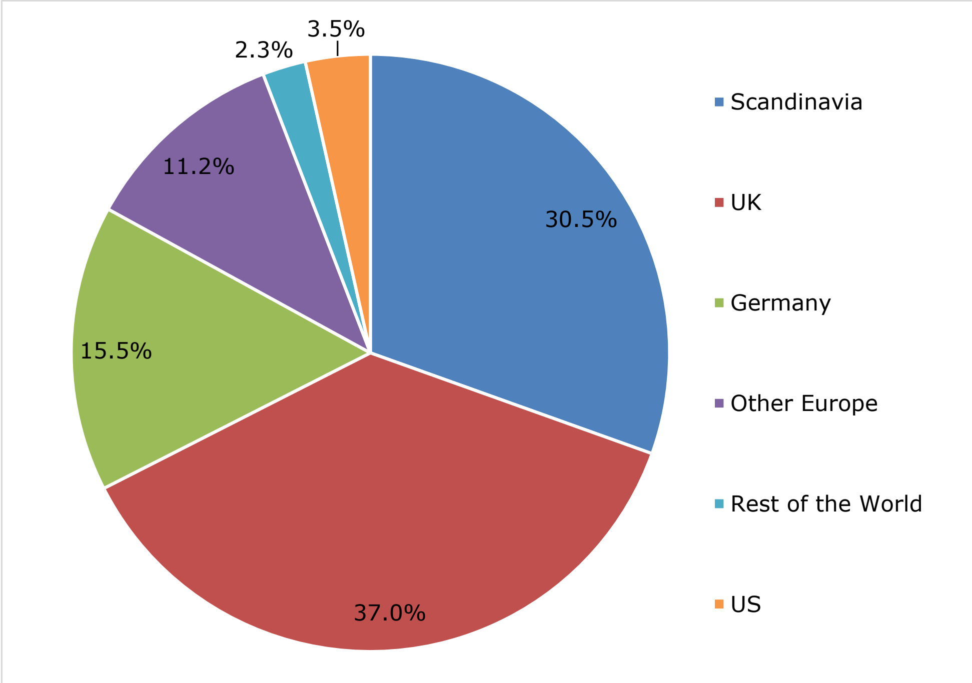
Source: Company historic data, Equity Development estimates

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, 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.

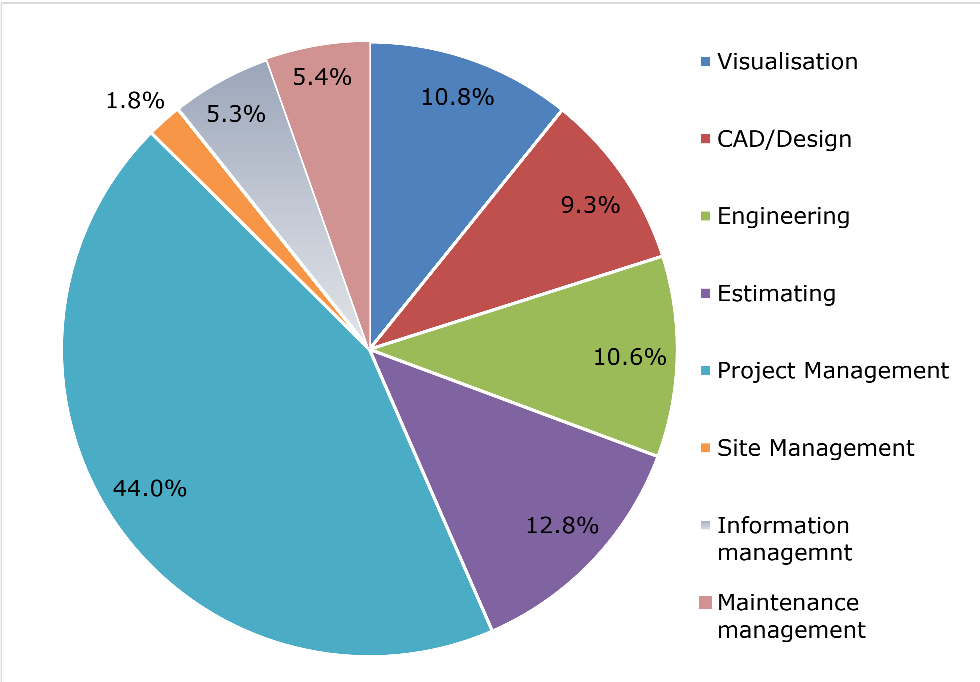
Appendices

2018 regional sales (£22.2m) split



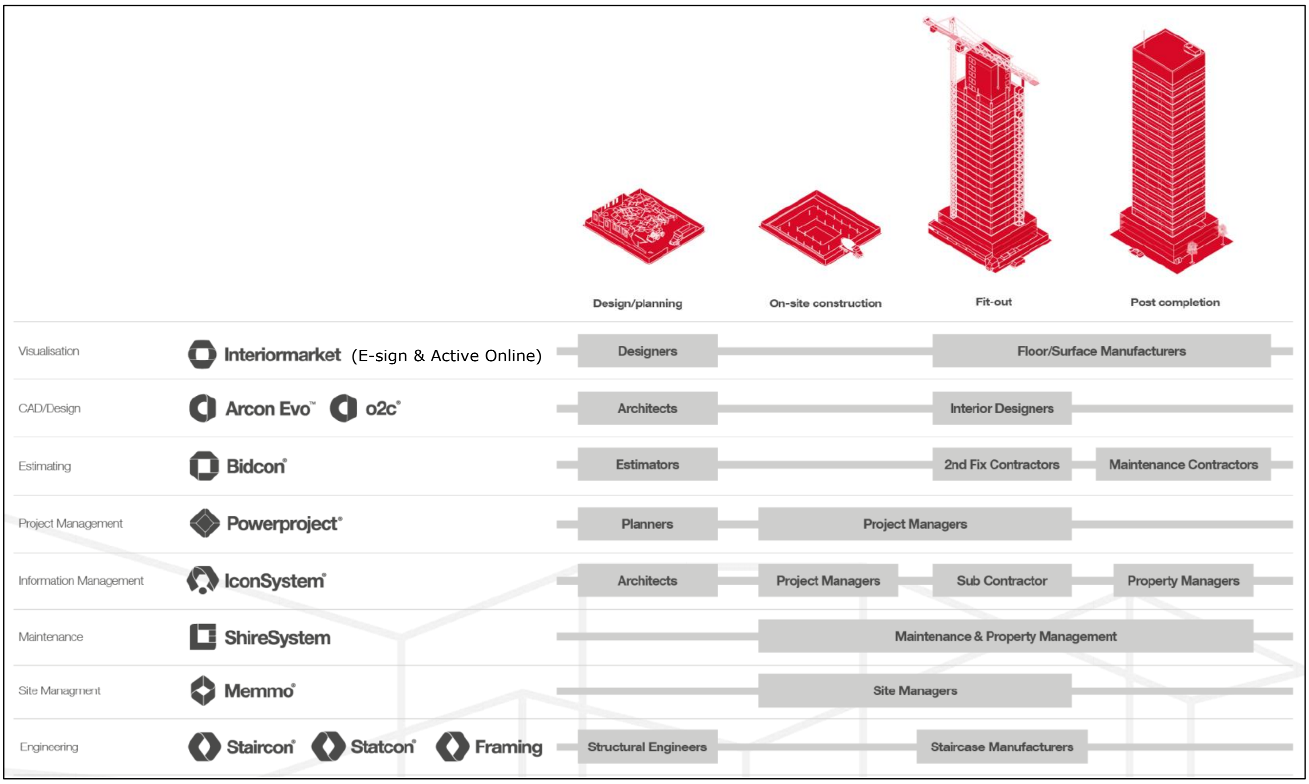
Source: Equity Development

2018 software product breakdown (£22.2m) split



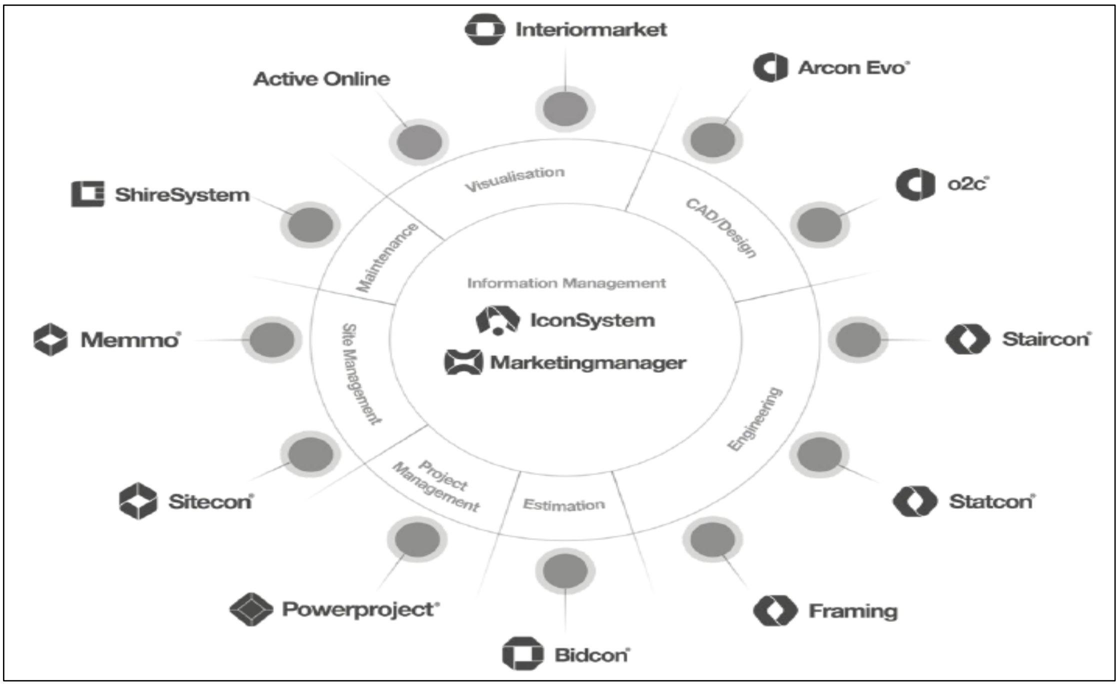
Source: Equity Development

Product range that services the full (perhaps 70-75 year) life-span of a property



Source: Elecosoft

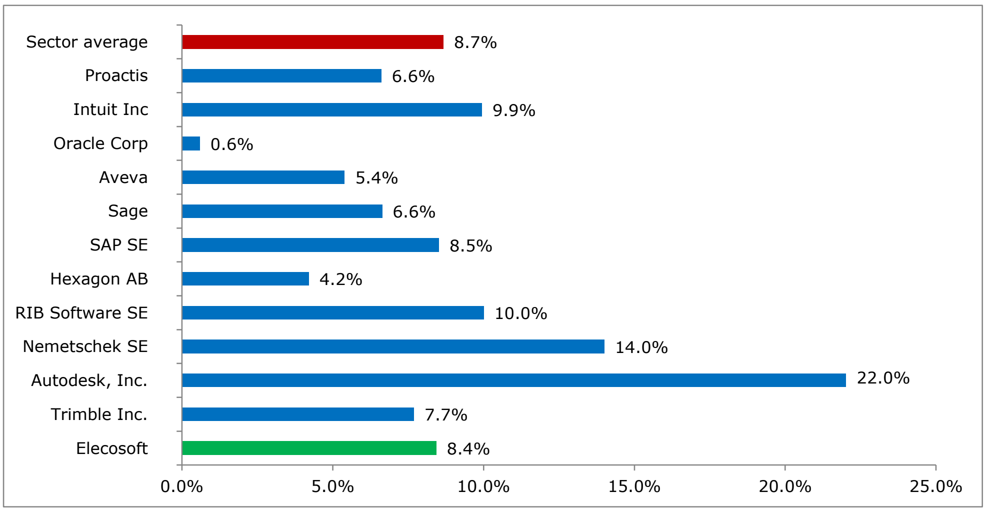
Software used by 90% of UK's top 100 construction firms



Source: Elecosoft

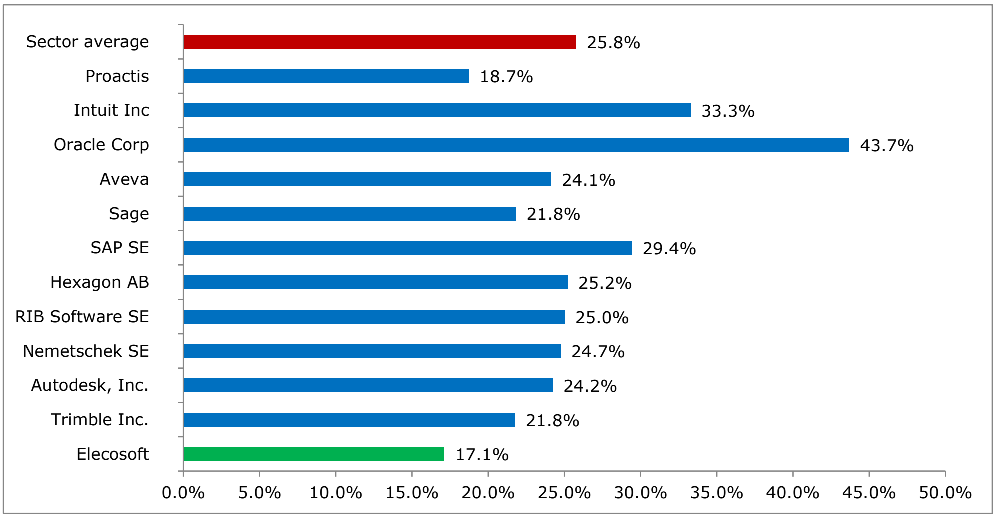
*Build*Tech industry financial KPIs

CY +1 sales growth rate vs *Build*Tech peers



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

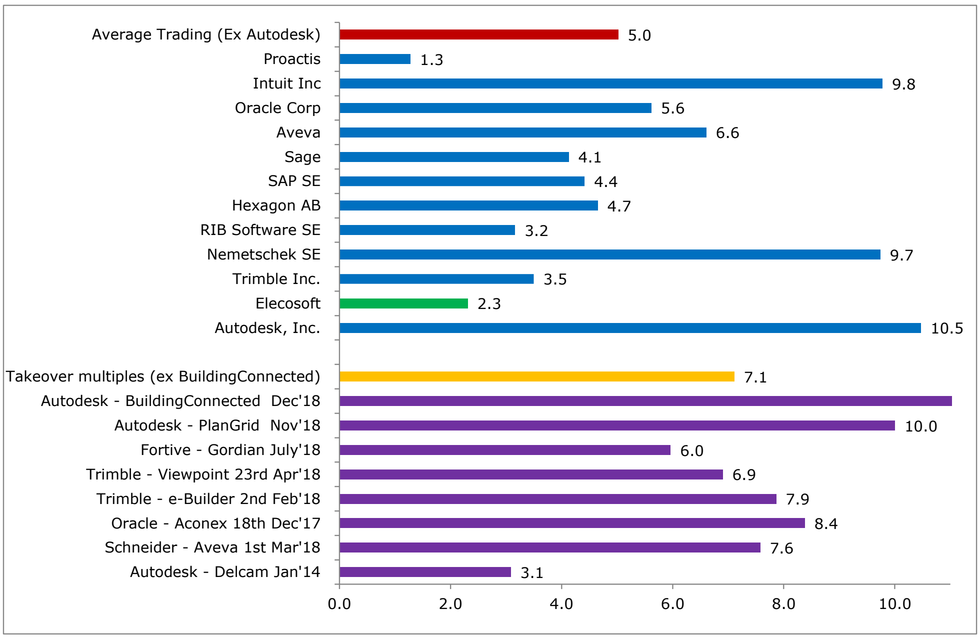
CY EBIT margins vs *Build*Tech peers



Source: Equity Development, arithmetic average for sector

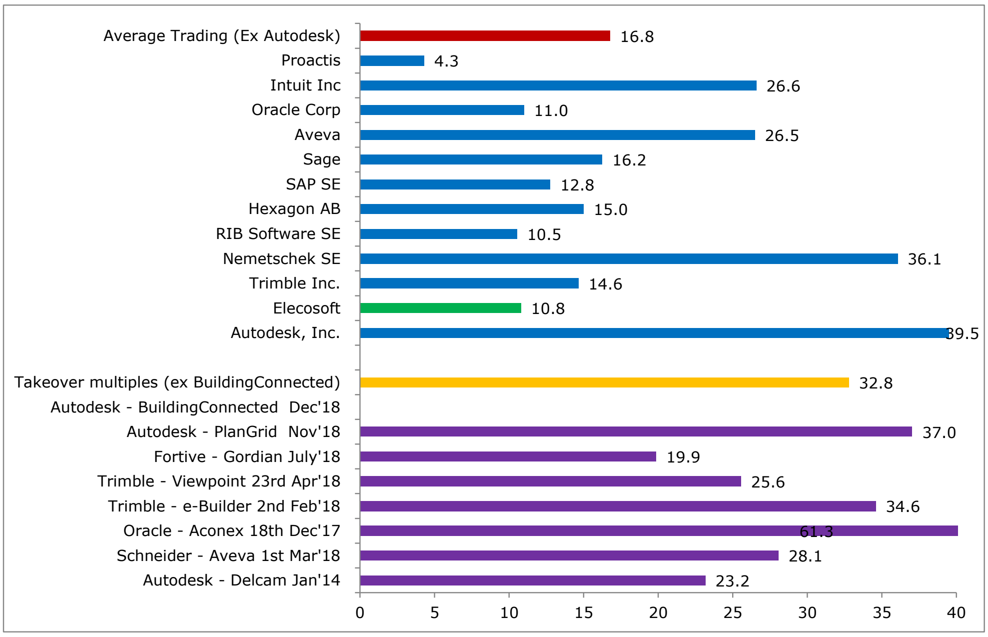
*Build*Tech industry valuation benchmarks

CY EV/sales multiples vs *Build*Tech peers



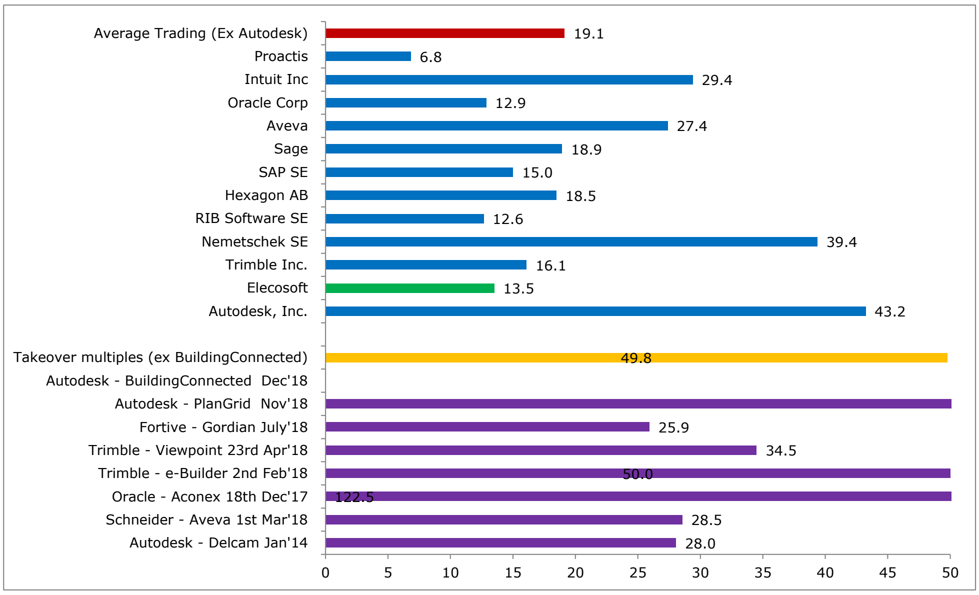
Source: Equity Development : CY = Current Year, arithmetic average for sector

CY EV/EBITDA multiples vs *Build*Tech peers



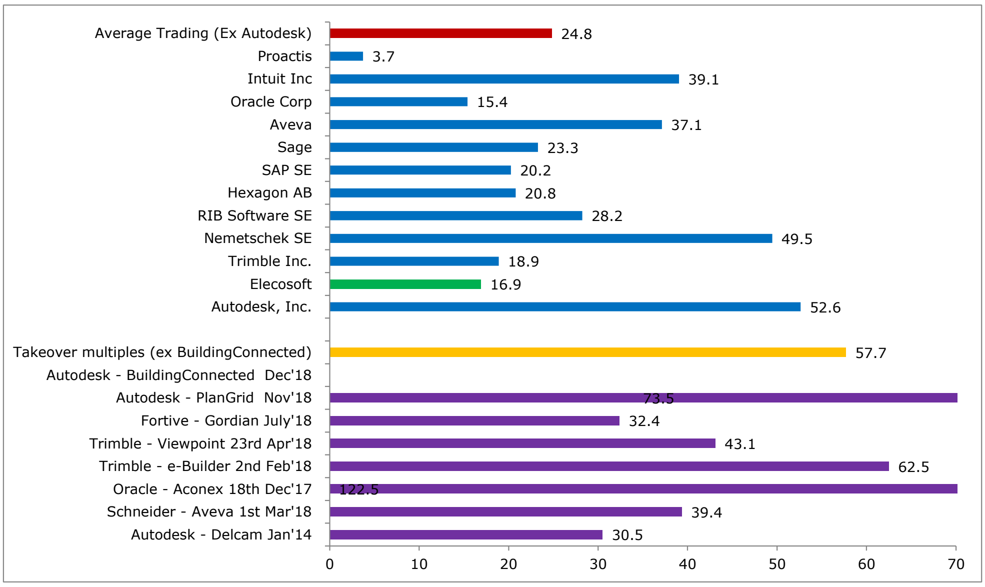
Source: Equity Development : CY = Current Year, arithmetic average for sector

CY EV/EBIT multiples vs *Build*Tech peers



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

CY PER multiples vs *Build*Tech peers



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

Investor Access

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