Blancco Technology Group plc

The future's bright, the future's Blancco

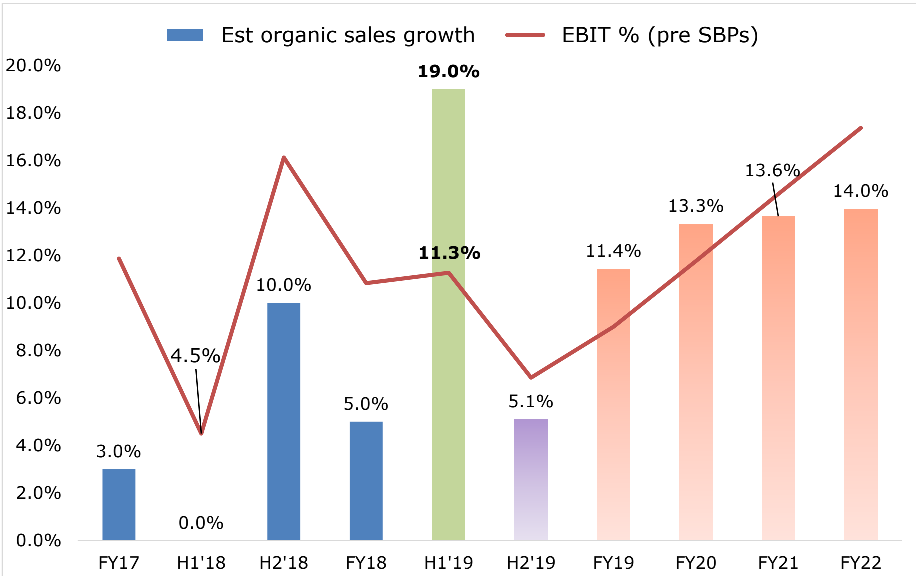
19th February 2019

Rarely does quality come cheap, or that's the accepted wisdom. The FTSE though is an 'irrational beast', failing sometimes to recognise 'deep value' opportunities right under its nose. Take Blancco, the world's #1 data erasure & mobile diagnostics software developer. The company is expanding rapidly, operates in a fabulous untapped niche, and generates almost all its revenues from repeat business, ongoing contracts and/or SaaS. In turn providing **excellent forward visibility**, **positive cashflows** and **improving profit margins**. The perfect triumvirate for long term investors.

H1'19 revenues up 19% (est. 0% H1'18 & 10% H2'18)

Today the firm posted what can only be described as **a bumper set of H1'19 numbers** (see below). **Turnover jumped 19% LFL to £14.6m** (vs £12.3m LY), **adjusted EBITDA soared 71% to £3.0m** (£1.8m), **EBITA margins climbed to 11.3%** (4.5%) and **underlying EPS came in at 1.6p** (0.28p LY).

Estimated LFL (CC) sales growth & EBIT margins (pre SBPs)



Source: Equity Development

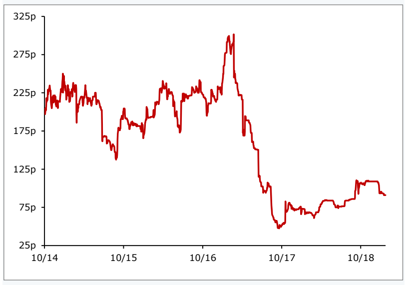
Double digit growth achieved across the patch

All 3 geographies and divisions (see below) **delivered double digit LFL growth** (constant currency), with **standout performances** from **Data Centres / Enterprise** (up +30% to £4.7m), **ITAD** (+20%, £4.9m), **Europe** (22%, £5.6m) & **North America** (+23%, £5.3m). Driven by macro data/cyber concerns, tightening regulation (eg EU GDPR & PCI DSS, 2018 California Consumer Privacy Act, etc), the re-provisioning of 100ms of smartphones/servers every year and the desire to reduce corporate IT costs without compromising security. Indeed **the company recently won a contract with a high profile Californian customer** as a direct result of the new legislation.

Company Data

EPIC	**AIM:BLTG**
Price (prior close)	90p
52 week Hi/Lo	112p/62p
Market cap	£58.7m
ED valuation / share	150p
Net debt (Est Jun'19)	£2.0m
Share count	65.2m
Avg. daily volume	40k

Share Price, p



Source: Web Financial

Description

Blancco is the world's leading developer of 'data erasure' software, used to protect governments and corporates from ID/data theft, ransomware and cyber-crime, along with being a pioneer in mobile device diagnostics. The business is materially larger than its closest competitor, and led by CEO Matt Jones, CFO Adam Moloney and non-exec Chairman Rob Woodward.

More than 95% of turnover relates to 'repeat/subscription' orders (performing >50,000 erasures/day), thus providing excellent visibility. With regards to overseas exposure, only ~10% is denominated in £ compared to $ (47%), € (18%), Yen (18%) and other (7%). Headcount as at Dec'18 was 265 (+11% vs 239 LY).

Next news: July trading update

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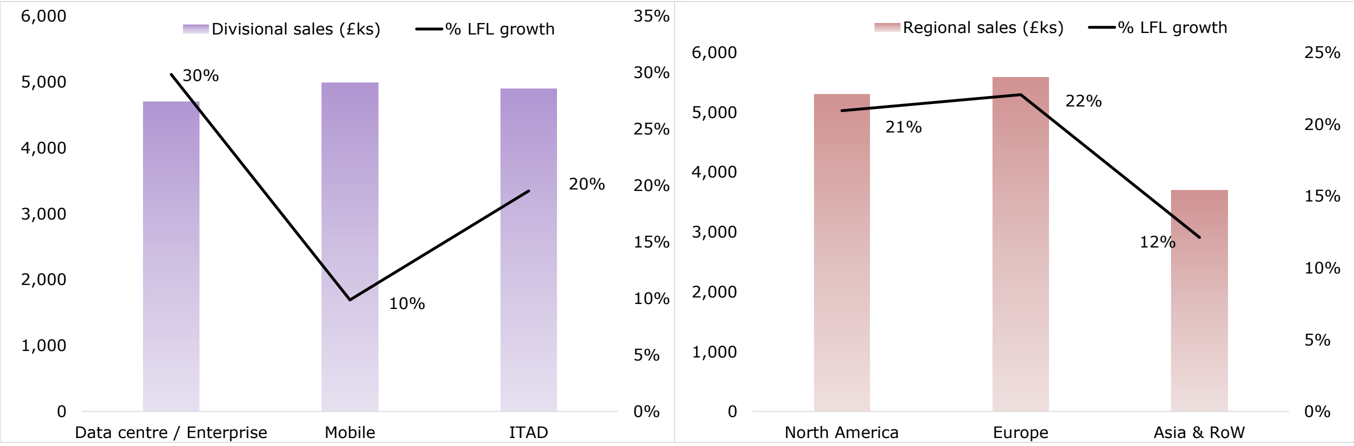
Leveraging its size, technology and heritage

In parallel, **3rd party channel revenues leapt 48% to £2.4m** (vs £1.6m LY), equivalent to 16.4% of the group and 46% (42% LY) of the Data Centre arm – thanks partly to distribution agreements signed with Arrow Electronics (EMEA) and Ingram Micro (US, Canada & Australia) in H2'18. Likewise, Blancco has a more comprehensive list of accreditations / certifications (c. 15) than any of its rivals, which in tandem with best-of-breed software, acts as major differentiators.

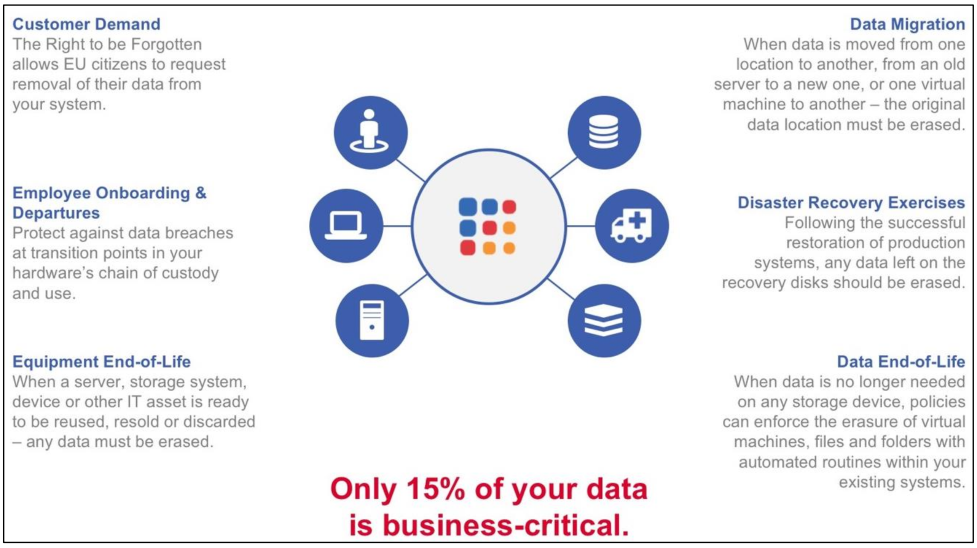
H1'19 revenue breakdown (£14.6m) and constant currency LFL growth rates



Source: Equity Development

Sure, future expansion in the ITAD division is set to moderate (ED estimate 6%-7% pa), however this should be more than offset by continued double digit growth in both Mobile (H1'19 +10%, £5.0m) and Data Centres / Enterprise (Est 20%+). Here large organisations are increasingly turning to the **industry's 'de facto standard'** to efficiently and securely manage their data.

When do corporates need to erase their data?



Source: Company

Mobile erasure is an enormous opportunity

In terms of Mobile, we think LFLs will accelerate (ED estimate 12%) in FY20, as the benefits of greater R&D spend and management resource filter through. Interestingly, research consultants IDC predict the 2nd hand smartphone market will balloon to $52.7bn by 2022 – on the back of resold units soaring from 165m in 2017 to 290m, representing 11.9% CAGR.

What's more, ahead of the Mobile World Congress in Barcelona later this month, Blancco published a study indicating that 64% of consumers would be happy to trade-in their old devices and/or purchase a refurbished handset, if more stringent data management processes were in place (see below). Highlighting the significant latent demand for technologies such as the firm's cutting-edge mobile device eraser (see below).

Blancco Mobile Device Eraser

Source: Company

Don't forget either, that nearly all of these smartphones have the capability to execute financial transactions, and thus hold buckets of confidential information. In the event the data wasn't properly erased (Nb simply deleting/formatting files or using the factory reset doesn't ensure this), then the previous owner could suffer possible ID theft and/or monetary loss.

Better than expected cash generation

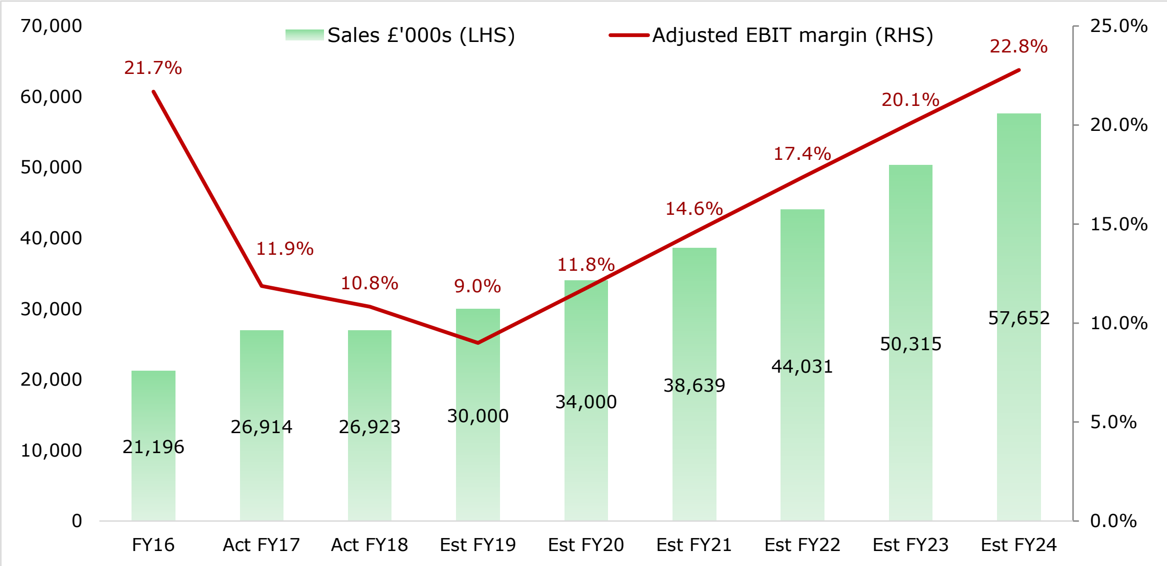
Switching to the balance sheet, **net debt fell by £431k to £2.3m** despite capitalising £1.3m of R&D/intangibles (vs £1.3m amortisation) and forking out another £446k in deferred consideration (re Xcaliber). **Operating cashflows** came in at **£2.5m** (£0.9m LY) – representing 83% EBITDA - which enabled £1m of bank borrowings to be repaid (£9.5m drawn down from a £12m facility). Elsewhere, a £190k (vs £240k LY) dividend was distributed to the 49% minority owners of the Japanese subsidiary. While the final payment relating to the Sept'15 Tabernus purchase was settled by issuing 1,208k new shares in Dec'18, with the group's only deferred consideration left (ie £684k for Xcaliber) scheduled to be cleared by July 2019.

With regards to the cost base, **H1'19 adjusted opex rose 7% to £12.1m**, with most of the increase simply a function of recruiting software engineers (headcount +26 to 265 with associated costs +18% to £7.4m) and higher marketing spend (£0.4m to £0.6m) – ie to lift the company's profile and enhance channel distribution.

So what about our forecasts?

Well, given the strong H1'19 numbers, the only tricky bit for us is not 'getting ahead of our skis' - especially in light of the wider economic uncertainties (eg trade tariffs, Brexit, slowing EU output, etc). Consequently at this point we've decided to 'bite our lip', and prudently hold the **'de-risked' FY19 turnover and adjusted EBIT targets of £30m and £2.7m** (margin 9.0%) respectively – rising to £34m & £4.0m (margin 11.8%) in FY20. That said, we recognise there may be a chance to upgrade as the year progresses – ie in the absence of any macro induced setbacks and/or other adverse factors.

Financial projections

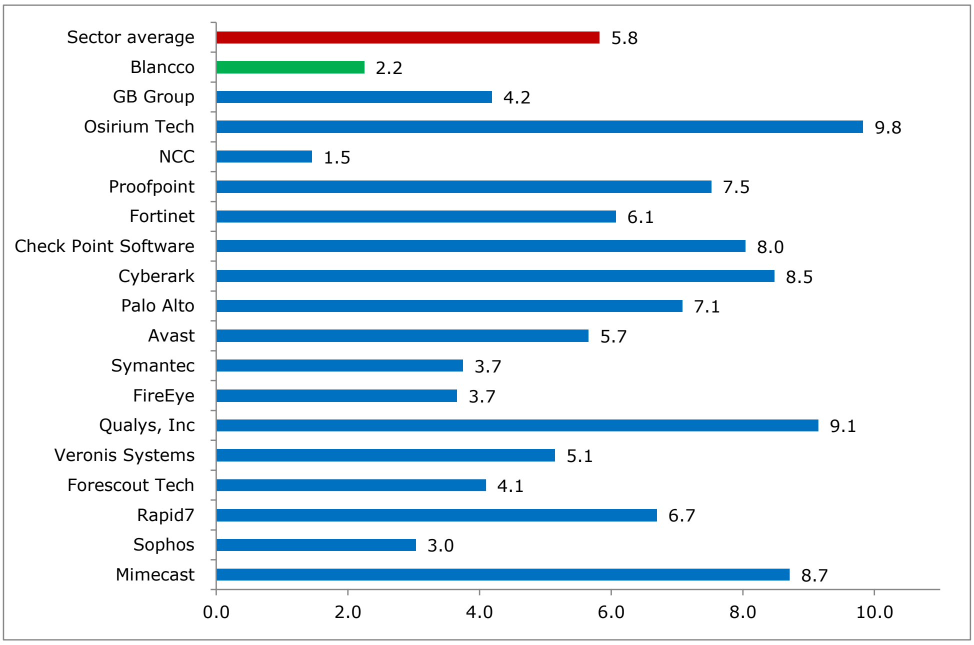


Source: Equity Development

Cheap as chips compared to cyber-security peers

Nonetheless, **we have nudged up the valuation from 140p to 150p/share**, mirroring **the improved risk profile**. Moreover the stock at 90p trades at an unwarranted discount the broader cyber-security sector (see below) in respect of EV/sales and most other benchmarks.

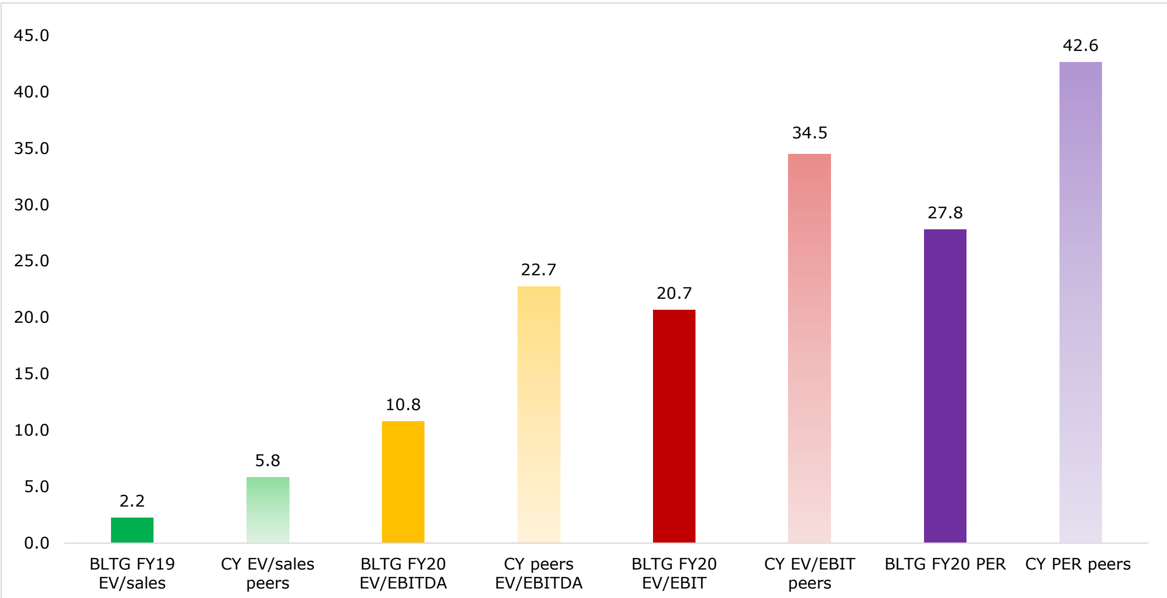
Current year (CY) EV/sales multiples vs cyber security peers



Source: Equity Development. Blancco adjusted for estimated impact of JVs

Separately too, **the PEG ratio between FY20–24 is anticipated to be less than 0.3,** which once again implies the shares are **materially undervalued**.

Blancco valuation multiples vs cyber security peers

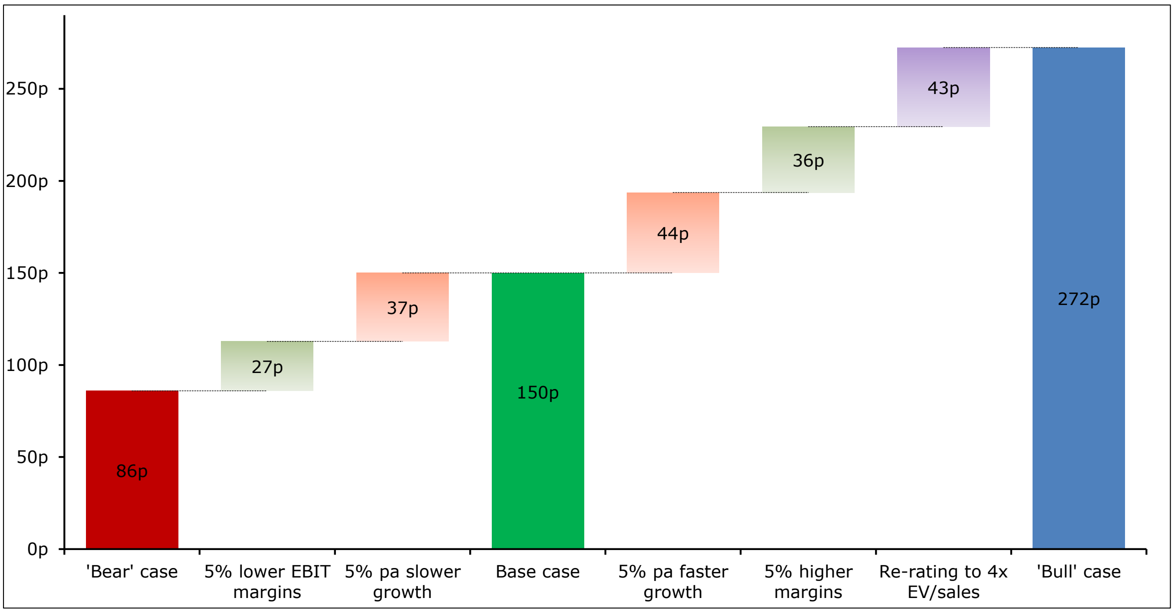


Source: Equity Development. Blancco adjusted for estimated impact of JVs

Sensitivities skewed to the upside

Plus, there is a **healthy margin of safety** and **minimal downside** to boot for risk tolerant investors - echoing Blancco's **predictable income streams** & **rising profit margins**, as illustrated in the below 'Bear' and 'Bull' case scenarios of 86p and 272p per share.

Sensitivity analysis (p/share)

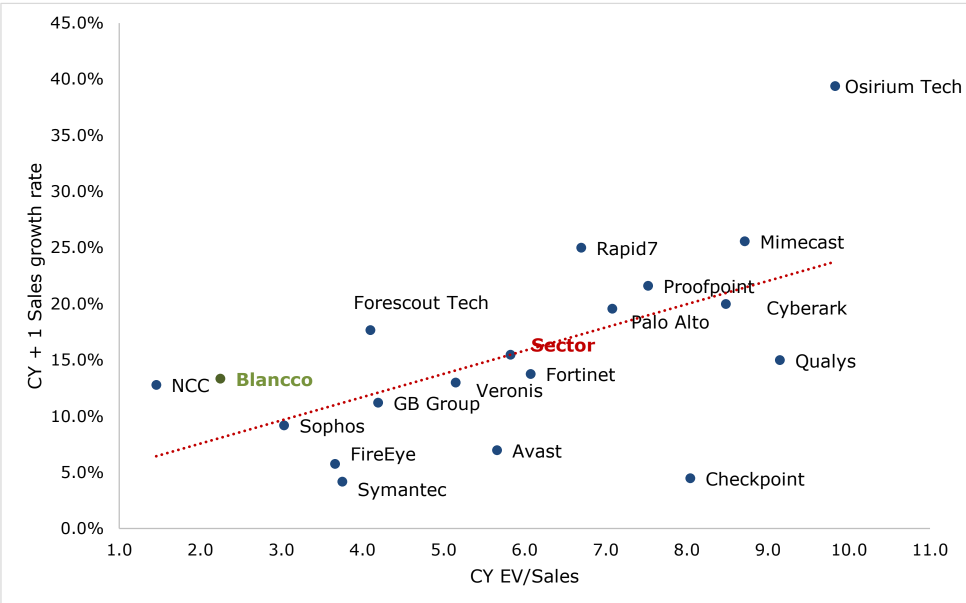


Source: Equity Development.

Possible upwards re-rating as growth accelerates

The good news is that shareholders might not have to wait long anyway, because once the 'bell rings' that LFLs are accelerating, the stock could trade up sharply (see below chart). Narrowing the discount to peers who presently deliver on average 21.3% EBIT margins and 15.5% LFL growth. Metrics that we feel Blancco can ultimately achieve, if not surpass.

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



Source: Equity Development. Blancco adjusted for estimated impact of JVs

So what else came out of today's interims?

For starters, it is worth briefly mentioning the impact of IFRS 15, which trimmed comparable H1'18 turnover & EBIT by £346k, and FY18 by £564k & £460k respectively. Additionally, the accounting standard wiped out most of the deferred revenue, with the restated Jun'18 balance dropping from £4.8m to £0.7m.

Elsewhere, 2 new patents were filed, detailing ways of erasing of high-speed devices (typically found in Data Centres) and automating Mobile diagnostics. ISO 9001 and 27001 certification was also achieved for the two R&D offices in Finland and India. Whilst in its capacity as an 'thought-leader', Blancco is actively engaging with the trade, media and investor communities - and published two popular studies on the data centre and 2nd hand smartphone markets.

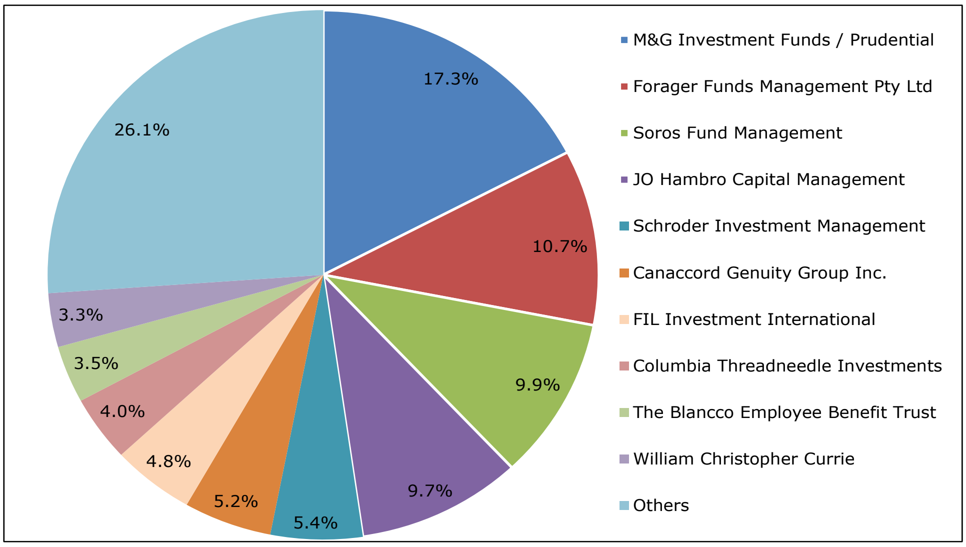
Industry consolidation is kicking-off

Ok, but what could derail the outlook? Apart from the usual concerns of a global recession, Brexit, trade tensions (US vs China/EU), tougher competition, etc – **we see little on the horizon for shareholders to be unduly worried about**. Besides, even if there was an economic slump, we believe investors would probably migrate to those stocks churning out **consistent and expanding earnings**.

Equally, **we suspect there might even be a chance for LFLs to surprise to the upside**, tracking the robust conditions - particularly if GDPR equivalent legislation was further introduced outside of the EU (eg India, North America, etc). Moreover, with another round of consolidation kicking off – eg BlackBerry's $1.4bn acquisition of Cylance in Nov'18, while PE house Thoma Bravo is 'rumoured' to be stalking Symantec & also in Jan'19 purchased Imperva for $2.1bn (or 4.2x EV/sales, 30x EV/EBITDA and 39x EV/EBIT) – then it is not out the question that further down the road, BLTG could even attract predatory interest itself.

Major institutions are supportive

Stockholders (65.2m shares issued)



Source: Company (as per 14th Jan'19)

Finally, investors should be able to glean a fair degree of reassurance from Blancco's register, which is populated by a rich seam of top rated investors (see above).

Increased air of optimism

CEO Matt Jones concluding "*In September, we announced a strategy to invest significantly in Marketing and R&D over the coming periods to support revenue growth in our three key markets of Mobile, Data Centre / Enterprise and ITAD. It has been pleasing to see the impact of this investment begin to take effect.* ***Revenue has grown in all three markets as well as in each of the EMEA, APAC and American geographies in which we operate****. We have also seen significant improvements in the profitability and cash generation of the business.*

The focus for FY19 has been based around the ***recruitment of a new senior management*** *team, which* ***is now complete****, followed by investments in our R&D team and marketing efforts to take advantage of Blancco's strengths and market opportunity and driving revenue growth. Whilst the positive impact of these investments is anticipated to have full effect in future financial years it is* ***extremely encouraging*** *to see a swift uplift in revenue, profit and cash generation.*

The Board reiterates its confidence for the full year market expectations and, looking forward to the longer term, the opportunity to drive sustainable profitable growth*.*"

Growth strategy is working a treat

In summary, following this morning's **encouraging statement**, we think that **the Board's strategy** – namely, to accelerate growth by focusing on substantial near-term opportunities (eg Mobile, Data centre / Enterprise, etc) by investing in new technology and beefing up marketing spend – **is working a treat**.

Stay tuned folks, there could be plenty more to come.

Summary projections

Blancco Technology Group (June year end) - continuing	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
				Restated						
Data centre / Enterprise				8,600	10,178	12,315	14,902	18,031	21,817	26,399
ITAD				8,600	9,400	10,012	10,664	11,358	12,097	12,885
Mobile				9,723	10,422	11,673	13,074	14,643	16,400	18,368
Turnover	**15,014**	**21,196**	**26,914**	**26,923**	**30,000**	**34,000**	**38,639**	**44,031**	**50,315**	**57,652**
Growth rate %		*41.2%*	*27.0%*	*0.0%*	*11.4%*	*13.3%*	*13.6%*	*14.0%*	*14.3%*	*14.6%*
Adjusted EBITDA (pre SBPs)		**5,379**	**4,965**	**5,450**	**5,570**	**7,210**	**9,099**	**11,479**	**14,173**	**17,469**
Margin %		*25.4%*	*18.4%*	*20.2%*	*18.6%*	*21.2%*	*23.5%*	*26.1%*	*28.2%*	*30.3%*
Adjusted amortisation & depreciation		-781	-1,770	-2,534	-2,870	-3,209	-3,463	-3,833	-4,060	-4,332
Adjusted EBIT (pre SBPs)	**4,023**	**4,598**	**3,195**	**2,916**	**2,700**	**4,000**	**5,636**	**7,646**	**10,113**	**13,137**
EBIT margin %	*26.8%*	*21.7%*	*11.9%*	*10.8%*	*9.0%*	*11.8%*	*14.6%*	*17.4%*	*20.1%*	*22.8%*
Share based payments (SBPs)	-371	-1,167	-675	255	-500	-522	-546	-571	-599	-628
Adjusted EBIT (post SBPs)	**3,652**	**3,431**	**2,520**	**3,171**	**2,200**	**3,478**	**5,090**	**7,075**	**9,514**	**12,509**
Margin %	*24.3%*	*16.2%*	*9.4%*	*11.8%*	*7.3%*	*10.2%*	*13.2%*	*16.1%*	*18.9%*	*21.7%*
Underlying net interest	-624	-348	-305	-263	-450	-200	50	0	0	0
Adjusted PBT (pre SBPs)	**2,653**	**4,095**	**2,890**	**2,653**	**2,250**	**3,800**	**5,686**	**7,646**	**10,113**	**13,137**
Adjusted PBT (post SBPs)	**2,282**	**2,928**	**2,215**	**2,908**	**1,750**	**3,278**	**5,140**	**7,075**	**9,514**	**12,509**
JV minorities (Japan 51% & APAC 70%)		-238	-448	-67	-375	-425	-454	-486	-520	-558
Implied corporate tax rate	-16.9%	-21.6%	-15.5%	-2.5%	-22.0%	-22.0%	-22.0%	-22.0%	-22.0%	-22.0%
Adjusted EPS (p) - Pre SBPs	**2.8**	**4.2**	**2.8**	**3.6**	**2.2**	**3.9**	**6.0**	**8.2**	**10.9**	**14.1**
EPS growth rate		*46.2%*	*-33.1%*	*27.8%*	*-38.8%*	*77.3%*	*55.2%*	*36.2%*	*33.2%*	*30.2%*
Adjusted EPS (p) - post SBPs	**2.4**	**2.9**	**1.8**	**4.0**	**1.6**	**3.2**	**5.3**	**7.5**	**10.2**	**13.4**
EPS growth rate		*17.7%*	*-36.6%*	*116.6%*	*-60.5%*	*107.5%*	*65.1%*	*40.2%*	*35.8%*	*32.0%*
Dividend (p)	**5.0**	**2.0**	**0.7**	**0.0**	**0.0**	**0.0**	**1.0**	**1.5**	**2.0**	**2.7**
Yield	*5.6%*	*2.2%*	*0.8%*	*0.0%*	*0.0%*	*0.0%*	*1.1%*	*1.7%*	*2.3%*	*3.0%*
Dividend cover		*2.1*	*3.8*				*6.0*	*5.4*	*5.3*	*5.3*
Valuation benchmarks										
P/E ratio (pre SBPs)	*31.7*	*21.6*	*32.4*	*25.3*	*41.4*	*23.3*	*15.0*	*11.0*	*8.3*	*6.4*
PER (post SBPs)	*36.8*	*31.3*	*49.3*	*22.8*	*57.7*	*27.8*	*16.8*	*12.0*	*8.8*	*6.7*
EV/Sales (adjusted for Est minority JVs)			*2.4*	*2.5*	*2.2*	*2.0*	*1.7*	*1.5*	*1.3*	*1.1*
EV/EBIT (pre SBPs)		*13.2*	*19.0*	*20.8*	*22.5*	*15.2*	*10.8*	*7.9*	*6.0*	*4.6*
EV/EBIT (post SBPs & adjusted for Est minority JVs)		*19.4*	*30.5*	*19.6*	*35.3*	*20.7*	*13.5*	*9.4*	*6.9*	*5.1*
EV/EBITDA (post SBPs & adjusted for Est minority JV)		*22.1*	*19.7*	*10.3*	*14.8*	*10.8*	*8.2*	*6.2*	*4.9*	*3.9*
PEG ratio (post SBPs)						*0.26*	*0.26*	*0.30*	*0.25*	*0.21*
EBITDA drop through rates			*21.5%*	*19.3%*	*19.4%*	*20.0%*	*22.5%*	*24.9%*	*27.2%*	*29.3%*
Capitalised R&D as % of sales			*9.8%*	*8.5%*	*11.0%*	*11.0%*	*9.0%*	*8.0%*	*8.0%*	*8.0%*
Cash flow yield (OCF/MrkCap post R&D cap)				*4.1%*	*1.9%*	*3.8%*	*7.1%*	*10.3%*	*13.1%*	*16.5%*
Sharecount (000s - incl EBT from FY18)	*77,550*	*71,537*	*56,668*	*61,714*	*63,456*	*65,850*	*66,508*	*67,173*	*67,845*	*68,523*
Net cash/(debt)	**7,786**	**1,042**	**1,732**	**-2,710**	**-2,000**	**-650**	**2,641**	**7,369**	**13,284**	**20,677**
Shareprice (p)	***90***									

Source: ED estimates, Company historic data. . Note: Adjusted EBITA, PBTA and EPS excludes non-recurring items, share based payments and the amortisation of 'purchased goodwill" but is stated after capitalised internal R&D.

Key risks

- Unforeseen events, such as severe economic downturn, potentially delaying client IT investments.
- Anticipated growth/profitability may take longer than originally envisaged, cost more or not be fully realised.
- Larger software deals can lead to more lumpy revenues.
- Foreign exchange fluctuations, albeit this is primarily a translation risk with 90% of Blancco's revenues being generated outside of the UK.
- Regulatory and tax changes.
- Competition may intensify due to new/existing players.

Investor Access

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