Blancco Technology Group plc

Exciting times ahead

25th September 2018

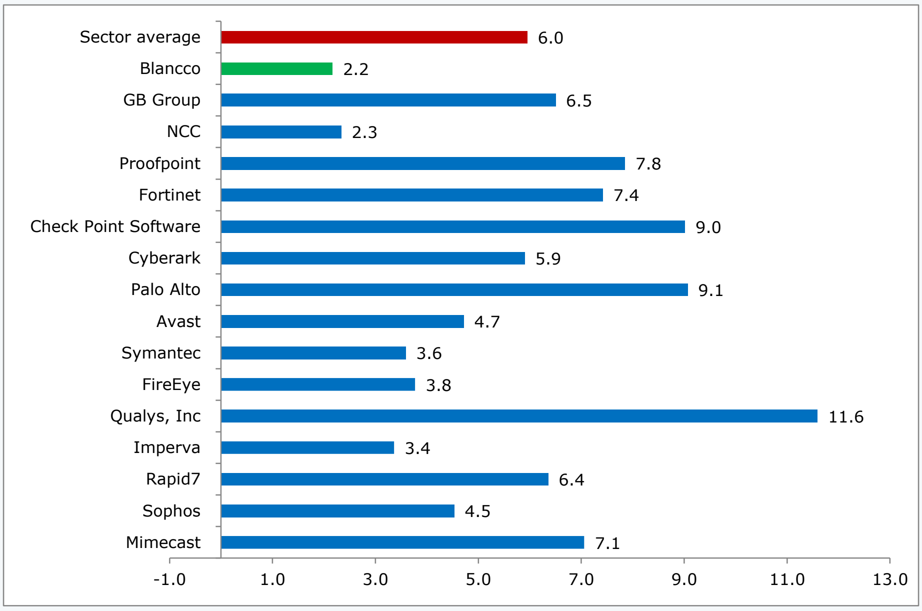
As Nasdaq reaches nose-bleed levels, many fund managers are scratching their heads to find reasonably priced tech stocks. A lot depends though on where one looks. Cast the net a little further down the food chain and in our view Blancco, the world's #1 data erasure & mobile diagnostics software developer, fits the bill.

Indeed, despite the stock being rated **at a modest 2.2x CY EV/turnover** (adjusted for JVs) vs **6.0x for the cyber-security sector** (see below), we are **encouraged by** this morning's **upbeat prelims**, **improving momentum** (H2'18 sales +5.3% vs -1.4% H1), **"*strong*" start to FY19** and **the Board's well balanced 'Growth Strategy.'**

We believe the shares are worth much >87p

So much so, that **our valuation has been upgraded from 106p to 140p/share**. Aided too, by the slightly **better than expected FY18 out-turn,** where adjusted EBIT came in 4% higher (17% CC) at £3.3m (margin 12.1% vs 11.9% LY) on revenues up +2.1% (5% CC) to £27.5m. Driving adjusted EPS to 4.7p (vs 2.8p), with **net debt closing June at a comfortable £2.7m** (vs £3.4m Dec'17) and falling further since the period end - reflecting **tight cost control** and **good working capital management** (cash conversion 123% vs 100% LY).

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



Source: Equity Development. Blancco adjusted for estimated JVs

Scalable business offering substantial upside

Going forward, **the trick to unlocking this hidden value will be re-energising the top line**. Grabbing share in its "priority"' verticals where there is greatest near-term opportunity - alongside bolstering those areas where Blancco already enjoys a formidable economic 'moat' (eg ITAD). Altogether, feeding through into enhanced economies of scale, more investment available for R&D/S&M, faster growth, superior returns and (in theory) a much higher stock price.

Company Data

EPIC	**AIM:BLTG**
Price (prior close)	87p
52 week Hi/Lo	87p/48p
Market cap	£56m
ED valuation / share	140p
Avg. daily volume	50k

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.

96% 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%). For H1'18 APRU came in at £59.4k whilst total headcount at Dec'17 at 239.

Next news: Late Nov'18 AGM and/or Jan H1'19 trading update.

Paul Hill (Analyst)
0207 065 2690
paul.hill@equitydevelopment.co.uk

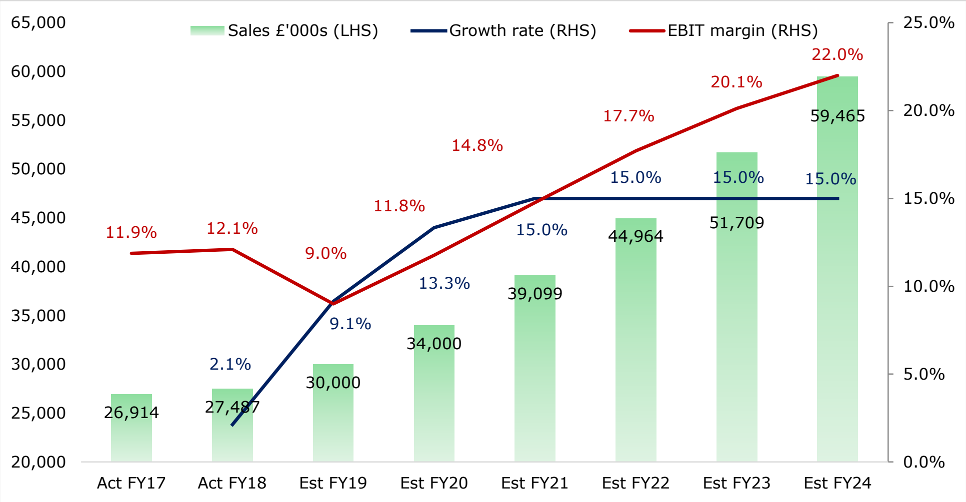
Andy Edmond
0207 065 2691
andy@equitydevelopment.co.uk

'Heavy lifting' over – now moving into growth mode

Granted, this strategy will involve spending a bit more over the next 2 years on R&D (20 extra software engineers), marketing (+30%), channel development and sales resource. In turn temporarily depressing adjusted EBIT margins for this year (9.0%) and next (11.8%).

However far more importantly, it will allow BLTG to **steal a march on its rivals**, and lift organic growth from 2.1% LY to an estimated 9.1% this, 13.3% in FY20 (see below) and mid-teens thereafter.

Revised financial projections



Source: Equity Development

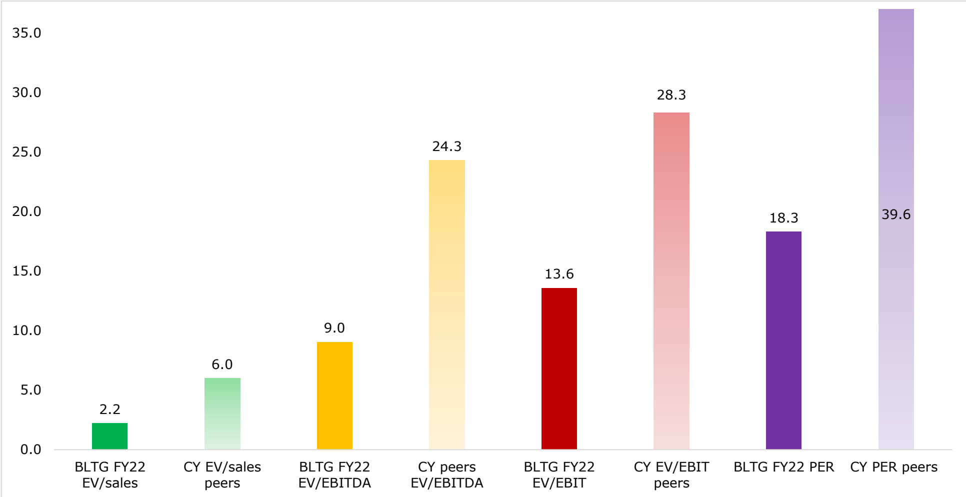
Equally we're confident that after a rocky couple of years, the '**tin helmets' can now safely be taken off**, since the business is **gaining real traction** with an **experienced management team** at the helm.

As evidenced recently by **a slew of new contract wins/renewals** (see later) with a host of household names. Providing excellent **customer endorsements and revenue visibility**.

140p could seem very cheap by FY22

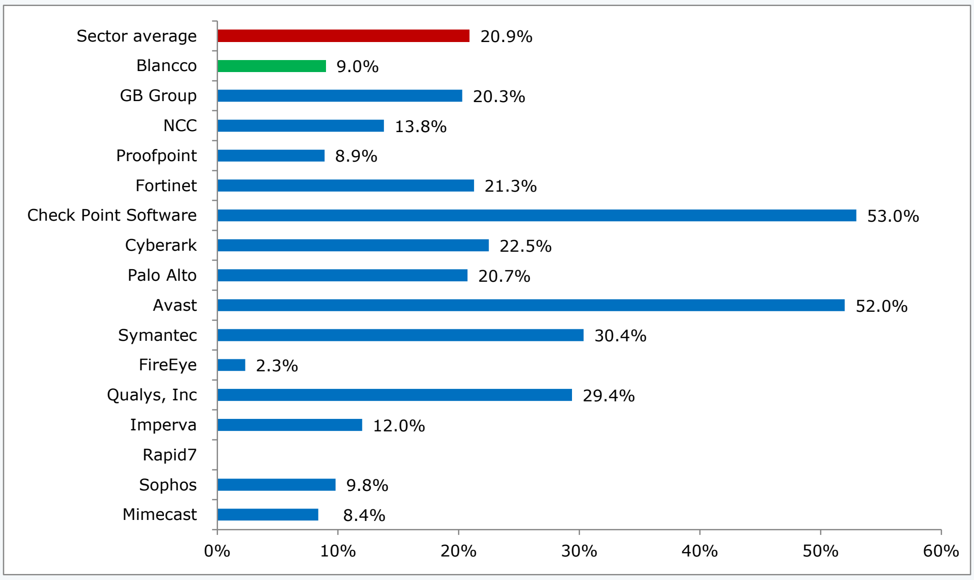
So where do we end up? Well, assuming things go to plan, we see no reason why eventually Blancco can't generate 20%+ EBIT margins in line with peers. Meaning that by FY22, the stock at 140p would still look significantly under-valued (see below) – trading once again at a frugal 2.2x EV/sales.

BLTG FY22 valuation multiples at 140p/share vs peers



Source: Equity Development

CY EBIT margins % - cyber security peers



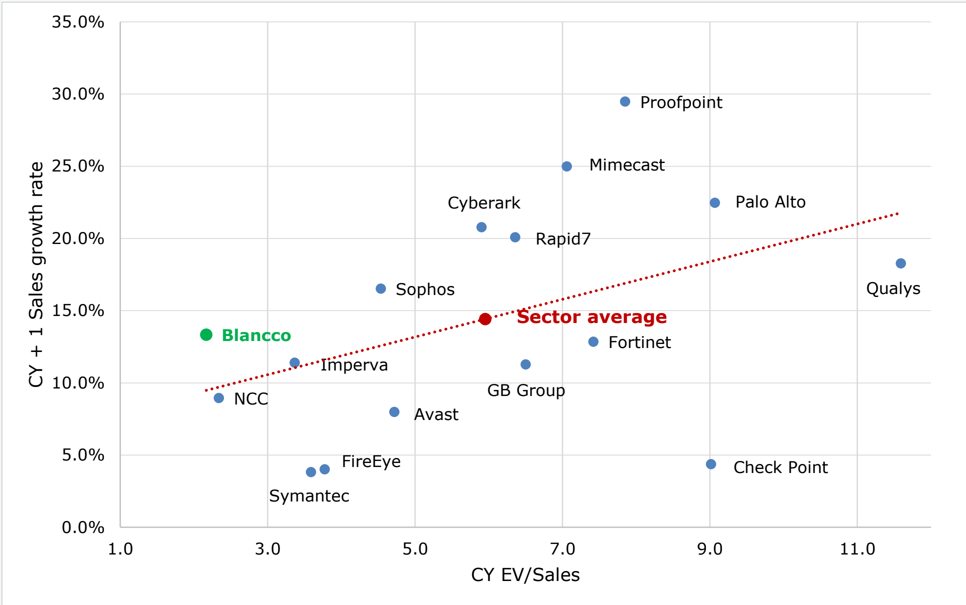
Source: Equity Development.

Faster growth may spark sharp re-rating

On the other hand, **push the clock forward to FY24** - and hypothetically using a multiple of 5x times EV/turnover - **the shares could be valued at north of 400p.** Investors might not have long to wait either, because once the City gets wind that growth is accelerating, the stock could re-rate quickly (see below chart).

Narrowing the **discount to peers**, who presently deliver on average 20.9% EBIT margins and 14.4% LFL growth. Metrics that we feel Blancco can readily achieve (if not surpass) in due course.

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



Source: Equity Development. Blancco priced at 87p.

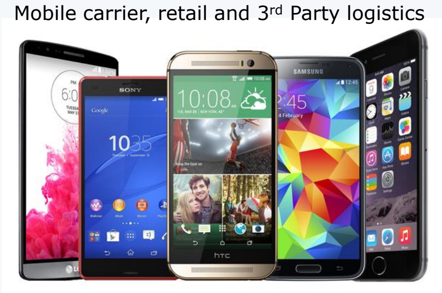
Ok, but where will the extra money be spent?

Well, following 12 months of belt-tightening, the majority of the '**growth capital' will target the rapidly expanding Mobile** (36% FY18 sales), **Data Centre and Enterprise** (33%) verticals, where Blancco already possesses a competitive edge.

That said, **these initiatives are 'incremental'**, and in no way lessen BLTG's ongoing efforts within IT Asset Disposition (ITAD - 31% sales). In fact, quite the opposite.

3 major growth engines augmented by a core ITAD market

Mobile carrier, retail and 3rd Party logistics



Enterprise - data centres

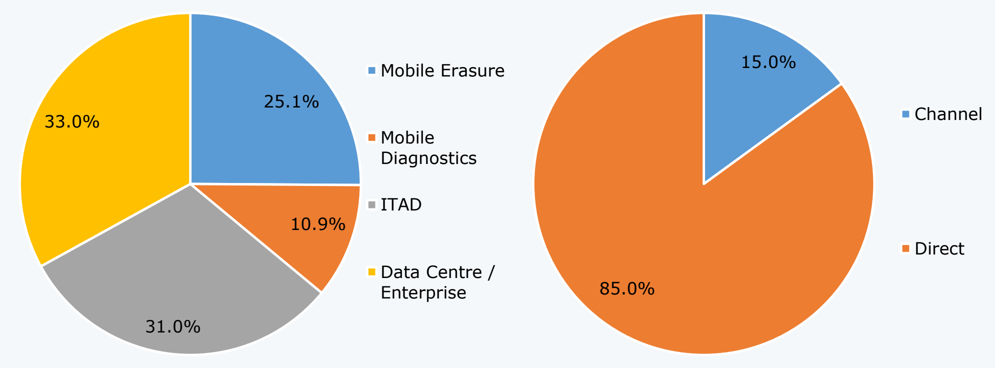
Enterprise eg online retailers

IT Asset Disposition (ITAD)

Source: Equity Development

CEO Matt Jones adding "*There is a significant amount of overlap between the technology supporting the Mobile and Data Centre / Enterprise markets - and the ITAD proposition will benefit from the increases to the R&D resource being implemented in those areas***. *We will continue to ensure that [our core] ITAD offering remains the best …and [BLTG's] leading position is maintained***."

Estimated FY18 breakdown of revenues (£27.5m)



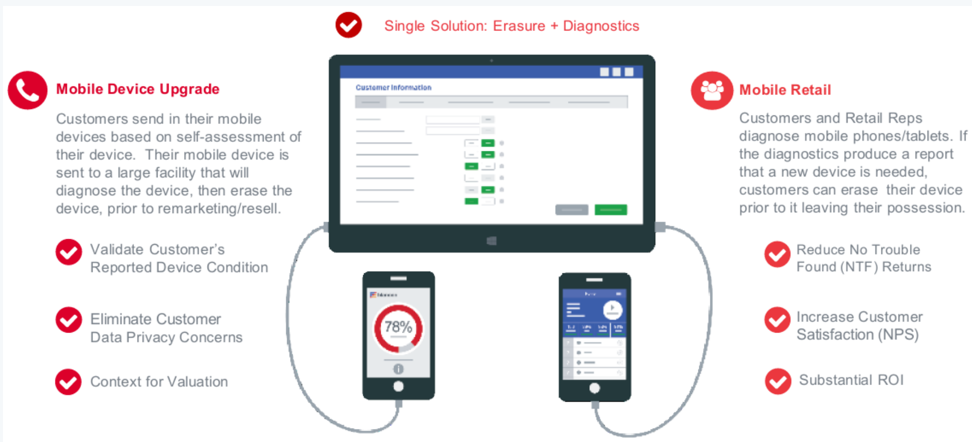
Source: Equity Development

Aiming to become the '*de facto*' standard in Mobile

Within Mobile the company offers the only commercially available solution that **securely erases up to 100 handsets simultaneously**, alongside performing a full range of diagnostics. Very handy for mobile repair centres (Carrier, OEM or 3rd party owned), which often process millions of trade-ins each year.

But that's not all. **Retail outlets can literally save $millions too**, enabling staff to test phones in-store, thus avoiding the expense of needlessly sending 'fully working' devices back to the factory for inspection. For instance, between Feb-Nov'17, diagnostics were run on 1.3m units across >6,000 US stores, of which 0.7m were found to have no fault. **Saving in the region of $80 each, or $56m in total**.

Blancco Mobile Device Eraser



Source: Company

Nonetheless, this is just the beginning. Globally 'No Trouble Found Returns' are estimated to cost mobile manufacturers, operators and retailers an eye-watering $4.5bn pa (Source: company).

Hardly surprising, therefore, that this huge potential efficiency saving, is helping to drive orderflow. With the company saying **it had extended & expanded its existing agreement with the above US carrier to March 2021** (worth >$10m). Whilst elsewhere a new $1m contract was won with a South Korean mobile carrier who has >13m subscribers & 1,100 shops.

The timing looks perfect

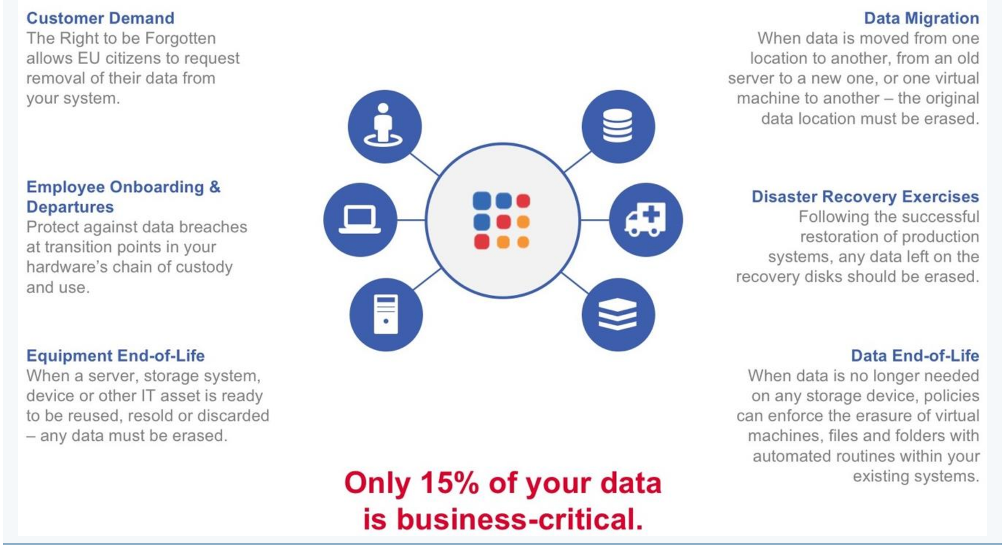
Although difficult to calibrate exactly, we think **Mobile is a substantial, fast growing and yet relatively untapped market**. According to eMarketeer, almost 2.4bn people worldwide own a smartphone, up 10.8% on LY. And due to the rising prices of some flagship models (eg iPhone X, Samsung note), more of us are buying 2nd-hand refurbished models instead. Hence the amount of resold devices is predicted by IDC to soar from 165m in 2017 to 290m by 2022 - **representing a CAGR of 12% pa**.

Remember that nearly all of these handsets have the capability to make financial payments, and therefore hold confidential banking information. Meaning that if the data is not appropriately erased before being reprovisioned (Nb simply deleting/formatting files or using the factory reset doesn't ensure this) then the previous owner is in danger of possible ID theft and/or monetary loss.

Corporate data centres can benefit too….

By the same token, corporates also hold prodigious quantities of personal information, which ideally needs to be erased - particularly where they operate their own data centres, involving a steady stream of older equipment being replaced by newer servers.

When should corporates securely erase data?



Source: Company

Some enterprises have already adopted best-in-class data handling protocols, albeit it is fair to say that the majority are just starting to get to grips with the issue. As such, like Mobile, we reckon that Enterprise is another vast (& principally) untapped market for BLTG, who has just renewed/expanded contracts with both a multinational tech client to decommission servers in 20 data centres, and a cloud-based software application firm.

Additionally, given the 'shift to the cloud', many of these facilities are gradually being decommissioned. In April, it was reported that Cox Automotive – owner of Autotrader, Dealer.com, etc – was going 'all in' on Amazon Web Services (AWS) and closing >40 such sites. Similarly News International is said to be shutting 60, and GE another 30. For BLTG, this type of work tends to be 'lumpy', yet nevertheless material.

...along with the broader Enterprise market

But that's not all. There are plenty of other corporate-related application areas for the company's software. Not least relating to 'reverse logistics', where **a very large online retailer has just signed up to handle returned electronic gadgets** from their customers across EMEA.

Elsewhere, we understand that **Blancco's Management Console** (see below) **provides the only solution that can erase data in both active and inactive environments**, and across a variety of IT assets, from mobile phones to large, virtualized data centers. And importantly provide categorical evidence that it's been done correctly.

Blancco Management Console

Source: Company

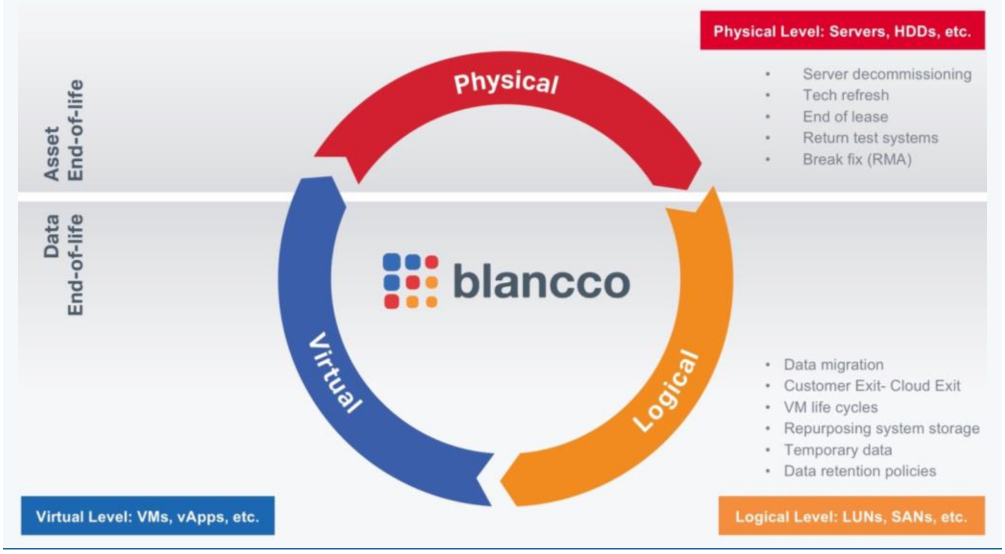
Greater emphasis on channel/technology partnerships

However, in order to access these customers, Blancco is further beefing up its OEM & channel relationships. Where for example, its software could be combined with server/PC manufacturers (eg Dell/VMWare), leading software houses, other cyber-security developers and/or system integrators (eg IBM). Perhaps even offering 'cradle to grave' solutions to help corporates manage their entire 'information life-cycle' requirements – which is where 'Live Erasure' is probably most pertinent.

With this in mind, Anders Klemmer (formerly at FireEye) has been recruited as VP Business Development to increase 3rd party relationships (circa 15% revenues). With new distribution agreements being signed in H2'18 with Arrow Electronics (EMEA) and Ingram Micro (US, Canada & Australia).

On top, the company launched its innovative 'Erasure as a Service (EaaS)' product in Nov'17 leading to deals with 14 partners, including Fujitsu and Techchef.

Data 'End of Life' (EoL) is even bigger opportunity than Asset EoL



Source: Company

Finally, within Enterprise we believe erasure software can be very useful for combating ransomware too (eg WannaCry NotPetya). The risk being that if infected IT systems are not totally wiped prior to reboot, then the offending malware could covertly bury itself in say a solid state drive, and later return. What's surprising, is that so few corporates seem aware of the issue, and have not included this critical step within their network recovery procedures. Albeit surely this is only a matter time….

Steady mid-single digit growth in ITAD

Let's not forget though the importance still being placed on ITAD. Here, **investments will continue to be made to improve product performance and customer service**, where **BLTG** is **acknowledged as the industry's undisputed leader**. A market worth circa $13bn globally and predicted to expand at a 6-7% pa clip to 2025 - and where a large ITAD serving >1,000 enterprise customers has just renewed terms.

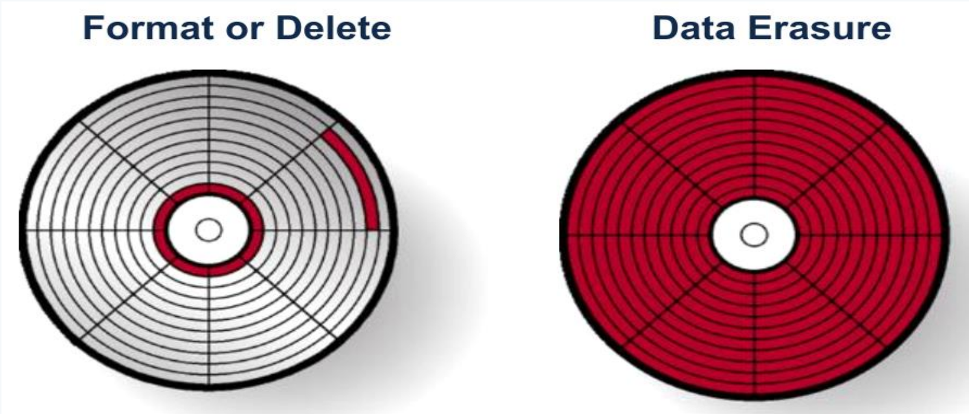
ITAD data erasure

Source: Internet

'Data erasure will become mainstream 2018-21'

CEO Matt Jones concluding "*Following the completion of the restructuring activities of the past year, the implementation of robust controls and procedures and introduction of a new management team, **Blancco is extremely well placed to capitalise on the regulatory drivers that will lead to growth in the years ahead**. The majority of data that is deleted can be recovered and is only safely erased when using solutions, such as those provided by Blancco.*

Data is easily recovered from storage devices if not 100% erased



Source: Company (red zones indicate where data has been 100% securely erased)

***The approach going forward is to focus on Mobile, Data Centre, Enterprise and ITAD**, where Blancco already has strong propositions. R&D resource is being added to complete [our] Mobile, Data Centre & Enterprise solutions… where the markets are the largest and growing at a rapid rate.*

Sales on a strong upwards trajectory

***Trading in the early months of the year has been very encouraging with invoiced sales ahead of last year, and net debt has reduced further with cash being generated from those increased sales**.*"

Lastly, industry research house, Gartner (July'18) predicts that **"*Data erasure will hit the mainstream between 2018–21."***

Blancco "*built on a strong, accountable and responsible culture*"

Source: Company

Summary projections (£'000s)

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	Restated							
Turnover	**15,014**	**21,196**	**26,914**	**27,487**	**30,000**	**34,000**	**39,099**	**44,964**	**51,709**	**59,465**
Growth rate %		*41.2%*	*27.0%*	*2.1%*	*9.1%*	*13.3%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Adjusted EBITDA (pre SBPs)		**5,379**	**4,965**	**5,827**	**5,575**	**7,210**	**9,249**	**11,834**	**14,536**	**17,524**
Margin %		*25.4%*	*18.4%*	*21.2%*	*18.6%*	*21.2%*	*23.7%*	*26.3%*	*28.1%*	*29.5%*
Adjusted amortisation & depreciation		-781	-1,770	-2,500	-2,875	-3,210	-3,477	-3,869	-4,128	-4,440
Adjusted EBIT (pre SBPs)	**4,023**	**4,598**	**3,195**	**3,327**	**2,700**	**4,000**	**5,771**	**7,965**	**10,407**	**13,085**
EBIT margin %	*26.8%*	*21.7%*	*11.9%*	*12.1%*	*9.0%*	*11.8%*	*14.8%*	*17.7%*	*20.1%*	*22.0%*
SBPs	-371	-1,167	-675	255	-400	-418	-439	-461	-484	-508
Adjusted EBIT (post SBPs)	**3,652**	**3,431**	**2,520**	**3,582**	**2,300**	**3,582**	**5,333**	**7,504**	**9,924**	**12,577**
Margin %	*24.3%*	*16.2%*	*9.4%*	*13.0%*	*7.7%*	*10.5%*	*13.6%*	*16.7%*	*19.2%*	*21.1%*
Underlying net interest	-624	-348	-305	-263	-263	-163	-63	0	0	0
Xcaliber (49% owned pre Jan'16)	-746	-155	0	0	0	0	0	0	0	0
Adjusted PBT (pre SBPs)	**2,653**	**4,095**	**2,890**	**3,064**	**2,437**	**3,837**	**5,708**	**7,965**	**10,407**	**13,085**
JV minorities (Japan 51% & APAC 70%)		-238	-448	-75	-450	-480	-516	-554	-596	-641
Implied corporate tax rate	-16.9%	-21.6%	-15.5%	-2.4%	-22.0%	-22.0%	-22.0%	-22.0%	-22.0%	-22.0%
Adjusted EPS (p) - Pre SBPs	**2.8**	**4.2**	**2.8**	**4.7**	**2.2**	**3.7**	**5.7**	**8.2**	**10.8**	**13.5**
EPS growth rate		*46.2%*	*-33.1%*	*67.6%*	*-53.7%*	*71.5%*	*55.1%*	*42.3%*	*31.6%*	*25.9%*
Adjusted EPS (p) - post SBPs	**2.4**	**2.9**	**1.8**	**5.1**	**1.7**	**3.2**	**5.2**	**7.6**	**10.2**	**13.0**
EPS growth rate		*17.7%*	*-36.6%*	*177.3%*	*-66.5%*	*90.1%*	*62.7%*	*45.9%*	*33.5%*	*27.1%*
Dividend (p)	**5.0**	**2.0**	**0.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Yield	*5.7%*	*2.3%*	*0.8%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Dividend cover		*2.1*	*3.8*							
Valuation benchmarks										
P/E ratio (pre SBPs)	*30.6*	*20.9*	*31.3*	*18.7*	*40.3*	*23.5*	*15.2*	*10.7*	*8.1*	*6.4*
PER (post SBPs)	*35.6*	*30.2*	*47.7*	*17.2*	*51.3*	*27.0*	*16.6*	*11.4*	*8.5*	*6.7*
EV/Sales (adjusted for Est minority JVs)			*2.3*	*2.4*	*2.2*	*1.9*	*1.6*	*1.4*	*1.2*	*1.1*
EV/EBIT (pre SBPs)		*12.7*	*18.3*	*17.5*	*21.6*	*14.6*	*10.1*	*7.3*	*5.6*	*4.5*
EV/EBIT (post SBPs & adjusted for Est minority JVs)		*18.7*	*29.3*	*16.7*	*33.9*	*19.7*	*12.5*	*8.6*	*6.4*	*5.0*
EV/EBITDA (post SBPs & adjusted for Est minority JV)		*21.3*	*18.9*	*9.3*	*13.9*	*10.1*	*7.6*	*5.7*	*4.6*	*3.7*
PEG ratio (post SBPs)			*-1.30*	*0.10*	*-0.77*	*0.30*	*0.26*	*0.25*	*0.25*	*0.25*
EBITDA drop through rates			*21.5%*	*19.8%*	*19.8%*	*20.0%*	*22.5%*	*25.1%*	*27.3%*	*28.8%*
Capitalised R&D as % of sales			*9.8%*	*8.3%*	*11.0%*	*11.0%*	*9.0%*	*8.0%*	*8.0%*	*8.0%*
Cash flow yield (OCF/MrkCap post R&D cap)				*5.5%*	*2.2%*	*4.0%*	*7.5%*	*11.2%*	*14.0%*	*17.2%*
Sharecount (000s - incl EBT from FY18)	*77,550*	*71,537*	*56,668*	*61,714*	*67,229*	*67,901*	*68,580*	*69,266*	*69,959*	*70,659*
Net cash/(debt)	**7,786**	**1,042**	**1,732**	**-2,710**	**-2,685**	**-622**	**3,278**	**9,177**	**16,611**	**25,724**
Shareprice (p)	***87***									

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.

Head of Corporate

Gilbert Ellacombe
Direct: 0207 065 2698
Tel: 0207 065 2690
gilbert@equitydevelopment.co.uk

Investor Access

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk