EDISON

Scale research report - Update

artec technologies

Technology

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Resilient H1, flurry of H2 contracts

H120 sales of €1.3m (up 43% from H119) represented a resilient first-half performance for artec, given the impact of the COVID-19 pandemic. Management also announced a number of attractive multi-year contracts across both security and broadcast customers, with €0.25m of revenue secured in Q320 and €0.25–0.30m expected in Q420, typically the company's strongest quarter. artec's positive trading highlights the benefits of a flexible, diversified business and leaves the group well placed for FY20 despite the uncertain macroeconomic outlook. With cash and undrawn facilities of €0.8m, artec offers potential share price upside if management can deliver on its guidance of significantly increased sales and positive profitability in FY20.

H120 results: 43% increase in revenues

H120 revenue of €1.3m rose by 43% from €0.9m in H119, although still 13% below management guidance of €1.5m as c €0.4m in contracts, expected in June 2020, were deferred to H220. With its team focused on operational delivery and sales, development work slowed with capitalised expenditure falling to €0.3m in H120 (H119: €0.4m). H120 EBITDA was €0.04m (H119: €0.05m) with a loss of €0.27m for H120 earnings (H119: loss of €0.26m). Cash and liquid assets came to €0.13m at H120 (H119: €0.0m), with €0.7m of undrawn facilities.

Outlook: FY20 profitability reconfirmed

In the context of a half year dominated by COVID-19, artec has delivered a resilient first-half performance, although not as strong as management had hoped. Ahead of its H120 interim results, artec announced a number of multi-year maintenance and support contracts, delivering revenue of €0.25m from new security and broadcast customers. Management expects further maintenance and support contracts worth €0.25–0.3m in Q420, which would lead to record service business sales in FY20. With positive demand for artec's products both domestically and internationally, management reconfirmed its guidance for significantly increased sales and positive profitability in FY20, despite the challenging economic backdrop.

Valuation: Growing base of recurring revenues

artec is seeing the benefits of management's investment in business development in H219, with new wins across the business extending the group's current EMEA footprint. As the group's recurring revenue base grows and if management can leverage artec's market position, there is scope for a return to profitability despite the continuing impact from COVID-19. Trading on 2.5x FY21 consensus EV/sales and 12.9x FY21 consensus EV/EBITDA, artec offers the potential for share price upside.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	2.94	0.42	0.02	0.0	N/M	N/A
12/19	2.01	N/M	N/M	0.0	N/M	N/A
12/20e	3.30	0.52	0.07	0.0	56.9	N/A
12/21e	4.52	0.88	0.14	0.0	28.4	N/A

Source: Refinitiv

Price	€3.98
Market cap	€11m

Share price graph

Share details

Code	A6T
Listing	Deutsche Börse Scale
Shares in issue	2.86m
Net cash (€m) at 30 June 2020	0.13

Business description

artec technologies develops cloud-based software solutions for the recording and analysis of video and audio, in two sectors: video security technology and crime prevention; and broadcast media.

Bull

- Strong start to H120, with management maintaining guidance for FY20 profitability.
- Growing list of reference clients in the security sector across the DACH region.
- IP-based, patent-protected technology solutions.

Bear

- Scale and growth potential limited by operational and resourcing constraints.
- Revenue visibility remains restricted.
- Volatile trading history, with financial outcome subject to contract delays.

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Business review: Diversified and resilient

artec navigated the COVID-19 pandemic well in H120 and continues to operate at full capacity (with no short-time working). In H120, artec hired a new AI specialist, taking the total to 29 members of staff and increasing its personnel costs to €0.76m (H119: €0.70m). Demand for artec's services has remained robust due to its diversified business model, which is focused on security solutions for government clients in the DACH region, while also offering scalable cloud/SaaS solutions to the media sector internationally.

The sales cycle has been elongated by COVID-19, with tenders taking longer to convert to contracts. artec's H120 product mix has also changed from FY19, with a greater focus on lower-margin hardware than software, so sales growth did not translate into improved earnings (H120 loss of €0.27m versus a loss of €0.26m in H119). Management expects the sales mix to reverse in H220, with a greater proportion of higher-margin software and services boosting profitability, including the maintenance and support contracts signed in Q320.

These recent contract wins were for both security and broadcast customers, including a media company and a sports academy from Qatar, a French sports broadcaster and a German security agency. This €0.25m of new contracts received (together with further maintenance and support contracts expected in Q420 of €0.25–0.30m) means artec would post record service sales in FY20. Q420 is typically artec's strongest quarter and management is confident of other large orders by year end, despite increased economic uncertainties. Management noted, in particular, a major tender (€0.5m) for an Asian client for a replacement system following the departure of Verizon Volicon, one of artec's close competitors.

In FY19, approximately 60% of artec's business was in video security, with 40% in media and broadcast. Video security revenues are highly localised and defensible but, in our view, the media business has greater growth prospects over the medium term, driven by adoption of artec's cloud solution and market share gains from the departure of Verizon Volicon.

Competitive environment

With the departure of Verizon Volicon from the market, competitors in media analysis include industry giant IBM Watson, Palantir (NYSE: PLTR) (a high-profile US IPO at the end of September, looking to diversify from its reliance on US government defence contracts) and Veritone (Nasdaq: VERI), a Nasdaq-quoted company that is probably artec's closest quoted peer. artec does not recognise any immediate peers offering surveillance solutions to state agencies in the DACH region. Although Palantir may look to expand its presence in the European market, targeting European security agencies, its data-mining expertise does not compete with artec's surveillance solutions.

Valuation: Upside potential

artec has no readily identifiable peers; however, with strong revenue growth and a positive outlook, the quoted European software peer group typically trades in a range of c 3–5x sales and 15–20x EBITDA.

Palantir is a data-mining company predominantly serving US defence agencies, offering parallels to the security side of artec's business. Veritone operates a similar model to artec, integrating third-party solutions into its platform, whereas IBM Watson, the sector leader, develops its own solutions. Veritone, based on consensus estimates, is expected to be significantly loss making for the foreseeable future, yet its share price has more than tripled over the last 12 months, with a market capitalisation of c $244m, trading on 3.6x FY20 consensus revenues, falling to 3.1x in FY21. Meanwhile, artec, which consensus forecasts to be profitable (FY20 consensus EPS of €0.07), trades on 3.4x FY20 revenues, falling to 2.5x in FY21.

Management is successfully building artec's recurring revenue base, c 12–15% of FY20 turnover but expected to grow further in FY21 and beyond. This will have an impact on short-term revenues but to the benefit of medium-term revenues and profitability. If management can leverage artec's market position in both security and media to operate closer to capacity, as the revenue base grows there is scope for a return to profitability and a narrowing of the valuation discount to its European software peer group.

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