EDISON Scale research report - Update

Max 21

Technology

6 September 2018

Appetite for more growth

Max 21 continues its successful turnaround story, with a solid increase in H118 sales related to Binect family products and LinOTP (even if somewhat behind management expectations). Encouraged by the top-line growth and recently introduced cost efficiencies, management has reaffirmed its FY18 revenue guidance at €7m (implying a 27% y-o-y growth) and is now expecting an EBITDA loss no greater than €1.5m (vs €2.5m previously). The reduced cash burn and business outlook for H218 will eliminate the need for a new share issue, according to the company.

Growing core revenues and cost reductions

Max 21 has delivered healthy growth in its strategic business verticals in H118, with Binect family product sales at €0.7m compared with €0.2m in H117 and LinOTP revenues up 90.5% y-o-y to €0.5m. Supported by the cost optimisation measures (particularly headcount reduction), the company's EBITDA loss came in at €0.5m, below the H117 loss at €2.3m. Binect was profitable throughout H118, while KeyIdentity improved its EBITDA but is still recording a loss (€0.8m vs €1.3m in H117).

Product adoption slower than expected

KeyIdentity's customer base grew to 308 contracts from 261 in H117 but remains below management expectations due to delays in investments into new products, as IT departments were tied up with the implementation of the General Data Protection Regulation (GDPR). Although Binect's Enterprise sales progress well, revenue growth in the Cube and Online product lines remains muted as a result of lacklustre adoption. Still, overall growth in strategically important revenues reached 164.6% y-o-y in H118.

Valuation: Still early stage

Lack of profits, both historical and implied by the Bloomberg consensus for FY18 and FY19, hamper any comparative valuation. On a historical EV/sales basis, the group's multiple of 3.8x compares with the average European TMT multiple of around 2x. If the group continues to translate current business growth into high levels of recurring SaaS revenues and exploit the market opportunity, this may result in earnings growth and be supportive of the valuation.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	EV/sales (x)	P/E (x)
12/16	3.3	(4.2)	(0.61)	0.0	7.4	N/A
12/17	6.4	(4.3)	(1.02)	0.0	3.8	N/A
12/18e	7.0	(0.9)	(0.16)	N/A	3.5	N/A
12/19e	9.0	1.5	(0.07)	N/A	2.7	N/A

Source: Max 21 accounts, Bloomberg consensus as at 3 September 2018. Note: Consensus is based on estimates of a single analyst (BankM).

Price	**€1.39**
Market cap	**€24m**

Share price graph

Share details

Code	MA1
Listing	Deutsche Börse Scale
Shares in issue	17.4m
Last reported net debt at 30 June 2018	€0.2m

Business description

Max 21 is a technology investment company with 100% stakes in two core subsidiaries: Binect in hybrid business communication and KeyIdentity in IT security.

Bull

- Surface of hybrid business communication market barely scratched.
- IT security market growth driven by multiple threats.
- Highly scalable recurring revenue model for both businesses.

Bear

- Break-even deferred.
- Long sales cycles.
- Extra equity financing may be required in case cash burn is ahead of management expectations.

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Edison profile page

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H118 results: Getting closer to the break-even point

Max 21 was able to reduce its EBITDA loss in H118 to €0.5m from €2.3m a year ago on the back of solid growth in the strategically important revenues (including the Binect product family and LinOTP) at 164.6% y-o-y to €1.3m, as well as cost savings initiatives at the two key subsidiaries, as well as the parent company. In particular, these cover headcount reductions (also within the R&D team following the completion of product development), but also marketing expenses (eg at KeyIdentity) and other overhead costs. It is also worth noting that last year's figures include costs related to the capital increase. As a result, Binect has already reached its EBITDA break-even point on a monthly basis (ie in every month in H118) and generated an EBITDA of €189k compared with a loss of €624k in H117. KeyIdentity is still reporting a loss but is getting closer to the break-even point as well (EBITDA loss at €0.8m in H118 vs a loss of €1.3m in the prior year). Overall group sales improved by 14.5% y-o-y to €3.5m, but the growth rate has been distorted by the disposal of Max 21's subsidiary NECDIS, a non-core business holding the distributorship for some NEC products in the German-speaking region, effective at the end of 2017. Adjusted for this effect, group revenue rose 30% y-o-y.

Exhibit 1: H118 results highlights

€ 000s unless otherwise stated	H118	H117	y-o-y change
Revenue	**3,478.9**	**3,039.8**	**14.5%**
Changes in inventory	(31.8)	(36.9)	-13.8%
Activated services	282.3	262.7	7.5%
Other revenue	66.1	72.5	-8.8%
Cost of materials	(1,141.7)	(838.8)	36.1%
Payroll costs	(2,371.7)	(3,298.3)	-28.1%
Depreciation and amortisation	(877.9)	(949.3)	-7.5%
Other operating expenses	(821.7)	(1,508.5)	-45.5%
Operating profit	**(1,417.5)**	**(3,256.8)**	**nm**
Financial result	(10.4)	(13.0)	-20.0%
Profit before tax	**(1,427.9)**	**(3,269.8)**	**nm**
Income tax	138.2	939.4	-85.3%
Net income	**(1,289.7)**	**(2,330.4)**	**nm**
EPS (c)	**(7.4)**	**(14.9)**	**nm**

Source: Max 21 accounts, Edison Investment Research

Exhibit 2: Max 21 revenue by division

€000s	H118	H117	y-o-y change
IT Security (KeyIdentity)	**680.2**	**689.3**	**-1.3%**
o/w LinOTP	539.1	283.4	90.2%
o/w Consulting	72.1	303.3	-76.2%
o/w Hardware	69.0	29.1	137.1%
Hybrid and digital posting (Binect)	**2,828.2**	**2,040.3**	**38.6%**
o/w Binect family products	739.8	199.6	270.6%
o/w Hardware	N/A	29.1	137.1%
NECDIS	**0.0**	**362.4**	**nm**
Eliminations	**(29.5)**	**(52.2)**	**-43.5%**
Total group revenue	**3,478.9**	**3,039.8**	**14.4%**
NECDIS adjustment	0.0	(362.4)	nm
Adjusted group revenue	**3,478.9**	**2,677.4**	**29.9%**

Source: Max 21 accounts, Edison Investment Research. Note: Some of the items do not sum up to totals as only selected numbers are presented.

Binect: Mailing volumes driven by Binect Enterprise

Revenues in the hybrid and digital post division represented by Binect improved 38.6% y-o-y to €2.8m, despite the deconsolidation of NECDIS. Strategically important sales went up to €739,800 from €199,600 in H117, supported by the increasing mailing volumes at Binect Enterprise. In this product group offered to Max 21's large-scale customers (10,000 or more mailings per month), the management highlighted the introduction of a new sales approach focused on application- and service-oriented products, as well as salesforce expansion. The revenue development in the Binect

Cube and Binect Online product lines for medium and small companies was negatively affected by the slow adoption on the client's side (as measured by the level of per-item usage). According to the company, this is a function of user dependency on the existing interface and the fact that management on the client's side is not putting enough emphasis on the adoption level. The cooperation with Deutsche Post is also being developed further, with a new version of the E-Postbusiness Box released in Q218. Overall, mailing volumes increased by 14.6% y-o-y to 55.3m in H118 (compared to 97.2m for FY17). According to the company, the market is growing at c 15–20% this year, similar to 2017.

Binect was able to sign 43 new contracts (compared to 41 in H117) with an average lifetime value (LTV) at €62,500 (H117: €21,800) and a total LTV of €2.7m (H117: €0.9m). However, management underlined that product roll-out has proven to be time consuming due to a lack of proper prioritisation during project implementation on the client's side. The company is addressing this by introducing new functionalities that increase the permeability between products and make adoption through the use of selected functionalities and services easier.

KeyIdentity: Customer base growing, but below expectations

Sales of KeyIdentity declined slightly by 1.3% y-o-y to €680,000, which was primarily the result of winding down the pentesting services within the consulting business (involving testing software for security flaws). However, LinOTP sales improved considerably by 90.5% y-o-y to €539,000. The company signed 35 new agreements in H118 (vs 22 in H117) and renewed 63 contracts (H117: 35), bringing the total number of contracts to 308 as at end June 2018 (up 18% y-o-y). New contracts represent an LTV at €565,000 and resulted in overall LTV increase to €3.2m (vs €1.9m in H117). They have also translated into an increase in average monthly recurring revenue to €88,000 from €53,000 in H117. KeyIdentity also has a minor business where it sells security tokens, which posted H118 revenues of €69,000 (up from €29,100 last year), driven by higher demand particularly on the back of the contract with Basler Versicherung signed in early March.

However, despite the solid sales-funnel, customer base growth remains behind management expectations, most likely due to the increased workload in the customer IT departments related to the recent introduction of the GDPR. This has resulted in delays in new product implementation, but should trigger higher demand for multi-factor authentication (MFA) solutions such as those offered by KeyIdentity over the medium term.

KeyIdentity should benefit from the planned expansion of the MFA value chain covered by the company through the long-term cooperation with a management advisory company (announced in June 2018) to develop identity-governance and access-management products. Upon reaching certain development milestones, the partner will have the option to receive a minority stake in KeyIdentity (slightly over 10%). A test version of the products (covering 80–90% of the end-product functionalities) will be presented in October at it-sa in Nürnberg (one of the key IT security trade shows), but the product has already received positive feedback during first presentations to prospective customers. Sales launch is planned for the beginning of 2019. Moreover, the recently signed contract with Basler Versicherung is important both from a revenue and a branding perspective. Meanwhile, the discussions with a potential strategic partner mentioned earlier by Max 21 were put on hold after more than eight months amid leadership changes on the partner's end that were not yet finalised.

Outlook

Management has reaffirmed its revenue guidance of €7m in FY18, which compares with €5.5m reported in FY17 (ex-NECDIS and pentesting) and implies a 27% y-o-y increase. This should be driven by the increase in strategically important revenues from Binect and KeyIdentity. In our previous research note, we highlighted that the earlier management expectations to reduce the

EBITDA loss to no more than €2.5m looked reasonable and achievable. This is confirmed by the current guidance revision, as the management now expects an EBITDA loss of no more than €1.5m. This is based on an expectation of stable competitive structures and market prices, as well as lack of major customer losses and continued positive developments in the relevant markets. Although the revenue guidance may be considered conservative (it implies no growth in H218 vs H118), it must be noted that even on KeyIdentity acquiring a large new client, revenues may be recognised with a delay (even from 2019). Moreover, H218 will not include any meaningful consulting revenues, which stood at €72.1m in H118. Finally, the company still has limited visibility in terms of the level of serviced mailing volumes.

Moreover, the company expects a reduction in cash burn in H218 on the back of contracted larger payments at KeyIdentity, as well as stronger earnings at Binect in Q418 (similar to last year). The operating cash outflow was already reduced in H118 to €0.9m from €2.6m in H117 and Max 21's current cash balance stands at €1.0m at 29 August 2018. On top of this, there are additional factoring facilities of €166,000 available to the company that were not yet drawn. Finally, a potential sale of the 8% minority interest in GFN (an IT training and personnel development company) could also contribute to Max 21's cash position. Consequently, management is confident the company is well funded until it starts to be profitable (presumably in 2019). At the EBITDA level, H218 is likely to contain additional marketing expenses (including costs related to the it-sa trade show) and potentially some variable personnel expenses.

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