EDISON

Blancco Technology Group

H118 results

Clean slate

Software & comp services

Blancco's H118 results reflect the non-recurrence of one-off licence deals signed in H117 as well as a period of restructuring. Despite the weak H1, management has a sufficiently strong sales pipeline that it expects to meet previous guidance for FY18. The company is now in better shape for the soon to be appointed new CEO to drive sustainable, cash-generative revenue growth.

Year end	Revenue (£m)	Adj. operating profit* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/16	21.2	4.6	4.16	2.0	15.9	3.0
06/17**	26.9	3.2	2.60	0.7	25.4	1.1
06/18e	28.4	2.3	1.94	0.0	34.0	N/A
06/19e	31.4	3.1	2.73	0.0	24.2	N/A

Note: *Adjusted operating profit (AOP) and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Restated.

H118 a period of restructuring

After restating financials to exclude the recently sold Mexican business, Blancco reported a 1.4% y-o-y decline in H118 revenues (flat in constant currency) and an adjusted operating profit margin of 6.6%. The company moved from a net cash position of £1.7m at end FY17 to a net debt position of £3.4m at the end of H118. During H118, management was focused on restructuring the headcount to reflect current revenue expectations, as well as putting in place strong financial and operational controls. This should result in a lower operating cost base from H218. Management also sought feedback from its customer base to shape its product and marketing strategies and has refined its target markets.

FY18 outlook unchanged

Despite a relatively weak H118 from a revenue perspective, the company expects to be able to meet the FY18 revenue growth and adjusted operating margin guidance it set in November, albeit from a slightly lower base now that the Mexican business has been excluded from FY17 results. We have revised our forecasts to reflect the removal of the Mexican business as well as the lowered operating cost base. Overall, our revenue forecasts are reduced by 3% in FY18 and FY19, while adjusted operating profit (AOP) is substantially unchanged in both years. A smaller minority interest deduction results in an increase in our normalised EPS forecasts of 44% in FY18 and 16% in FY19. We forecast net debt of £3.5m at the end of FY18, substantially unchanged from the H118 level.

Valuation: Reinvigorating sales is key to upside

On our new forecasts, Blancco is trading on a P/E multiple of 34.0x in FY18e and 24.2x in FY19e, which is at a discount to UK and global cybersecurity peers. Upside to the share price from this point will depend on the company demonstrating progress towards achieving at least the low end of revenue growth guidance, with a recovery in the end-of-life business a key factor in this. One-off licence deals could add materially to profitability.

23 March 2018

Price	**66.0p**
Market cap	**£42m**

Net debt (£m) at end H118	3.4
Shares in issue	64.0m
Free float	95.6%
Code	BLTG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.2)	(9.0)	(72.2)
Rel (local)	1.5	(1.3)	(71.2)
52-week high/low		239p	48p

Business description

Blancco Technology Group develops and sells data erasure and mobile diagnostics software. Its headquarters are in the US and it has sales offices in 15 countries around the world.

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Review of H118 results

This is the first reporting period since Blancco sold its 70% stake in the Mexico joint venture (completed in January 2018). The Mexican contribution has been reclassified into discontinued operations. The table below shows the results for H118 and the restated results for H117. H117 restated numbers also take into account the shift of revenues from H117 to H217, which overall has no impact on FY17 revenues. Pre-restatement, Mexico contributed revenues of £0.77m (2.8% of the total) and adjusted operating profit of £0.24m in FY17. Revenues declined marginally year-on-year, although on a constant currency basis were flat. Divisional adjusted operating profit (AOP) declined from a year ago as headcount increases in H217 took full effect in H118. Central costs were also higher, reflecting the changes to the management team. Exceptional costs included a £0.6m charge for restructuring and £0.6m in legal costs relating to the review of contracts signed in FY16 and FY17. The company moved from a net cash position of £1.7m at the end of FY17 to a net debt position of £3.4m at the end of H118. During the period, the company paid £0.7m for earnouts, as well as paying for exceptional costs relating to prior periods.

Exhibit 1: Half-yearly results highlights

£m	H118	H117 restated	y-o-y
Revenues	12.61	12.79	(1.4%)
Divisional adjusted operating profit	1.75	3.29	(46.9%)
Central costs	(0.92)	(0.81)	13.2%
Total adjusted operating profit	0.83	2.48	(66.6%)
Divisional adjusted operating margin	13.9%	25.8%	(11.9%)
Total adjusted operating margin	6.6%	19.4%	(12.8%)
Normalised net income - continuing only	0.44	1.54	(71.2%)
Reported net income - continuing only	(1.09)	(2.66)	(59.1%)
Normalised net income - total	0.48	0.75	(36.0%)
Reported net income - total	(1.08)	(5.09)	(78.7%)
Normalised basic EPS (p) - continuing only	0.72	2.75	(73.8%)
Normalised basic EPS (p) - total	0.78	1.34	(41.8%)
Reported basic EPS (p) - continuing only	(1.76)	(4.77)	(63.1%)
Reported basic EPS (p) - total	(1.75)	(9.13)	(80.8%)
Net debt	3.36	5.92	(43.2%)

Source: Blancco Technology Group

The table below shows progress with invoiced sales by product. End-of-life erasure declined year-on-year as a result of one-off deals in H117 that did not repeat in H118. Mobile erasure continued to show strong growth. Active erasure saw a small increase, although this is the smallest product line by revenue. Diagnostics invoiced sales declined as the end of some legacy contracts offset growth from new contract wins.

Exhibit 2: Half-yearly invoiced sales by product

Invoiced revenues (£m)	H118	H117 restated	Growth	Constant currency growth
End-of-life erasure	6.5	7.9	(17%)	(17%)
Mobile erasure	3.6	2.8	25%	29%
Active erasure	0.4	0.4	8%	9%
Professional services	0.6	0.9	(27%)	(24%)
Erasure total revenues	11.1	12.0	(7%)	(5%)
Diagnostics revenues	1.7	1.9	(14%)	(11%)
Total revenues	12.8	13.9	(8%)	(6%)

Source: Blancco Technology Group

Business update

Mexican subsidiary sold

In H217, Blancco increased its stake in the Mexico joint venture from 51% to 70%, but towards the end of H118 decided to sell its entire stake to the management of the JV. The disposal completed in January and Blancco should receive the proceeds of $0.5m/£0.4m by the end of FY18. The joint venture partner now has a distributor agreement in place and could yet generate revenues for Blancco in Latin America.

Restructuring the business

Management's focus in H118 was on rebuilding the confidence and focus of the Blancco team, as well as putting in place solid financial and operational controls. During the period, the company sought feedback from existing customers to assess the direction of product development and marketing. As a result, the sales and operations teams were organised to focus on four key customer categories: IT Asset Disposition (ITAD), Mobile Processors, Mobile Retail and Enterprise Data Centres. Product development was focused on the company's mobile offering, where Blancco is seeing good demand for a solution that combines diagnostics with erasure for use in the mobile resale market. Several products were released in H118 to support this functionality.

Sales activity

While there has been a net reduction in sales headcount, the company has strengthened the end-of-life (EOL) salesforce and expects EOL sales to normalise in H218. Keen to drive growth via the indirect sales channel, Blancco established 35 new partner channels in H118 and recently signed a distribution agreement with Ingram Micro. The company is seeing new opportunities in the enterprise data centre market, where it believes there should be good demand for both its EOL and active erasure software.

Management changes

The search for a permanent CEO is nearing completion and the company expects to be able to update the market shortly. During H118, Alan Bentley, who previously headed up the European sales effort, was appointed head of global sales.

Outlook and changes to forecasts

Management has maintained its full year guidance – for reported revenue growth of 6-16% and adjusted operating margin of 8-12%. In January, it confirmed that it expected revenues at the lower end of the range, with AOP and cash flow in line with guidance. We have revised our forecasts to reflect the removal of the Mexican contribution from continuing operations. We continue to forecast reported revenue growth at the bottom end of the revenue guidance range, with operating margins also at the bottom end of the range. This assumes that H218 revenues grow 25% h-o-h/12% y-o-y – this is supported by the recent signing of several enterprise deals as well as the strength of the pipeline.

Our AOP forecast is broadly unchanged as the removal of profits from the Mexican business is offset by lower operating costs post restructuring. We note that our normalised EPS forecast has increased in both years – this is due to a reduction in the minority interest deduction in both years. This partly reflects the exclusion of the Mexican business, but is also due to lower profitability generated by the remaining joint ventures in H118.

As we illustrated in our note post FY17 results (Rebasing the business, published in November 2017), one-off contracts could add materially to profitability – these are not factored into our forecasts.

Exhibit 3: Changes to forecasts

£m	FY18e				FY19e			
	Old	New	Change	y-o-y	Old	New	Change	y-o-y
Revenues	29.4	28.4	(3.2%)	5.6%	32.2	31.4	(2.7%)	10.4%
Gross profit	27.3	27.1	(0.7%)	5.2%	30.0	29.8	(0.6%)	9.9%
Gross margin	*93.0%*	*95.4%*	*2.4%*	*(0.4%)*	*93.0%*	*95.0%*	*2.0%*	*(0.4%)*
EBITDA	4.2	4.8	13.3%	(4.5%)	5.8	6.3	9.9%	31.4%
EBITDA margin	*14.5%*	*16.9%*	*2.5%*	*(1.8%)*	*17.9%*	*20.2%*	*2.3%*	*3.2%*
Normalised operating profit	2.3	2.3	(1.5%)	(27.6%)	3.2	3.1	(1.0%)	35.2%
Normalised operating profit margin	*8.0%*	*8.1%*	*0.1%*	*(3.7%)*	*9.8%*	*10.0%*	*0.2%*	*1.8%*
Reported operating profit	(1.1)	(0.9)	(17.8%)	(63.1%)	(0.3)	(0.4)	9.7%	(61.0%)
Reported operating margin	*-3.9%*	*-3.3%*	*0.6%*	*6.2%*	*-1.0%*	*-1.2%*	*(0.1%)*	*2.1%*
Normalised PBT	2.0	2.0	3.2%	(30.1%)	2.8	2.7	(1.2%)	35.9%
Reported PBT	(1.8)	(1.3)	(29.7%)	(30.1%)	(0.9)	(0.9)	9.5%	(24.6%)
Normalised net income	0.8	1.2	43.7%	(18.7%)	1.4	1.7	16.3%	40.9%
Reported net income	(3.3)	(1.6)	(51.0%)	(67.2%)	(2.3)	(1.5)	(35.3%)	(4.8%)
Normalised basic EPS (p)	1.3	1.9	43.7%	(25.4%)	2.3	2.7	16.3%	40.9%
Normalised diluted EPS (p)	1.3	1.9	43.7%	(25.4%)	2.3	2.7	16.3%	40.9%
Reported basic EPS (p)	(5.3)	(2.6)	(51.0%)	(69.9%)	(3.8)	(2.5)	(35.3%)	(4.8%)
Dividend per share (p)	0.0	0.0	N/A	N/A	0.0	0.0	N/A	N/A
Net debt	0.9	3.5	(285.0%)	N/A	1.6	2.9	79.8%	(16.9%)

Source: Edison Investment Research

Exhibit 4: Financial summary

£m	2015	2016	2017	2018e	2019e
30-June	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	15.0	21.2	26.9	28.4	31.4
Cost of Sales	(0.5)	(1.9)	(1.1)	(1.3)	(1.6)
Gross Profit	14.6	19.3	25.8	27.1	29.8
EBITDA	4.2	5.4	5.0	4.8	6.3
Normalised operating profit	4.0	4.6	3.2	2.3	3.1
Amortisation of acquired intangibles	(2.0)	(2.5)	(2.5)	(2.5)	(2.5)
Exceptionals	(2.5)	(2.7)	(2.6)	(1.2)	0.0
Share-based payments	(0.4)	(1.2)	(0.7)	0.4	(1.0)
Reported operating profit	(0.9)	(1.7)	(2.6)	(0.9)	(0.4)
Net Interest	(0.5)	(0.3)	(0.3)	(0.3)	(0.4)
Joint ventures & associates (post tax)	(0.7)	(0.2)	0.0	0.0	0.0
Exceptionals	(0.3)	(0.6)	1.1	(0.0)	(0.2)
Profit Before Tax (norm)	2.8	4.1	2.9	2.0	2.7
Profit Before Tax (reported)	(2.4)	(2.8)	(1.8)	(1.3)	(0.9)
Reported tax	(0.9)	(0.6)	(0.7)	(0.1)	(0.1)
Profit After Tax (norm)	1.9	3.2	2.0	1.5	2.1
Profit After Tax (reported)	(3.3)	(3.5)	(2.5)	(1.3)	(1.1)
Minority interests	0.3	(0.2)	(0.6)	(0.3)	(0.4)
Discontinued operations	8.4	(22.2)	(1.9)	0.0	0.0
Net income (normalised)	2.2	3.0	1.5	1.2	1.7
Net income (reported)	5.4	(25.9)	(4.9)	(1.6)	(1.5)
Basic average number of shares outstanding (m)	78	72	57	62	62
EPS - basic normalised (p)	2.84	4.16	2.60	1.94	2.73
EPS - diluted normalised (p)	2.84	4.16	2.60	1.94	2.73
EPS - basic reported (p)	6.97	(36.20)	(8.59)	(2.59)	(2.46)
Dividend (p)	5.00	2.00	0.70	0.00	0.00
Revenue growth (%)		41.2	27.0	5.6	10.4
Gross Margin (%)	96.9	91.1	95.9	95.4	95.0
EBITDA Margin (%)	28.3	25.4	18.7	16.9	20.2
Normalised Operating Margin	26.8	21.7	11.9	8.1	10.0
BALANCE SHEET					
Fixed Assets	119.1	67.3	66.6	64.9	62.5
Intangible Assets	110.2	66.9	66.2	64.4	62.0
Tangible Assets	6.4	0.4	0.4	0.5	0.6
Investments & other	2.5	0.0	0.0	0.0	0.0
Current Assets	56.2	16.2	20.2	14.9	16.5
Stocks	9.5	0.1	0.1	0.1	0.2
Debtors	34.6	6.6	8.4	9.3	10.3
Cash & cash equivalents	12.1	4.8	11.6	5.4	6.0
Other	0.0	4.8	0.0	0.0	0.0
Current Liabilities	(43.2)	(22.5)	(17.5)	(16.6)	(16.0)
Creditors	(40.5)	(13.4)	(14.0)	(12.1)	(13.7)
Tax and social security	(0.6)	(2.3)	(1.5)	(1.5)	(1.5)
Short term borrowings	0.0	0.0	0.0	0.0	0.0
Other	(2.1)	(6.8)	(2.1)	(3.1)	(0.8)
Long Term Liabilities	(9.4)	(13.5)	(18.7)	(14.0)	(14.0)
Long term borrowings	(4.4)	(3.7)	(9.9)	(8.9)	(8.9)
Other long term liabilities	(5.0)	(9.8)	(8.7)	(5.1)	(5.1)
Net Assets	122.7	47.6	50.6	49.1	49.1
Minority interests	(0.2)	(0.5)	(1.0)	(1.1)	(1.5)
Shareholders' equity	122.4	47.1	49.6	48.1	47.5
CASH FLOW					
Op Cash Flow before WC and tax	4.2	5.4	5.0	4.8	6.3
Working capital	0.8	0.9	(1.6)	(1.9)	0.6
Exceptional & other	2.8	(12.2)	(5.1)	(1.2)	0.0
Tax	(0.6)	(0.6)	(0.7)	(1.3)	(0.1)
Net operating cash flow	7.3	(6.6)	(2.5)	0.4	6.8
Capex	(1.8)	(2.5)	(3.4)	(3.3)	(3.4)
Acquisitions/disposals	(2.5)	(7.5)	(0.7)	(1.1)	(2.5)
Net interest	(0.4)	(0.2)	(0.3)	(0.3)	(0.4)
Equity financing	(3.6)	(50.7)	9.5	0.0	0.0
Dividends	(3.4)	(3.1)	(1.4)	(0.2)	0.0
Other	(6.5)	65.1	(0.4)	(0.8)	0.0
Net Cash Flow	(10.8)	(5.6)	0.84	(5.2)	0.6
Opening net debt/(cash)	(20.6)	(7.8)	(1.0)	(1.7)	3.5
FX	(1.9)	(1.2)	(0.1)	0.0	0.0
Other non-cash movements	(0.1)	0.0	(0.0)	0.0	0.0
Closing net debt/(cash)	(7.8)	(1.0)	(1.7)	3.5	2.9

Source: Blancco Technology Group, Edison Investment Research

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