EDISON

Kape Technologies

Strong H1 performance

Interim results

Software & comp services

With Kape's transition to a consumer cybersecurity business essentially complete, investors can focus on the trends in its core business. The interim results highlighted big improvements in both margins and visibility. A doubling of subscribers helped drive a 178% y-o-y rise in underlying EBITDA. We leave our estimates unchanged but with Intego adding $3m in subscription revenue in H2, the mix and margins should improve further. Stripping out $52m of cash, Kape trades at 19x FY19e EPS.

Year end	Revenue (US$m)	EBITDA* (US$m)	PBT* (US$m)	EPS* (c)	EV/EBITDA (x)	P/E (x)
12/16	56.5	6.4	4.8	2.9	30.0	59.5
12/17	66.4	8.3	7.5	4.9	23.3	35.6
12/18e	59.5	10.2	8.7	5.2	18.8	32.9
12/19e	69.7	13.7	11.8	7.0	14.1	24.6

Note: *EBITDA, PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. EPS is diluted

Improving trends in App distribution…

Following the disposal of Media and acquisition of Intego in July, Kape is now 100% focused on consumer cybersecurity. Headline figures for the core App distribution business were disclosed in July's trading statement (revenues up 14% y-o-y) but the interims showcased the underlying trends. Customer retention rose 5pp to 74%, the shift towards subscription substantially improved visibility and a 16pp y-o-y jump in segment margin (from 31.7% to 47.6%) drove a 71% rise in profit (see Exhibits 1 and 2). These trends primarily reflected the focus on subscription in Reimage plus the contribution of CyberGhost, which traded ahead of management expectations and was consolidated for a full period.

…look set to continue in H218e and beyond

Consolidating Intego in H218 ($3m of subscription revenue) should improve visibility still further. We forecast subscription sales reaching over 40% in H2. Re-iteration of "market expectations" guidance leads us to keep our FY18 estimates largely unchanged. Our FY18 revenue and segment profit margin estimates of $59.5m and 48.5% respectively should be readily achievable given the H1 performance. As the impact of the shift away from one time licensing sales annualises and revenue synergies with Intego grow, we forecast 12% top-line organic growth in FY19e.

Valuation: Improving growth, visibility and margins

The benefits of Kape's strategic shift to consumer cybersecurity are becoming increasingly obvious. The sale of Media and the acquisition of Intego should lift both subscription revenue and margins still further in H2 and the business should return to strong organic growth in FY19e. In a fragmented market and with cash on the balance sheet, we see scope for Kape to make more value accretive deals that leverage its distribution network and enhance its strategic position. On our current forecasts and stripping out $52m cash, the shares trade at 19x FY19e EPS, a modest discount to Kape's international B2C cybersecurity peers.

24 September 2018

Price	**132p**
Market cap	**£187m**
	US$1.33:£1
Net cash (US$m) at FY18e	52
Shares in issue	141.9m
Free float	27%
Code	KAPE
Primary exchange	AIM
Secondary exchange	NA

Share price performance

%	1m	3m	12m
Abs	6.1	6.5	61.7
Rel (local)	7.0	7.4	56.1
52-week high/low		136p	63p

Business description

Kape Technologies specialises in consumer cybersecurity software. It markets four proprietary products: PC repair and maintenance (Reimage and Reimage for MAC), PC driver repair software (DriverAgent), anti-malware (Intego) and a virtual private network (CyberGhost).

Next events

Trading statement	January 2019

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Improvements in underlying performance

Kape's interims demonstrated improvements across a range of key performance indicators in its core App distribution segment (see Exhibit 1). The strategic decision to shift from one time licences to recurring subscriptions suppressed growth, but subscription customers offer both better visibility and higher margins. This effect is apparent in Kape's H1 results. In particular, a strong performance from CyberGhost more than doubled the number of subscribers in just six months. This drove the mix of revenue 'recognised over a period' to 25.5% and segment margins to 47.6% (up 16ppt y-o-y). As a consequence, underlying adjusted EBITDA (ie stripping out the disposal of the web apps and licence business) rose 178% y-o-y to $4.3m (headline EBITDA rose 48%). Customer retention, a particularly key metric for long-term growth and margin performance, also improved (up 5pp to 74%).

Exhibit 1: App distribution key performance indicators

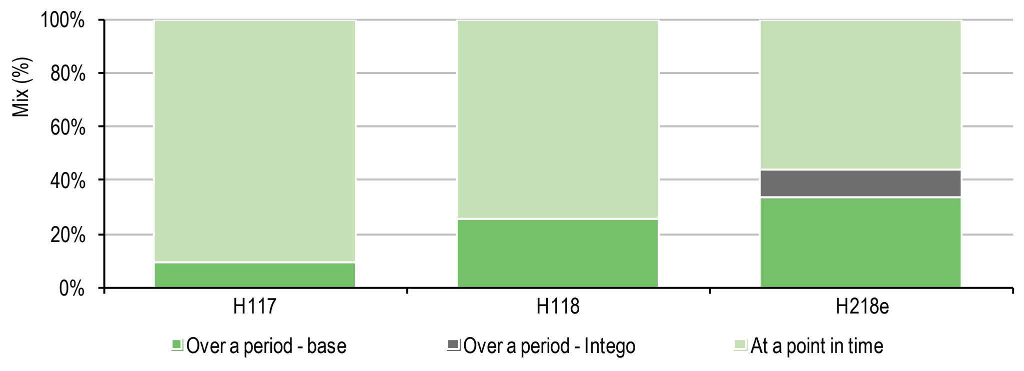
(US$m unless stated)	H117	H217	FY17	H118	H218e	FY18e
Revenue						
Reported	21.1	27.1	48.2	24.1	31.7	55.8
Headline growth (%)			26.1	14.1	16.9	15.7
Visibility						
Subscribers (m)	0.2		0.3	0.6		
Revenue from existing users in future periods			8.0	18.0		
Revenue "recognised over a period"	1.9	4.5	6.5	6.1	13.0	19.1
Revenue "recognised over a period" (%)	9.2	16.7	13.4	25.5	41.0	34.3
Profitability						
Segment profit	6.7	10.5	17.2	11.5	15.6	27.0
Segment margins (%)	31.7	38.7	35.7	47.6	49.2	48.5
Customer retention (%)	69.0		69.0	74.0		

Source: Company data, Edison Investment Research

In H218e we expect visibility to improve further: consolidating Intego should lift subscription revenue to over 50% (see Exhibit 2). Backing out our estimate of the $3.0m contribution from Intego implies revenues rise c 6% y-o-y in H2 as the shift towards subscription and the first revenue synergies from Intego offsets the decline in one-time licence sales. Our 49% segment profit margin forecast looks relatively conservative given the performance in H1 and the expectation of higher revenues in H2. Our $10.2m FY18 EBITDA forecast implies a 19% margin in H2.

Into FY19e, revenue growth should accelerate as the impact of lower one-off licence sales reduces and the further revenue synergies with Intego are realised. We forecast 12% organic revenue growth in FY19e and a 19% EBITDA margin.

Exhibit 2: Visibility improving - the rising % of revenues recognised 'over a period'



Source: Company data, Edison Investment Research

Exhibit 3: Financial summary

31-December (US$000s)	2015	2016	2017	2018e	2019e
Income statement					
Revenue	84,635	56,532	66,383	59,468	69,685
Cost of sales	(58,111)	(37,277)	(42,366)	(32,422)	(35,086)
Gross profit	26,524	19,255	24,017	27,046	34,599
EBITDA	10,064	6,413	8,261	10,221	13,691
Operating profit (before amort. and except.)	9,016	5,034	6,946	8,701	11,801
Amortisation of acquired intangibles	(8,322)	(8,505)	(5,130)	(700)	(700)
Exceptionals	(11,089)	(5,545)	(899)	0	0
Share-based payments	(3,407)	(716)	(3,516)	(500)	(600)
Reported operating profit	(13,802)	(9,732)	(2,599)	7,501	10,501
Net interest	(855)	(328)	(255)	(14)	(35)
Joint ventures & associates (post tax)	(38)	47	(40)	0	0
Exceptionals	0	0	858	0	0
Profit before tax (norm)	8,123	4,753	7,509	8,687	11,766
Profit before tax (reported)	(14,695)	(10,013)	(2,036)	7,487	10,466
Reported tax	(2,902)	(665)	(467)	(973)	(1,413)
Profit After Tax (norm)	7,421	4,088	7,042	7,714	10,353
Profit After Tax (reported)	(17,597)	(10,678)	(2,503)	6,514	9,053
Minority interests	0	0	0	(80)	(80)
Discontinued operations	0	0	0	0	0
Net income (normalised)	7,421	4,088	7,042	7,634	10,273
Net income (reported)	(17,597)	(10,678)	(2,503)	6,434	8,973
Average number of shares outstanding (m)	148	141	142	142	143
EPS - normalised (c)	5.02	2.90	4.98	5.37	7.19
EPS - diluted normalised (c)	5.02	2.90	4.85	5.23	7.01
EPS - basic reported (c)	(11.91)	(7.57)	(1.77)	4.53	6.28
Dividend per share (c)	0.00	0.00	4.93	0.00	0.00
Revenue growth (%)	19.0	(33.2)	17.4	(10.4)	17.2
Gross margin (%)	31.3	34.1	36.2	45.1	49.7
Ebitda margin (%)	11.9	11.3	12.4	17.2	19.6
Normalised operating margin	10.7	8.9	10.5	14.6	16.9
Balance sheet					
Fixed assets	21,785	8,729	13,312	26,980	26,782
Intangible assets	19,254	7,113	12,350	25,950	25,528
Tangible assets	1,003	591	815	883	1,107
Investments & other	1,528	1,025	147	147	147
Current Assets	87,616	80,014	82,430	65,548	76,714
Stocks	0	0	65	65	65
Debtors	16,280	7,950	11,071	8,146	8,362
Cash & cash equivalents	71,336	72,064	69,502	52,024	60,109
Other	0	0	1,792	5,312	8,178
Current liabilities	(16,721)	(7,339)	(15,028)	(14,000)	(16,108)
Creditors	(15,316)	(7,096)	(10,094)	(7,981)	(8,331)
Tax and social security	0	0	0	0	0
Short term borrowings	0	0	0	0	0
Other	(1,405)	(243)	(4,934)	(6,019)	(7,777)
Long term liabilities	(1,170)	(851)	(1,342)	(1,342)	(349)
Long term borrowings	0	0	0	0	0
Other long term liabilities	(1,170)	(851)	(1,342)	(1,342)	(349)
Net Assets	91,510	80,553	79,372	77,186	87,038
Minority interests	0	0	977	977	977
Shareholders' equity	91,510	80,553	80,349	78,163	88,015
Cash flow					
Op cash flow before WC and tax	10,064	6,413	8,261	10,221	13,691
Working capital	(2,197)	613	(1,392)	(754)	(1,096)
Exceptional & other	(1,297)	(823)	(624)	0	0
Tax	(1,826)	(904)	(109)	(973)	(1,413)
Net operating cash flow	4,744	5,299	6,136	8,494	11,181
Capex	(1,813)	(1,678)	(2,020)	(2,088)	(2,192)
Acquisitions/disposals	(1,402)	(1,439)	(5,337)	(16,870)	(870)
Net interest	(660)	(281)	156	(14)	(35)
Equity financing	(5,131)	(995)	(1,477)	0	0
Dividends	0	0	0	(7,000)	0
Other	0	0	0	0	0
Net cash flow	(4,262)	906	(2,542)	(17,478)	8,084
Opening net debt/(cash)	(76,041)	(71,336)	(72,064)	(69,502)	(52,024)
FX	(443)	(178)	(20)	0	0
Other non-cash movements	0	0	0	0	0
Closing net debt/(cash)	(71,336)	(72,064)	(69,502)	(52,024)	(60,109)

Source: Company data, Edison Investment Research

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