EDISON

Scale research report - Update

artec technologies

Technology

2 June 2021

A solid FY20, uncertainties persist for FY21

In FY20, artec increased sales by 53% to €3.1m despite the COVID-19 pandemic, with positive EBITDA of €0.33m. Recurring revenues rose to €0.75m, with the company targeting €1m by FY22. artec reported 11% l-f-l sales growth for Q121 but, with sales heavily skewed to Q4, the outlook for FY21 is far from clear due to the lingering effects of the pandemic and hardware supply issues from an industry-wide semiconductor shortage. At year end, artec had cash on the balance sheet of €0.47m. Management remains confident in the outlook for both the media and security segments in the medium term, but security is its key focus for FY21.

FY20 results: 53% y-o-y increase in revenues

FY20 turnover increased by 53% to €3.1m (FY19: €2.0m) despite the COVID-19 pandemic, with positive EBITDA of €0.33m (FY19: loss of €0.15m). Due to ongoing travel restrictions and the cancellation of trade fairs, other operating expenses fell by 11% to €0.64m (FY19: €0.72m), with personnel costs rising by 11% to €1.47m (FY19: €1.36m) due to new hires. PAT rose to €0.17m (FY19: €0.0m) with EPS of €0.06 per share (FY19: €0.44 loss per share); the positive EPS outcome was influenced by the capitalisation of deferred taxes in FY20 of €0.41m (FY19: negative €0.52m). With net debt of €0.1m and cash and undrawn facilities of €0.8m, the business remains well placed to benefit from opportunities in FY21 and beyond.

Strong Q121, but FY21 outlook still unclear

artec reported 11% l-f-l sales growth for Q121, but the outlook for FY21 is far from clear with annual sales heavily skewed to Q4 (Q420 was c 60% of FY20 sales), given the lingering effects of the pandemic, continuing travel restrictions and increasing concerns over hardware supply as a result of the industry-wide semiconductor shortages. As a result, management expects further progress in 2021, but is not in a position to provide revenue guidance for FY21.

Valuation: Growing base of recurring revenues

Artec delivered a resilient performance in FY20 and the group's prospects in the medium term remain strong. However, in our opinion given both the continuing impact of the pandemic and semiconductor shortages, consensus forecasts for FY21 might look optimistic. Artec trades on 3.7x consensus FY20 EV/revenues and 34x EV/EBITDA, falling to 24x FY22e EV/EBITDA. If management can leverage artec's market position in both security and media to operate closer to capacity, there is scope for sustained profitability as the group's recurring revenue base grows. This could lead to profit progression and a share price uplift over the medium term, assuming artec trades in line with its European software peer group.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/19	2.01	(0.16)	(0.42)	0.0	N/A	N/A
12/20	3.08	0.33	0.06	0.0	63.5	N/A
12/21e	4.30	0.46	0.05	0.0	76.2	N/A
12/22e	5.59	0.84	0.16	0.0	23.8	N/A

Source: artec technologies accounts, Refinitiv

Price	**€3.81**
Market cap	**€11m**

Share price graph

Share details

Code	A6T
Listing	Deutsche Börse Scale
Shares in issue	2.86m
Net debt at 31 December 2020	€0.1m

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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Specialist in video security and media analysis

artec technologies is a specialist technology company, developing innovative solutions for recording and analysing video, audio and metadata on networks and in the cloud. It offers an end-to-end service, including project planning, commissioning, service and support, incorporating both hardware and software solutions. With a modular structure, its open software architecture enables a wide range of connection and expansion options. artec's technology set is constantly evolving, with its 20 qualified and experienced computer scientists working to innovate and deliver new products into the market through R&D.

The company operates in two market segments with separate products, based around the same core technology: video security (MULTIEYE) targets state security agencies and public authorities in the DACH countries, while media analysis systems (XENTAURIX) targets the European and international broadcast media sector. TV and radio stations, IPTV and cable operators use XENTAURIX as long-term video recorders for legal proof of broadcasting (compliance). TV stations also use the system to create video clips for their media libraries and to analyse TV viewer ratings.

artec offers a buy, build, partner approach to technology. As well as developing its own IP, artec also partners with third-party software vendors to bolt on established solutions to its MULTIEYE and XENTAURIX platforms. Third-party modular technologies integrated with its platforms include number plate recognition, facial recognition, sentiment analysis, ratings analysis, video fingerprinting and centralised administration of mobile systems. The platform also incorporates artificial intelligence (AI) from Finnish AI specialist Valossa.

Customers typically sign long-term (three- to four-year) contracts with the software installed on-site. artec also offers a pay-as-you-go (PAYG) cloud-based model, where customers upload videos to artec's cloud-based platform for analysis. The PAYG solution involves minimal investment from the customer, whereas in-house solutions typically require a tender. artec anticipates monthly revenues in the range of €1–25k per PAYG customer as against typical one-off implementation costs of €0.1–1.5m. Monthly recurring revenues are attractive as they offer predictability and aggregate revenues over a multi-year period tend to be higher than for one-off sales, but revenues can be adversely affected in the short term as the recurring revenues build (€0.75m in FY20).

FY20 results: A step-up from FY19

After a slightly disappointing FY19, artec produced an improved FY20 sales and earnings performance. Turnover increased by 53% to €3.1m (FY19: €2.0m) despite the COVID-19 pandemic, with positive EBITDA of €0.33m (FY19: loss of €0.16m), PAT of €0.17m (FY19: €0.0m) and EPS of €0.06 per share (FY19: €0.44 loss per share). Including capitalised R&D development costs, total output in FY20 was €3.5m, a 39% rise on FY19 (€2.5m). The cost of materials increased 74% to €1.12m (FY19: €0.64m), reflecting the higher proportion of sales in the security sector, including complete systems with a higher hardware component. Due to ongoing travel restrictions and the cancellation of trade fairs, other operating expenses fell by 11% to €0.64m (FY19: €0.72m), with personnel costs increasing by 11% to €1.47m (FY19: €1.36m) following new hires.

artec's positive EPS outcome was significantly influenced by the capitalisation of deferred taxes in FY20 of €0.41m (FY19: negative €0.52m), with the positive contribution reflecting the stronger demand outlook for security products and the company's growing order book.

artec has an equity ratio of 84.4% and, with net debt of €0.1m and cash and undrawn facilities of €0.8m, the business remains relatively well capitalised to benefit from the opportunities in FY21 and beyond.

Exhibit 1: Financial summary

€000s, HGB	FY15	FY16	FY17	FY18	FY19	FY20
INCOME STATEMENT						
Revenue	3,469	2,475	1,462	2,936	2,010	3,080
Operating profit (loss)	637	(415)	(776)	33	(683)	(238)
Operating margin	18.4%	(16.8%)	(53.1%)	1.1%	(33.4%)	(7.7%)
Pre-tax profit (loss)	636	(414)	(782)	28	(677)	(233)
EPS (€)	0.22	(0.13)	(0.33)	0.01	(0.42)	0.06
DPS (€)	-	-	-	-	-	-
BALANCE SHEET						
Total non-current assets	1,461	1,959	2,196	2,433	2,614	2,717
Total current assets	1,827	1,905	1,312	1,713	1,322	1,894
Total assets	3,288	3,864	3,508	4,146	3,936	4,610
Total non-current liabilities	(57)	(71)	(83)	(93)	(73)	(63)
Total current liabilities	(202)	(90)	(523)	(174)	(145)	(645)
Total liabilities	(259)	(161)	(606)	(267)	(218)	(708)
Net assets	3,029	3,703	2,902	3,879	3,718	3,903
CASH FLOW						
Net cash from operating activities	963	(290)	208	(136)	169	121
Net cash from investing activities	(506)	(706)	(595)	(617)	(700)	(669)
Net cash from financing activities	(218)	989	154	798	1,023	476
Net cash flow	239	(7)	(233)	45	492	(72)
Cash & cash equivalents at end of year	240	233	0	46	538	466

Source: artec technologies accounts

artec currently reports under the accounting regulations of the German Commercial Code (HGB). Although no final decision has yet been taken, management is considering reporting its financials under International Financial Reporting Standards (IFRS), in addition to HGB, to help provide international investors with a clearer view of the company's financial position.

Recurring revenues continue to build

Artec continues its transformation towards software and cloud services in both security and media segments. In FY20, artec reported recurring revenues of €0.75m (FY19: €0.25m) (with a term of up to four years), representing c 25% of FY20 turnover (FY19: 12.5%) and beating its FY20 target of €0.5m. Recurring revenues are expected to grow further, with the company targeting €1m by FY22. This growth will have a negative impact on revenue and profit progression in the short term, but will benefit medium-term revenues and profitability. Management expects further progress in 2021 but, given the current uncertainties (the continuing pandemic, travel restrictions and hardware supply issues), is not in a position to provide revenue guidance for FY21.

Lingering impact of the pandemic raises FY21 uncertainty

The impact of the COVID-19 pandemic is still being felt, in particular by artec's international business, where sales have suffered from travel restrictions and the absence of trade fairs. Increasingly, issues around the industry-wide shortage of semiconductors have created capacity bottlenecks that remain a concern for timely delivery of hardware components in FY21. Management is actively managing the issue, swapping hardware components and building up stock to ensure continuity of supply. As a result of the drawn-out sales cycle, slow contract awards and hardware shortages slowing contract execution, we believe that there is a risk that a proportion of Q421 revenue may slip into FY22. The company may also need to increase its borrowings to fund a likely rise in inventory build-up.

Business review: A resilient and balanced group

Demand for artec's services has remained robust, with its diversified business model meaning that the group has continued to make progress: focusing on security solutions for government clients in the DACH region, while also offering scalable cloud/SaaS solutions to the media sector internationally. Despite the impact of COVID-19, the company has continued to operate at full capacity (with no furloughing of staff/short-time working), while investing in business development.

artec's customers include both German and international companies, including eight of the 14 German federal media authorities. artec has also signed contracts worth €0.2m with security authorities in the DACH region. Following a sales drive in FY19 and FY20, artec has built a significant order book, with further interest received from clients in the Middle East, although international business, particularly in the Middle East, has been difficult to finalise in the absence of face-to-face meetings.

In FY20, two-thirds of artec's business was in video security, with one-third in media and broadcast. Video security revenues are highly localised and defensible and have held up well under the challenging economic environment that persists, with artec well-established in its target market. In the medium term the media business has strong growth prospects with the adoption of artec's cloud solution and market share gains from the departure of Verizon Volicon. However, with trade fairs cancelled and business development constrained by the pandemic, we do not expect a material pick-up in sales in FY21 (although consensus anticipates a 39% rise in sales in FY21). We expect a similar balance between video security and media and broadcast revenues in FY21 as in FY20.

Highlighting the modular and flexible nature of artec's technology solution, management has launched a series of evolutionary new products in FY20, attracting new clients:

- **MULTIEYE NEXT:** a market-leading, client-operated video management system, including AI-based video analysis, and encrypted recording and transmission for the private sector. The system supports multi-monitor operation as well as a fully automated video display wall. In partnership with an international infrastructure and security company, artec received its first order to equip situation centres for highway monitoring in Slovakia. Further contracts with this same partner are in the pipeline.
- **MULTIEYE BOS Manager:** artec developed MULTIEYE BOS Manager for situation centres and security control centres ('BOS' in German). The first client to use the solution, a federal authority, has been trialling it since Q120 and artec has recently received a follow-on order worth c €400–500k to roll out the platform more widely in FY20.

Despite the challenging economic environment, artec has a robust pipeline of new business in both broadcast and security segments, including multi-year, multi-million-euro contracts with key federal security clients. As such, management remains confident in the outlook for the business.

Valuation: Upside potential in the medium term

artec has no clear peers; however, with strong revenue growth and a positive outlook, the quoted European software peer group typically trades in a range of c 4–5x EV/sales and 15–20x EV/EBITDA. Palantir, a US data-mining company predominantly serving US defence agencies, that is now starting to move into the UK and Europe, offers parallels to the security side of artec's business and trades on c 100x consensus FY21 EV/EBITDA. Another US business, Veritone, operates a similar model to artec, integrating third-party solutions into its platform, but is expected to be significantly loss making for the foreseeable future, yet trades on c 10x FY20 revenues.

Artec delivered a resilient performance in FY20 and the group's prospects in the medium term remain strong. However, in our opinion given both the continuing impact of the pandemic and semiconductor shortages, consensus forecasts for FY21 might look optimistic. Artec trades on 3.7x consensus FY20 EV/revenues and 34x EV/EBITDA, falling to 24x FY22e EV/EBITDA. If management can leverage artec's market position in both security and media to operate closer to capacity, there is scope for sustained profit progression as the group's recurring revenue base grows. This could lead to a share price uplift over the medium term, assuming artec trades in line with its European software peer group.

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