

# Kape Technologies

## Intego deal adds Mac and anti-malware capability

Kape's acquisition of Intego for \$16m looks a good fit. It broadens Kape's portfolio by adding anti-malware software and significantly strengthening its Mac offering. We see good scope for sales synergies through cross-selling and leveraging Kape's customer acquisition platform. The deal boosts our FY18 and FY19 EPS by 2% and 9% respectively, while synergies should strengthen beyond our forecast period.

Year end	Revenue (\$m)	EBITDA* (\$m)	PBT* (\$m)	EPS (c)	EV/EBITDA (x)	P/E (x)
12/16	56.5	6.4	4.8	2.9	23.9	50.2
12/17	66.4	8.3	7.5	4.8	18.6	30.0
12/18e	75.9	10.6	9.1	5.5	14.4	26.5
12/19e	84.6	14.5	12.5	7.5	10.6	19.5

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

## Strengthening the portfolio and development team

Intego provides a suite of products including anti-malware, firewall and parental control products to 150,000 Mac users, all on a subscription basis, significantly strengthening Kape's position in the Mac ecosystem. The anti-malware product in particular, fills a big gap in Kape's portfolio, while the Intego engineering team will also strengthen the company's product development capability.

## Sales synergies thorough leveraging Kape's platform

The deal creates the potential for sales synergies in three areas: cross-selling Intego's anti-malware product to Kape's existing Mac user base; using Kape's digital marketing expertise across Intego's product suite; and using the strengthened engineering team, Intego product core to develop a windows antimalware product. Once released this should be a highly complementary addition to the portfolio.

## Executing the strategy

This deal delivers on many of the strategic initiatives we highlighted in [Unveiling Kape](#) (June 2018). Aside from building scale and bolstering its cybersecurity offering, it accelerates the company's transition to a SaaS and subscription-based model. If delivered, we believe this transition will bring improved earnings visibility that should be rewarded with a higher rating. We would expect Kape to continue to use its balance sheet cash to enhance its scale and accelerate this transition.

## Valuation: Clear catalysts for upside

Factoring in Intego (assuming little near-term benefit from revenue synergies), raises our FY19e adjusted EPS forecasts by 9% to 7.5c. At the current share price, this implies a P/E multiple of 19.5x, broadly in line with peers (c 20x, see Exhibit 2). However, stripping out the FY18 cash estimate of \$53m (post Intego acquisition), Kape trades at just 14.5x FY19e P/E. We see a number of potential catalysts for upside: stronger realisation of synergies or further earnings-enhancing acquisitions could drive EPS upside and we see scope for a rerating upwards as the business migrates to a recurring subscription model.

## Acquisition of Intego

### Software & comp services

24 July 2018

**Price** 111p

**Market cap** £158m

£:US\$1.32

Net cash (£m) at December 2017 69.5

Shares in issue 141.9m

Free float 27%

Code KAPE

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (11.8) 1.4 76.4

Rel (local) (12.2) (2.5) 71.0

52-week high/low 127.5p 59.0p

### Business description

Kape Technologies specialises in the online distribution of consumer cyber security software. It markets four proprietary products: PC repair and maintenance (Reimage and Reimage for MAC), PC driver repair software (DriverAgent) and a virtual private network (CyberGhost).

### Next events

Trading update July 2018

H1 results October 2018

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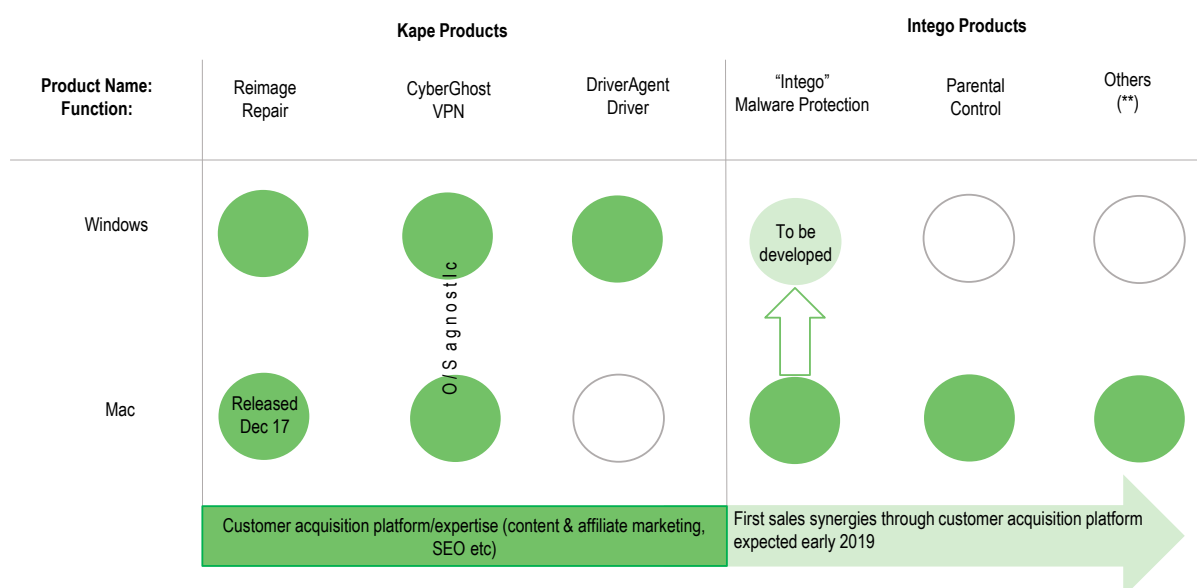
## Investment summary

### Deal summary

Kape has agreed to pay \$16m (£12.4m) in cash for 100% of Intego, a provider of anti-malware, firewall, anti-spam, backup, data protection and parental controls for Mac users. The company has 150,000 subscribers, generating \$6m in annual revenues (an average annual subscription of \$40 per customer). The customer renewal rate of 75% compares well with Kape's existing subscriber base. The consolidation is effective from 23 July 2018.

We believe this deal delivers on many of Kape's strategic priorities. It adds scale and broadens the company's cyber security portfolio, giving it more product to sell via its customer acquisition platform (all of Intego's subscribers have thus far been acquired through organic sources). The deal also supports Kape's transition to a SaaS subscription model with 100% of revenues from subscriptions and a 75% renewal rate.

#### Exhibit 1: Product and sales synergies



Source: Edison Investment Research. Note: \*PC version to be developed; \*\*other includes firewall, anti-spam, backup, data protection and parental controls

### Key benefits: Boosting the portfolio and cross-selling

Intego appears to be a very good fit for Kape. As Exhibit 1 highlights, its flagship Malware Protection product fills a gap in Kape's existing portfolio. Anti-malware software is an essential component of a suite of consumer cybersecurity products, which adds substantial credibility to its proposition. It also enhances its position in the Mac ecosystem (a market it has begun to explicitly target only recently) and gives the company a greater North American presence. Combining Intego and Kape's product development teams gives the group much greater resources to build new products. Management expects to develop an anti-malware product for Windows based on Intego's technology and release it during 2019.

We believe the deal also has the potential to generate revenue synergies. These can be categorised in three areas:

- By applying Kape's digital marketing expertise, arguably its key differentiator, to the Intego product base, the company believes it should be able to substantially increase the current subscriber base. We believe the benefits here should be relatively large and achievable in 2019.
- By cross-selling Intego's flagship anti-malware product to its existing Mac customers, the company believes it can accelerate its nascent presence in this market. It may take some time to fully integrate the product portfolios and may be relatively modest given the small size of the addressable market.
- Once an anti-malware product for the windows user base has been developed, Kape will be able to bundle this with its existing customer base. We believe this could take some time to align but it could be significantly boost revenues.

We understand that prior to the acquisition Intego was run as a cash cow. We believe the combination of these synergies should drive a progressive return to growth over 2018, 2019 and 2020.

## Financials: Accretive deal, modestly priced

Assuming the deal is consolidated from 23 July, we expect Intego to contribute revenue of \$3m in FY18 (\$6m pro-forma, assuming an average annual subscription of \$40 per customer) rising to \$7.5m (25% growth) in FY19, driven by organic growth, cross-selling and leverage from Kape's customer acquisition platform.

Intego generated profit before tax of \$1.4m in FY17. There will be initial investment in setting up the customer acquisition platform for Intego, hence the modest profit forecast for Intego in FY18. Supported by cost synergies, we expect EBITDA margins to be broadly similar to Kape's levels (15-17%) in FY19. Further revenue synergies should release into FY20 contribution from PC anti-malware software and full benefit from leveraging Kape's customer acquisition platform. Having incorporated Intego's acquisition, at this point we make no changes to underlying forecasts for Kape set out in our initiation report [Unveiling Kape](#) (June 2018) but would highlight that the company is expected to release a trading statement shortly.

We estimate that the \$16m price tag implies a 2.1x FY19e revenue and FY19e EBITDA multiple of 7x for Intego. The deal is immediately earnings accretive, raising our FY18e and FY19e EPS estimates for Kape by 2% and 9% respectively.

### Exhibit 2: Estimate changes

	\$000s	2017	2018e	2018e	Change	2019e	2019e	Change
31-December		IFRS	Old	New		Old	New	
INCOME STATEMENT								
Revenue		66,383	72,892	75,882	4%	77,084	84,587	10%
EBITDA		8,261	10,341	10,643	3%	13,249	14,469	9%
Operating profit (before amort. and except.)		6,946	8,891	9,123	3%	11,499	12,579	9%
Profit before tax (norm)		7,509	8,919	9,109	2%	11,544	12,544	9%
Profit before tax (reported)		(2,036)	7,719	7,909	2%	10,244	11,244	10%
EPS - diluted normalised (c)		4.85	5.37	5.48	2%	6.88	7.47	9%
EPS - basic reported (c)		(1.77)	4.67	4.78	2%	6.14	6.75	10%
Closing net debt/(cash)		(69,502)	(69,022)	(53,140)	-23%	(76,724)	(61,508)	-20%

Source: Edison Investment Research, Company Reports

## Valuation

Factoring in the acquisition, at the current share price, Kape trades at a FY19e P/E multiple of 19.5x, broadly in line with UK software and b2c security peers (20.1x and 20.2x respectively). However, stripping out FY18e \$53m cash estimate (post acquisition of Intego), Kape trades at just 14.5x FY19e P/E. We see a number of potential catalysts for upside: stronger realisation of synergies or further earnings-enhancing acquisitions could drive EPS upside and we see scope for a rerating upwards as the business proves its model and migrates to a recurring subscription revenue profile.

**Exhibit 3: Valuation vs peer groups**

	Current price (ccy value)	Market cap (m)	EV/sales 1FY (x)	EV/sales 2FY (x)	EV/EBITD A 1FY (x)	EV/EBITD A 2FY (x)	EV/EBIT 1FY (x)	EV/EBIT 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
Kape Technologies	111.0	158	2.0	1.8	14.4	10.6	16.8	12.2	26.5	19.5
Customer acquisition average			1.2	1.1	5.1	4.7	7.8	7.0	10.0	8.9
B2C cyber security average			3.9	3.7	15.3	12.1	22.0	15.9	30.5	20.2
B2B cyber security average			5.8	5.0	24.4	26.0	28.8	23.5	44.9	36.1
Uk software average			3.1	3.0	13.9	12.0	17.4	15.3	23.2	20.1

Source: Edison Investment Research, Bloomberg consensus. Note: Priced at 19 July 2018.

**Exhibit 4: Financial summary**

	\$'k	2016	2017	2018e	2019e
31-December		IFRS	IFRS	IFRS	IFRS
<b>INCOME STATEMENT</b>					
Revenue		56,532	66,383	75,882	84,587
Cost of Sales		(37,277)	(42,366)	(45,415)	(46,909)
Gross Profit		19,255	24,017	30,467	37,678
EBITDA		6,413	8,261	10,643	14,469
Operating Profit (before amort. and except.)		5,034	6,946	9,123	12,579
Amortisation of acquired intangibles		(8,505)	(5,130)	(700)	(700)
Exceptionals		(5,545)	(899)	0	0
Share-based payments		(716)	(3,516)	(500)	(600)
Reported operating profit		(9,732)	(2,599)	7,923	11,279
Net Interest		(328)	(255)	(14)	(35)
Joint ventures & associates (post tax)		47	(40)	0	0
Exceptionals		0	858	0	0
Profit Before Tax (norm)		4,753	7,509	9,109	12,544
Profit Before Tax (reported)		(10,013)	(2,036)	7,909	11,244
Reported tax		(665)	(467)	(1,028)	(1,518)
Profit After Tax (norm)		4,088	7,042	8,080	11,026
Profit After Tax (reported)		(10,678)	(2,503)	6,880	9,726
Minority interests		0	0	(80)	(80)
Discontinued operations		0	0	0	0
Net income (normalised)		4,088	7,042	8,000	10,946
Net income (reported)		(10,678)	(2,503)	6,800	9,646
Average Number of Shares Outstanding (m)		141	142	142	143
EPS - normalised (c)		2.90	4.98	5.63	7.66
EPS - diluted normalised (c)		2.90	4.85	5.48	7.47
EPS - basic reported (c)		(7.57)	(1.77)	4.78	6.75
Dividend per share (c)		0.00	4.93	0.00	0.00
Revenue growth (%)		(-33.2)	17.4	14.3	11.5
Gross Margin (%)		34.1	36.2	40.2	44.5
EBITDA Margin (%)		11.3	12.4	14.0	17.1
Normalised Operating Margin		8.9	10.5	12.0	14.9
<b>BALANCE SHEET</b>					
Fixed Assets		8,729	13,312	26,980	26,782
Intangible Assets		7,113	12,350	25,950	25,528
Tangible Assets		591	815	883	1,107
Investments & other		1,025	147	147	147
Current Assets		80,014	82,430	68,912	80,310
Stocks		0	65	65	65
Debtors		7,950	11,071	10,395	10,150
Cash & cash equivalents		72,064	69,502	53,140	61,508
Other		0	1,792	5,312	8,586
Current Liabilities		(7,339)	(15,028)	(16,997)	(18,664)
Creditors		(7,096)	(10,094)	(10,978)	(10,887)
Tax and social security		0	0	0	0
Short term borrowings		0	0	0	0
Other		(243)	(4,934)	(6,019)	(7,777)
Long Term Liabilities		(851)	(1,342)	(1,342)	(349)
Long term borrowings		0	0	0	0
Other long term liabilities		(851)	(1,342)	(1,342)	(349)
Net Assets		80,553	79,372	77,552	88,079
Minority interests		0	977	977	977
Shareholders' equity		80,553	80,349	78,529	89,056
<b>CASH FLOW</b>					
Op Cash Flow before WC and tax		6,413	8,261	10,643	14,469
Working capital		613	(1,392)	(5)	(1,486)
Exceptional & other		(823)	(624)	0	0
Tax		(904)	(109)	(1,028)	(1,518)
Net operating cash flow		5,299	6,136	9,609	11,465
Capex		(1,678)	(2,020)	(2,088)	(2,192)
Acquisitions/disposals		(1,439)	(5,337)	(16,870)	(870)
Net interest		(281)	156	(14)	(35)
Equity financing		(995)	(1,477)	0	0
Dividends		0	0	(7,000)	0
Other		0	0	0	0
Net Cash Flow		906	(2,542)	(16,362)	8,368
Opening net debt/(cash)		(71,336)	(72,064)	(69,502)	(53,140)
FX		(178)	(20)	0	0
Other non-cash movements		0	0	0	0
Closing net debt/(cash)		(72,064)	(69,502)	(53,140)	(61,508)

Source: Company data, Edison Investment Research

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