EDISON **Scale research report - Update**

artec technologies

Technology

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Carrying sales momentum into FY20

FY19 revenues of €2.0m were weaker than management expected due to a small number of material contracts failing to materialise by year-end. However, those contracts did not disappear and investment in sales in FY19 led to a strong start to H120 (management estimates H120 revenues will exceed €1.5m) with momentum expected to continue in H220. Recent trading has highlighted the benefits of a flexible, diversified business, with the security segment (DACH-focused, government contracts) benefiting, while uncertainty is higher in the broadcast segment (international, private sector clients), despite market share gains following the exit of Verizon Volicon. However, COVID-19 uncertainties make forecasting difficult, particularly for Q420, typically the strongest quarter. With net cash of €0.5m, artec remains sufficiently capitalised and, if management can build on a strong H120, we believe there is significant upside to the shares.

FY19 results: Disappointing Q419, benefit to H120

FY19 revenues fell to €2.0m (FY18: €2.9m) due to a shortfall of expected contracts in Q419, as well as clients preferring multi-year rental contracts over upfront sales. This decline in revenues, together with investment in business development and one-off expenses for the July 2019 capital raise, led to an EBITDA loss of €0.16m (FY18: €0.42m profit) and a €0.68m EBIT loss (FY18: €0.03m profit). However, with €0.54m net cash and an equity ratio of 94.5%, artec remains sufficiently well capitalised to benefit from its investment in FY20 and beyond.

FY20 outlook: Resilient business, strong pipeline

FY20 has started strongly, driven by the investment in sales in FY19. In H120, management expects revenues of €1.5m (H119: €0.9m, 65%+ y-o-y growth) with sales momentum carrying through to H220. Although COVID-19 makes forecasting Q420 difficult, artec has a significant new business pipeline in H220 (€2m+), including key federal security clients, with access to emergency funding in times of crisis. Based on strong demand for its services, management expects a significant year-on-year increase in sales in FY20 and a return to profitability.

Valuation: An option on a significant opportunity

Having invested in business development in H219, artec offers an option on management's ability to scale the business from its current EMEA footprint, seeing the benefit in FY20 and FY21. Although there is no formal guidance, based on strong demand for its services, management expects a significant year-on-year increase in sales in FY20 and a return to profitability.

Historical financials

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	2.5	(0.1)	(0.13)	0.0	N/A	N/A
12/17	1.5	(0.4)	(0.33)	0.0	N/A	N/A
12/18	2.9	0.4	0.01	0.0	N/A	N/A
12/19	2.0	(0.2)	(0.44)	0.0	N/A	N/A

Source: Company accounts

Price	**€3.26**
Market cap	**€9m**

Share price graph

Share details

Code	A6T
Listing	Deutsche Börse Scale
Shares in issue	2.86m
Net cash at 31 December 2019	€0.54m

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

- IP-based, patent-protected technology solutions.
- Strong start to H120 with robust pipeline, capitalising on departure of key competitor.
- Growing list of reference clients in the security sector across the DACH region.
- Moving to a more scalable cloud/SaaS model.

Bear

- Scale and growth potential limited by operational and resourcing constraints.
- Revenue visibility remains restricted.
- Volatile trading history.

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Edison profile page

Video security and media analysis specialist

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.

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 (eg TutorialVIS) 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 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, as was seen in FY19, revenues can be adversely affected in the short term.

FY19 results

FY19 revenue fell to €2.0m (FY18: €2.9m) due to a shortfall in expected contracts being signed in Q419, as well as clients preferring multi-year rental contracts over upfront sales. In FY19, cloud-based recurring revenues grew to represent 12.5% of overall sales. Despite this, the short-term decline in revenues, together with the FY19 investment in business development (including recruitment, marketing and event attendance) and expenses of €0.1m related to the €1m July 2019 capital raise, led to an EBITDA loss of €0.16m (FY18: €0.42m profit) and an EBIT loss of €0.68m (FY18: €0.03m profit). Based on a change to its five-year forecasts, the company also suffered a reversal in deferred tax treatment in FY19, with a non-cash tax charge of €0.52m (FY18: €0.015m benefit), meaning that the overall loss for the year was €1.2m (FY18: €0.042m profit).

Despite a relatively weak performance in FY19, artec has an equity ratio of 94.5% and, with net cash of €0.54m, the business remains relatively well capitalised to benefit from the opportunities in FY20 and beyond.

FY20 has started strongly, driven by the investment in sales in FY19. In H120, management expects revenues of at least €1.5m (H119: €0.9m, 65%+ y-o-y growth) with sales momentum carrying through to H220. Although COVID-19 makes forecasting Q420 difficult, artec has a significant new business pipeline in H220 (€2m+), including key federal security clients (multi-year, multi-million-euro government contracts), with access to emergency funding in times of crisis.

Although not in a position to offer formal guidance for FY20, management believes the business is proving itself in difficult economic times. Management is confident in the outlook for the business and is investing in product development, business development and recruitment to ensure that the business remains well placed to benefit from future opportunities. Based on strong demand for its services, management expects a significant year-on-year increase in sales in FY20 and a return to profitability. While recent margins have been negative, it is instructive to note that artec achieved an 18.4% EBIT margin in FY15, with revenues of €3.5m. Based on this high-water mark, if the company is able to increase revenues with its current staffing and cost base, we believe it should be able to achieve positive EBIT margins and return to profitability.

Exhibit 1: Financial summary

€000s	FY14	FY15	FY16	FY17	FY18	FY19
	HGB	HGB	HGB	HGB	HGB	HGB
INCOME STATEMENT						
Revenue	2,436	3,469	2,475	1,462	2,936	2,010
Operating profit (loss)	108	637	(415)	(776)	33	(683)
Operating margin	4.4%	18.4%	(16.8%)	(53.1%)	1.1%	(33.4%)
Pre-tax profit (loss)	108	636	(414)	(782)	28	(677)
EPS (€)	0.24	0.22	(0.13)	(0.33)	0.01	(0.44)
DPS (€)	0.00	0.00	0.00	0.00	0.00	0.00
BALANCE SHEET						
Total non-current assets	1,797	1,461	1,959	2,196	2,433	2,614
Total current assets	566	1,827	1,905	1,312	1,713	1,322
Total assets	2,363	3,288	3,864	3,508	4,146	3,936
Total non-current liabilities	-	(57)	(71)	(83)	(93)	(73)
Total current liabilities	(276)	(202)	(90)	(523)	(174)	(145)
Total liabilities	(276)	(259)	(161)	(606)	(267)	(218)
Net assets	2,087	3,029	3,703	2,902	3,879	3,718
CASH FLOW						
Net cash from operating activities	227	963	(290)	208	(136)	169
Net cash from investing activities	(331)	(506)	(706)	(595)	(617)	(700)
Net cash from financing activities	104	(218)	989	154	798	1,023
Net cash flow	(1)	239	(7)	(233)	45	492
Cash & cash equivalent end of year	1	240	233	0	46	538

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.

Business review: Diversified and resilient

Demand for artec's services has remained robust due to its diversified business model: 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), invested in business development and hired a senior AI specialist.

The domestic and international sales initiative, started at the end of FY19, has started to deliver returns, with the company announcing that it had received new orders of €400k+ from a number of well-known media companies for the year to 6 April 2020. Further interest has been received from clients in the Middle East, including Qatar and Oman, although new business in the Middle East can be difficult to finalise in the absence of face-to-face meetings. Altogether, artec has a significant new business pipeline for H220 (€2m+), with multi-year, multi-million-euro contracts expected to be awarded in H220, including key federal security clients, with access to emergency funding in times of crisis. The company has also started to invest in inventory to ensure it can fulfil client orders in case of any prolonged supply chain issues in Asia.

In FY19, approximately 60% of artec's business was in video security, with 40% in media and broadcast. Video security revenues are highly localised and defensible but, in our view, the media business has greater growth prospects over the medium term, driven by adoption of artec's cloud solution and market share gains from the departure of Verizon Volicon. However, in FY20 we expect the 60/40 revenue split to persist as the more challenging economic environment favours the more defensive characteristics of the security business.

Highlighting the modular and flexible nature of artec's technology solution, it 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.
- **TutorialVis:** artec has reconfigured proven hardware and software components from its existing video surveillance and transmission systems to enable a tracking camera solution for educational use. This is controlled by an intuitive PC/tablet interface to facilitate interactive online experiments and lessons delivered via for example Microsoft Teams, Skype or Zoom, allowing the teacher/lecturer to move freely around the room while remaining on-screen to the audience. artec is currently bidding with a partner on a multi-million-euro tender to support multiple European higher education institutions, including universities in London and Dublin. The solution will also shortly be offered in a number of German federal school tenders.

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.

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