EDISON

Scale research report - Update

artec technologies

Technology

11 October 2019

Prepped and ready to scale

After a strong FY18 with a number of reference orders, H119 was slower than anticipated. Management remains confident about FY19 (H2 should be stronger than H1 due to year-end budgetary cycles), with additional public service wins indicated in Q4. In media, with the exit of Verizon Volicon from the market management believes artec is well placed to win additional European clients. artec invested in capacity in H119 and raised c €1m of equity capital in July to target these accounts and is considering a convertible bond issue to fund M&A. If management can build on the opportunities outlined, we believe there is significant upside to the shares.

H119 results: Slow H1, stronger H2 anticipated

H119 revenue of €0.9m fell below H118 (€1.4m) due to delays in commissioning a major public sector project and consequential delay in the expected follow-on work. These sales are now expected in a strong H219 (assuming no further delays). As a result, artec made an operating loss (EBIT) of €0.2m (H118: €49k profit). The group ended June with a modest cash position of €1.6k, prior to a 10% (c €1m) capital increase post period end to support sales and to develop its technology base.

An evolving strategy

In terms of new business, management is focused on its strategy of targeting public authorities in the DACH (German-speaking) countries, while offering scalable cloud/SaaS offerings to the media and broadcast sector. Management is also focused on more modular solutions rather than the high-touch, resource intensive, tailored solutions (which it has offered historically) as part of its buy, build and partner approach for its MULTIEYE and XENTAURIX platforms.

Strong pipeline of new business for H219 and FY20

artec's sales pipeline is up 30% on previous years. In the media sector, in H119 artec invested in its cloud infrastructure to ensure it is ready to scale. The team is now focused on business development, actively targeting Verizon Volicon accounts, as well as anticipating three further Qatari projects in H219. In video security, its major FY18 public sector project is in the test phase with acceptance scheduled to take place in Q419 – management expects this to lead to FY19 follow-on orders as budgets are used up by year end.

Valuation: An option on a significant opportunity

Operating in attractive markets, artec offers an option on management's ability to develop a broader-based, more scalable model from its current European footprint.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	1.5	(0.4)	(0.34)	0.0	N/A	N/A
12/18	2.9	0.4	0.02	0.0	187.5	N/A
12/19e	4.0	0.7	0.05	0.0	75.0	N/A
12/20e	6.0	1.3	0.31	0.0	12.3	N/A

Source: Refinitiv

Price	**€3.75**
Market cap	**€11m**

Share price graph

Share details

Code	A6T
Listing	Deutsche Börse Scale
Shares in issue	2.86m
Last reported net debt (€m) at 30 June 2019	0.05

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 technology solution, supported by a German patent.
- Strong customer list, particularly in Europe, with a growing list of reference clients.
- Moving to a more scalable cloud/SaaS model.
- Opportunity to secure market share following the discontinuation of a competitor, Verizon Volicon.

Bear

- Scale and growth potential limited by operational and resourcing constraints.
- Small balance sheet position, with limited cash resources.
- Limited (40%) free float.
- Volatile trading record.

Analyst

Richard Williamson +44 (0)20 3077 5700

tech@edisongroup.com

Edison profile page

Edison Investment Research provides qualitative research coverage on companies in the Deutsche Börse Scale segment in accordance with section 36 subsection 3 of the General Terms and Conditions of Deutsche Börse AG for the Regulated Unofficial Market (Freiverkehr) on Frankfurter Wertpapierbörse (as of 1 March 2017). Two to three research reports will be produced per year. Research reports do not contain Edison analyst financial forecasts.

Technology for video security and media analysis

artec technologies is a specialist in recording and storing audio-visual information. The company operates in two market segments with separate products, based around the same core technology: video security (MULTIEYE) targets state agencies and public authorities in the DACH countries whereas 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's latest product, XENTAURIX 'Mobile TV', will allow live and time-shifted streaming playback on mobile devices.

artec offers a buy, build, partner approach to technology – as well as developing some of its own IP, it partners other software vendors to take advantage of established solutions that can be bolted on to its MULTIEYE and XENTAURIX platforms. Third-party 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. artec's XENTAURIX AI platform was demonstrated at the IBC trade show in Amsterdam. artec constantly seeks to add new functionality, with social media recording and analysis on the platform shortly.

Customers typically sign long-term (three- to four-year) contracts when the software is installed on-premise. artec now also offers a pay-as-you-go (PAYG) cloud-based model and is evolving a hybrid approach. Under the PAYG model, customers upload videos to the 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 €1k–25k per PAYG customer as against one-off orders of typically €100k–1.5m. Consequently, management is confident it can grow the cloud revenue to €1.2m in the near future. artec can also deliver on larger contracts, as exemplified by its customer in Qatar, which has increased the number of channels it takes from 400 to 520; artec can deliver on substantially more channels.

Business review

artec employs c 28 staff, of whom approximately 20 are technicians, operating across two divisions: video security technology and crime prevention for state agencies in the DACH region; and the global media and broadcast sector. For both divisions, artec expects significant new business opportunities in the second half of the year, with its pipeline of high-quality leads 30% above previous years.

Approximately 60% of business is in video security, with the balance (40%) in media and broadcast. Although the video security revenues are highly localised and defensible, in our view the media business has the greater growth prospects so we would expect the business balance to switch over the medium term. artec's cloud solution will also help avoid future resource bottlenecks, as the company moves away from one-off projects (at peak, a recent project involved 80% of artec's staff) towards modular solutions, offering a more scalable (and less lumpy) approach.

Historically, artec started to diversify away from video surveillance work to media analysis, due to the increasing threat of commoditisation from Chinese surveillance systems. However, in the current geopolitical climate, European public authorities strongly prefer to deal with European suppliers. Together with increasing European regulation (eg General Data Protection Regulation), artec's public sector video surveillance position appears significantly strengthened, with rising barriers to entry for foreign competitors.

In video security, artec's major FY18 public sector project is in the test phase with acceptance scheduled to take place in Q419 – management expects this to lead to FY19 follow-on orders (eg with the Austrian state authorities) as public sector budgets are used up by year end. However, any further unforeseen delays might push orders into FY20.

artec has also attracted attention with its privacy-compliant, data collection and analysis platform for public safety organisations. The strength of the platform was underlined in August, with the renewal of artec's contract with the Independent Media Commission for the Republic of Kosovo. The IMC manages, regulates and controls all private and state media companies in Kosovo and has been using XENTAURIX since 2009. The renewal for media monitoring and analysis is in 'the lower six-digit euro range' and is expected to generate sales in the current year.

In H119, artec invested in its cloud infrastructure to prepare for further growth. In media and broadcast, following the departure of Verizon Volicon from the market, artec sees a huge opportunity to significantly increase the company's global market share for monitoring and analytics systems for media companies. This prompted artec to issue 10% of its equity capital in July, raising c €1m, to allow for marketing and business development resources to target Verizon Volicon accounts and build artec's sales pipeline.

Following artec's investment in capacity, management believes the company can generate €4m+ of revenues with current staffing and without a further expansion of its cost base. Recent margins have been negative, however, looking at the 18.4% EBIT margins that artec achieved in FY15, if the company is able to leverage its market position and achieve EBIT margins of 15%+, this would imply potential EBIT of €600k+ at full capacity.

Competitive environment

With the departure of Verizon Volicon from the market, competitors in media analysis include industry giant IBM Watson, Palantir, a private US company and Veritone (Nasdaq: VERI), a Nasdaq quoted company that is probably artec's closest quoted peer. artec recognises no immediate peers offering surveillance solutions to state agencies in the DACH region.

Valuation: Upside potential

There are no immediate peers to artec; however, with strong revenue growth and a positive outlook, the quoted European software peer group typically trades in a range of c 3–5x sales. Veritone (Nasdaq: VERI) operates a similar model to artec, integrating third-party solutions into its platform, whereas IBM Watson, the sector leader, develops its own solutions. Veritone, based on consensus estimates, is expected to be significantly loss making for the foreseeable future (FY20/21 EBITDA losses of $36.5m/$19.6m), has a market capitalisation of $72m and trades on 0.5x FY19 consensus revenues, falling to 0.4x in FY20. Meanwhile, artec, which consensus forecasts to be profitable, trades on c 2.7x FY19 revenues, falling to c 1.8x in FY20.

With the additional funding, if management can convert the promising sales pipeline to successfully leverage artec's market position with additional project wins and operate closer to capacity, there is scope for a return to profitability and a narrowing of the valuation discount to its European software peer group.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia