Allenby Capital

Company Note

Interims

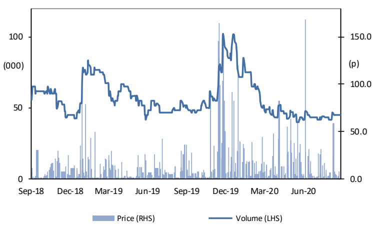
23 September 2020

Corporate

Current price	**67.5**

Sector	**TMT**
Code	**ECSC.L**
AIM	**AIM**

Share Performance



	1m	3m	12m
ECSC.L	+3.8%	+3.8%	-12.9%

Source: Thomson Reuters, Allenby Capital

Share Data

Market Cap (£m)		**7.0**
Shares in issue (m)		**9.1**
52 weeks	High	Low
	152.5p	**60p**
Financial year end		**December 31**

Source: Company Data, Allenby Capital

Key Shareholders

Ian Mann	22.8%
Unicorn AIM VCT	14.5%
Ravinder Bahra	10.7%
Phil Mclear	4.7%
Hargreaves Lansdown	3.4%

Source: Company Data, Allenby Capital

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Equity Research

ECSC Group plc (ECSC.L)

Growth in recurring revenue, return to profit

Interims from ECSC Group plc, the UK's longest-running full service cyber security provider, are in line with August's trading update with group revenue flat but growth in both Managed Detection and Response (MDR) recurring revenue and Assurance. The partner programme is building well with 120 partners generating >160 sales opportunities and contributing 27% of the new client MDR order book and 7% of Assurance revenue. ECSC has further increased its addressable market through May's Nebula Cloud launch. ECSC achieved its target of adj. EBITDA breakeven in May and a move into profit and H1 overall saw a small adj. EBITDA profit of £52k (H1 FY19: £184k loss). It remains reasonably capitalised with cash of £1.25m at H1, although this includes £0.8m of CV-19 related government support. Revenue growth has continued in H2 and ECSC remains profitable in a market where spend is expanding given the ever-increasing volume of cyber security threats. Forecasts currently remain under review.

- **MDR (formerly Managed Services):** Recurring revenue increased 25% to £1.2m and the H1 MDR order book stood at £2.9m (H119: £2.7m; FY19: £2.6m) - incident response revenue was down. MDR revenue offers greater visibility and gross margin should increase as capacity at the company's two Security Operations Centres is utilised. Contract newsflow has been encouraging with a new contract of £190k over three years (June), two totalling £590k for a national charity and high street retailer (March) and a series of new contracts and renewals in January. In May, ECSC launched Nebula Cloud, a cloud-based option for its cyber security breach detection service. This expands ECSC's addressable market as it has a lower entry price and is designed to be sold by resellers.

- **Assurance (formerly Consulting):** Revenue +4% to £1.2m but this was against weak comparator and H1 revenue was down £0.7m sequentially. As expected, there was a reduction in activity in Q2 with clients cancelling or delaying projects that that tend to be conducted on site as CV-19 restrictions came into effect. To put this into context, Q1 Assurance revenue had increased >15%. This reduced utilisation impacted gross margins (H1: 51.0%; FY19: 53.9%) and we would expect an improvement in H2.

- **CV-19 impact and outlook:** ECSC moved quickly to being able to deliver its full range of services remotely, including 24/7/365 monitoring and incident response. The company did make use of government support and has continued to implement a phased return of furloughed employees. H2 has seen a strong recovery in Assurance revenue with July up 33% on the Q2 average and total bookings in mid-September were up 75% on the H1 average. ECSC has also maintained its adj. EBITDA profitability into H2. Cash at 18th September was £1.6m and there is also the unutilised bank facility of £0.5m.

Year End: December					
(£'000)	**2017A**	**2018A**	**2019A**	**2020E**	**2021E**
REVENUE	3,998	5,382	5,905		
ADJ. EBITDA	(2,939)	(635)	1		
ADJ. PBT	(3,187)	(1,026)	(639)		
ADJ. EPS (p)	(34.4)	(10.5)	(6.8)	**Under review**	
NET CASH (£m)	1,531	610	351		
EV/EBITDA (x)	NEG	NEG	>100		
PER (x)	NEG	NEG	NEG		

Allenby Capital acts as Nomad & Broker to ECSC Group plc (ECSC.L).

Please refer to the last page of this communication for all required disclosures and risk warnings.

Investment summary

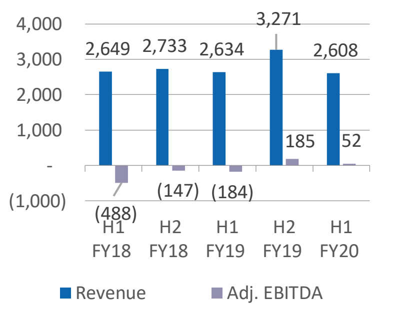
ECSC provides investors with exposure to the UK cyber security services market through its two divisions: Managed Detection and Response (MDR) (managed services and incident response) and Assurance (testing, standards and certification services). Although COVID-19 inevitably disrupted the company in H1 as clients delayed some projects, the pandemic has also created additional opportunities as the number of cyber security incidents has increased as organisations accelerated the existing trend towards remote and cloud-baed working.

ECSC is the UK's longest-running full cyber security provider and enjoys the lowest staff attrition rates in a sector that typically struggles with staff retention. Cyber security breach detection and expert incident response is vital to the protection of personal information and the maintenance of critical IT systems. Outsourcing these critical functions is the logical choice for all but the largest global organisations and ECSC has the technology, expertise and processes to capitalise on the opportunity.

H1 financial performance

ECSC returned to profit in H1 with a £0.2m positive swing in adj. EBITDA to £52k. Although H1 revenue was essentially flat at the group level at £2.6m, recurring revenue in the MDR division increased 25% to £1.2m to represent 45% of group revenue and the H1 order book stood at £2.9m (FY19: £2.6m). Within MDR, Incident Response revenue fell to £0.07m (H1 FY19: £0.31m) given a lack of major cyber security incidents. In Assurance, there was strong performance in Q1 followed by a significant drop at the start of Q2 before some recovery at the end of the quarter. Overall, Assurance revenue increased 4% to £1.2m and 48 new clients were secured (H1 FY19: 59).

Exhibit 1: Revenue & Adj. EBITDA (£000s)

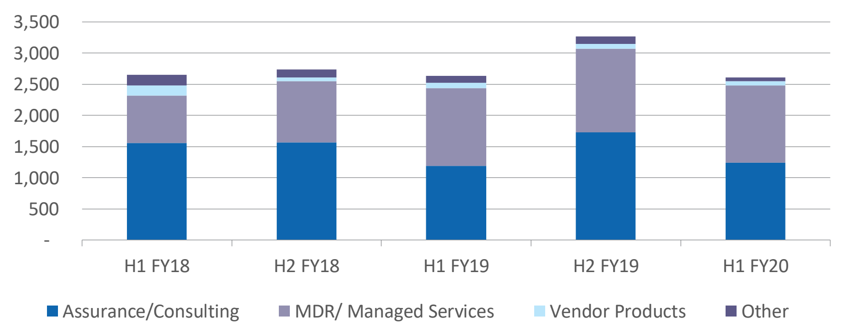


Source: Company; Allenby Capital

The H1 MDR order book stood at £2.9m, a combined measurement of new client contracts together with renewals of existing client contracts, and deferred income (contracted and invoice revenue yet to be recognised) at £1.4m. Although there is a little overlap between these KPIs, they demonstrate ECSC's increasing revenue visibility. MDR services remain the strategic focus for the company.

Group gross margin increased 140bps to 56%, reflecting improved margins in the Assurance division – 51% in H1 (H1 FY19: 47%) – with the increase in revenue. MDR margin fell 200bps to 67%, a function of the fall in the higher margin but lumpy Incident Response revenue. Operating costs fell 6% to £1.6m with lower Sales and Marketing expense given the lack of trade shows and there was a £54k exceptional item associated with a small amount of restructuring in March.

Exhibit 2: Revenue by type (£000s)



Source: Company; Allenby Capital

Exhibit 3: ECSC KPIs

	H1 FY18	FY18	H1 FY19	FY19	H1 FY20
Revenue growth	43%	35%	-1%	10%	-1%
Managed Detection & Response Recurring Revenue Growth	52%	46%	28%	27%	25%
Managed Detection & Response Recurring Revenue Proportion	29%	29%	35%	34%	45%
Managed Detection & Response Order Book (£m)	2.4	2.5	2.7	2.6	2.9
Managed Detection & Response Gross Margin	41%	53%	69%	68%	67%
Assurance Repeat Revenue	78%	78%	77%	73%	69%
Assurance Gross Margin	57%	57%	47%	54%	51%
Contract liabilities (Deferred Income) (£m)	0.9	0.9	1.1	1.2	1.4
Research and development (% of revenue)	9.2%	8.5%	11.8%	13.0%	14.0%

Source: Company

H1 cash of £1.3m (H1 FY19: £0.2m; FY19: £0.4m) benefited from the swing into profit but also included £0.8m of COVID-19 related medium-term government support and was bolstered by April's £0.5m (gross) raise. ECSC also has an unutilised £0.5m bank facility.

Indirect channel

ECSC is successfully building its indirect channel as a means of extending its sales reach. Cyber security represents an attractive growth market but resellers recognise the need for specialist skills and are hence happy to refer business. At H1, ECSC had 120 partners and these generated >160 sales leads. During H1, the partner programme contributed 27% of the new client recurring revenue MDR order book and 7% of Assurance revenue. Many of these partners were focused on helping clients establish remote and cloud working. These working practices present additional cyber security challenges and we anticipate increased indirect sales going forward.

Nebula Cloud

In May, ECSC announced the Nebula Cloud cyber security breach detection service. This takes ECSC's existing 24/7/365 managed service, that uses its proprietary KEPLER artificial intelligence (AI) technology, and introduces cloud-based service options. This increases ECSC's addressable market as it will offer a lower cost of entry and is designed for the wider reseller base.

Nebula Cloud enables users to collect, store, and use AI to analyse IT system logs and generate 24/7 alerts to potential cyber security breaches. This system, when combined with the ECSC mature Security Operations Centres, expert management, and incident response, gives a fully functioning Security Orchestration, Automation and Response (SOAR) service. The service is being made available in three variants that are set at lower price points than ECSC's traditional MDR offering.

KEPLER sits at the core of ECSC's 24/7/365 security monitoring and breach detection services and aids ECSC's engineers at its SOCs in the UK and Australia to process billions of client security events each month in order to identify cyber security breaches at the earliest stage and enable clients to contain and repel attacks before data breaches occur. KEPLER complements the work of ECSC's engineers rather than replacing them.

Good start to H2

Management reports a good start to H2 with Assurance revenue up 33% in July on the Q2 average and total bookings in mid-September up 75% on the H1 average as clients are resuming projects (both on-site and working remotely). ECSC continues to be profitable at the adj. EBITDA level and cash as at 18th September stood at £1.6m.

Disclaimer

Research Recommendation Disclosure

David Johnson is the author of this research recommendation and is employed by Allenby Capital Limited as an Equity Analyst. Unless otherwise stated, the share prices used in this publication are taken at the close of business for the day prior to the date of publication. Information on research methodologies, definitions of research recommendations, and disclosure in relation to interests or conflicts of interests can be found at www.allenbycapital.com. Allenby Capital acts as Nomad and broker to ECSC Group plc.

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