![Allenby Capital]

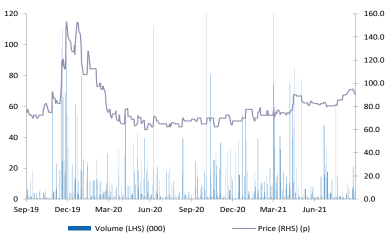
Company Note

Interims
22 September 2021

Corporate

Current price	90.5p
Sector	TMT
Code	ECSC.L
Listing	AIM

Share Performance



	1m	3m	12m
ECSC.L	5.2%	9.7%	34.1%

Source: Thomson Reuters, Allenby Capital

Share Data		
Market Cap (£m)		9.1
Shares in issue (m)		10.0
52 weeks (p)	High	Low
	95.0	62.5
Financial year end		31 December

Source: Company Data, Allenby Capital

Key Shareholders	
Ian Mann (CEO)	23.1%
Unicorn Asset Management	14.5%
Ravinder Bahra	10.7%
Hargreaves Lansdown	5.2%
Phil Mclear	4.7%

Source: Company Data, Allenby Capital

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Equity Research

ECSC Group plc (ECSC.L)

Strong revenue growth across Assurance and MDR

Encouraging interim results from the UK's longest-running 'full service' cyber security provider with strong revenue growth in the two key divisions: Assurance (+20%) and Managed Detection & Response (MD&R) (+17%) and group +15.3% to £3.0m. Higher utilisation in Assurance increased group gross margin (60.4% vs 56.1%) but the planned investment meant adj. EBITDA decreased to £19k (H1 FY20: £52k). The accelerated adoption of remote and cloud working occasioned by COVID-19 has increased the number of attack surfaces that need protecting and cyberattacks continue to proliferate, particularly ransomware. Outsourcing remains the only logical choice for all but the largest organisations and ECSC has proven expertise and an experienced team, backed by its proprietary technology stack and is well positioned to capitalise. Revenue and profit forecasts and 130p/share fair value remain unchanged though we trim our FY21 cash forecast for some working capital expansion that reverses in FY22.

- **Financial performance:** H1 FY21 revenue increased 15% to £3.0m with Assurance (testing, standards and certification services) +20.0% to £1.5m and MD&R +17.0% to £1.4m. The latter included Incident Response of £0.14m (H1 FY20: £0.07m). The non-core Vendor Products revenue fell 30% to £0.05m and group revenue was up 15.3% to £3.0m. Increased Assurance utilisation resulted in divisional gross margin increasing to 61% (H1 FY20: 56%) and this more than offset the lower GM at MD&R (64% vs 67%) on increased investment. Operating costs also increased 16.0% to £2.0m and adj. EBITDA reduced to £19k (H1 FY20: £52k). ECSC continues to invest in its technology stack with R&D spend equivalent to 16% of revenue and £0.1m was capitalised. Cash, including COVID-19 support, reduced £0.6m to £0.6m during H1. The Group's £0.5m bank facility remains unutilised.

- **Outlook:** Cyber security remains a key organisational priority and area of IT spend. The adoption of cloud computing and remote working has significantly increased the number of surfaces that need to be secured and the volume of attacks continue to increase, particularly highly disruptive ransomware attacks. Ransomware and the threat of major fines also keeps cyber security at the top of the corporate agenda. The cost of 24x7 coverage and the widely reported shortage of cyber security skills means that outsourcing remains the only logical choice for all but the largest organisations. ECSC brings considerable experience and expertise backed by its proprietary AI technology stack. This is a key differentiator and enables scaled growth.

Year End: 31 December					
(£'000)	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
REVENUE	5,382	5,905	5,663	6,563	7,898
ADJ. EBITDA	(635)	1	375	153	564
ADJ. PBT	(1,026)	(639)	(153)	(346)	(0)
ADJ. EPS (p)	(10.5)	(6.8)	(0.9)	(3.6)	(0.0)
NET CASH	610	351	1,122	562	1,170
EV/REVENUE	1.6	1.5	1.4	1.3	1.0
EV/EBITDA (x)	NEG	>100	21.2	55.5	14.0

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

Investment summary

Return to revenue growth

Interims results, as flagged in July's trading update, demonstrate that both main ECSC divisions have returned to revenue growth as the disruption associated with the pandemic begins to subside and corporates resume spend on cyber security. The pandemic has accelerated the existing trend towards remote and cloud working and this has increased the need for investment in cyber security as the number of potential attack surfaces has expanded. Management controlled costs and made use of government schemes during the worst of the lockdown but has since returned to investment to capitalise on the opportunity. This, as anticipated, is creating short term pressure on profitability.

ECSC Group plc provides investors with exposure to the growing cyber security services market through its two divisions: Managed Detection and Response (MDR) and Assurance. MDR covers managed services (monitoring and alerting) and incident response and Assurance involves services around penetration testing, standards and certifications. The total annual UK cyber security market is estimated to be worth >£8bn and growing c. 9% per annum.

Longest-running full service cyber security provider

ECSC represents the UK's longest-running full service cyber security provider with more than twenty years' experience. Over this time, it has built its own proprietary technology stack to support its Security Operations Centres (SOCs) in the UK and Australia. The systems are designed to enable operators to cover multiple clients from a single interface and the IP includes the KEPLER AI system that sifts through vast quantities of data logs to identify potential incidents that require further human investigation. ECSC continues to invest in its IP, spending c. 14% of revenue per annum. The company also enjoys the lowest staff attrition rates in a sector that has consistently struggled with staff retention (91% retention in 2020).

Broad customer base

ECSC has a broad base of customers across multiple sectors with no major revenue concentration – in H1 FY21 the largest customer accounted for c. 6% of revenue and the top five Assurance and MDR clients accounted for 7% and 34% respectively. ECSC also counts 10% of the FTSE 100 as clients. It operates predominantly in the UK but has done work in more than thirty countries. The company also has a long history of organic growth, typically averaging 20% per annum. Although it will look at acquisitions, management does not believe that acquisitions are necessary to fuel growth. In 2019, it initiated a Partner Programme that enables it to expand its addressable market. Having recruited a base of partners, the focus is now on developing those that can deliver larger MDR clients.

Reintroducing physical events

MDR contracts provide greater revenue visibility and represent a much more scalable model as they leverage ECSC's SOCs and AI technology. Increased SOC utilisation drives margin appreciation at the divisional and group level. During FY20, ECSC successfully switched its marketing to monthly webinars from quarterly physical events given the lockdowns. As COVID-19 restrictions are lifted, the company is reintroducing physical events (three scheduled in London and three at its Bradford HQ) alongside the webinars. Face to face meetings and showcasing the SOC should help to drive MDR sales pipeline conversions as potential customers can see the scale of ECSC's operations.

Fair value of 130p/share

The ECSC share price has appreciated 34% over the past twelve months but still fails to reflect the company's considerable experience and expertise in the cyber security sector, its history of growth (before the 2020 blip) and the value of its technology stack. We maintain a fair value of 130p/share, equivalent to an FY22 EV/revenue of 1.5x and an EV/EBITDA of 21.0x.

Although this represents a significant upside to the current price, the fair value multiple remains modest compared to many others in the cyber security space, particularly given the investment made in its technology offering. For example, NCC (NCC.L) that offers both cybersecurity and software resilience is currently on an FY22 EV/Revenue of 2.8x.

Meanwhile many of the other listed cybersecurity players with an investment in IP remain loss-making. As ECSC demonstrates its return to revenue growth and margin appreciation through greater SOC utilisation, we would expect the FV multiple would increase.

Exhibit 1: Summary financials

	H1 FY20	H1 FY21	% change
Revenue			
Assurance	1,241	1,489	*20.0%*
MDR	1,239	1,450	*17.0%*
Vendor Products	70	49	*-30.0%*
Other	58	19	*-67.2%*
	2,608	**3,007**	***15.3%***
Gross Margin			
Assurance	*51%*	*61%*	*10.0ppts*
MDR	*67%*	*64%*	*-3.0ppts*
Vendor Products	*20%*	*16%*	*-5.0ppts*
Other	*-33%*	*-153%*	*NEG*
Gross profit	**1,462**	**1,816**	***24.2%***
Gross margin	***56.1%***	***60.4%***	***4.3ppts***
Adjusted EBITDA*			
Other Income	211	117	*-44.5%*
Sales & Marketing Costs	-844	-1025	*21.4%*
Administration Expenses (excl. depreciation & amortisation)	-888	-984	*10.8%*
Adj. EBITDA	**52**	**19**	***-63.5%***
EBITDA			
Share Based Payments	-57	-69	*21.1%*
Exceptional Items	-54	-26	*-51.9%*
EBITDA	**-59**	**-76**	***NEG***
Cash	**1,258**	**591**	***-53.0%***

Source: Company; Allenby Capital. * excludes one-off and share-based charges

H1 FY21 revenue increased 15% to £3.0m with Assurance +20.0% to £1.5m and MD&R +17.0% to £1.4m. The latter included Incident Response of £0.14m (H1 FY20: £0.07m). The MDR order book saw an £0.1m increase in H1 to £2.7m (Exhibit 2) but existing clients tended towards shorter service contracts and renewals, there is some churn in the base and decision cycles at potential clients have yet to normalise. Assurance Repeat Revenue was particularly high at 83% as management successfully upsold into the base. The non-core Vendor Products revenue fell 30% to £0.05m and client chargeable expenses (Other) fell 67% to £0.02m. Group revenue was up 15.3% to £3.0m.

Increased Assurance utilisation resulted in divisional gross margin increasing to 61% (H1 FY20: 56%) and this more than offset the lower GM at MD&R (64% vs 67%) on increased investment. We would expect Assurance gross margin would reduce to the mid-50s as more normal utilisation rates return. Group gross margin increased 4.3ppts to 60.4%.

Exhibit 2: Key performance indicators

	H1 FY20	FY20	H1 FY21
Revenue growth	-1.0%	-4.0%	15.0%
Managed Detection & Response Recurring Revenue Growth	25.0%	22.0%	12.0%
Managed Detection & Response Recurring Revenue Proportion	45.0%	43.0%	44.0%
Managed Detection & Response Order Book (£m)	2.9	2.6	2.7
Managed Detection & Response Gross Margin	67.0%	73.0%	64.0%
Assurance Repeat Revenue	69.0%	73.0%	83.0%
Assurance Gross Margin	51.0%	58.0%	61.0%
Research and development (of revenue)	14.0%	14.0%	16.0%

Source: Company; Allenby Capital

Operating costs (excluding depreciation and amortisation) increased 16.0% to £2.0m and R&D tax credit reduced (Other income) to £0.1m (H1 FY20: £0.2m). As a result, adj. EBITDA reduced to £19k (H1 FY20: £52k). ECSC continues to invest in its technology stack with R&D spend equivalent to 16% of revenue and £0.1m was capitalised.

Cash, including £0.14m of COVID-19 medium-term government support, reduced £0.6m to £0.6m during H1 (FY20: £1.1m cash, including £0.4m of support). This reflected the investment in operations and R&D, and some working capital expansion. We would anticipate some recovery in cash levels in H2 but to a lower level than previous expected and hence we reduce our FY21 cash forecast to £0.6m from £1.1m. This should improve in FY21 as more MDR contracts are secured and the FY22 cash forecast remains unchanged (£1.2m). The company continues to be capex light and has very low levels of bad debt. The Group's £0.5m bank facility remains unutilised.

Post period end (August), the company announced that the High Court had approved the cancellation of the balance (£6.1m) of the share premium account. As a result, ECSC will have distributable reserves that can be used to pay dividends or make distributions to shareholders and/or undertake a share repurchase programme when deemed appropriate.

Review of operations

Managed Detection & Response

24/7/365 'eyes on glass'

ECSC's Security Operations Centres in the UK and Australia providing true 24/7/365 'eyes on glass' monitoring, alerting and incident response to clients. Australia is a trusted regulatory/government location rather than offering cost-saving through offshoring. The use of SOCs in different time zones also addresses the challenges of recruiting and retaining staff willing to work night shifts.

ECSC's Managed Detection & Response division delivers a wide range of managed technologies that can be categorised as Protect, Detect and Respond.

Protect systems are designed to block attacks without requiring time-consuming analysis and investigation:

- Firewalls to provide external network protection and internal segmentation of critical systems
- Web Application Firewalls (WAFs) deliver enhanced attack blocking for Internet-facing systems
- Intrusion Prevention Systems (IPS) are designed to automatically block suspicious traffic
- Internal and external scanning to confirm an organisation's current vulnerability status

Detect systems form part of the overall Security Information & Event Management (SIEM) solution. These combine cyber security event sources, such as Intrusion Detection Systems (IDS), System Logging and File Integrity Monitoring (FIM). This is supported by ECSC's proprietary KEPLER AI engine to correlate events and support expert engineer analysis and breach identification. Protect and Detect are critical in protecting companies against the increasing wave of ransomware attacks, where hackers encrypt an organisation's data and back-ups and demand the payment of a ransom before releasing the decryption key.

Respond, delivered by ECSC's Incident Response Team, focuses on:

- Investigation – confirm the scope and nature of the breach
- Containment – limit the damage and block further intrusions

- Recovery – restore IT systems and related business functions
- Communications – help with timely communications both internally and externally

Nebula Cloud

Cloud-based service

In May 2020, ECSC announced the Nebula Cloud cyber security breach detection service. This takes the existing 24/7/365 managed service, that uses KEPLER and introduces cloud-based service options. This increases the addressable market as ECSC is able to offer a lower cost point of entry and is designed for the wider reseller base to sell.

Assurance services

Highly qualified

All of ECSC's consultants are highly qualified with a minimum qualification of the Certified Systems Security Professional (CISSP). The company's PCI specialists are all Payment Card Industry Qualified Security Assessors (PCI QSA) and the ISO 27001 specialists have all passed the ISO 27001 Lead Auditor examination. ECSC was also the UK's first PCI cyber security Level 1 Service Provider.

Testing

ECSC offers a wide range of security testing services, including:

- Annual external and/or internal penetration testing
- Specific application penetration testing
- Code auditing
- Social engineering testing

ISO 27001

ECSC can help clients prepare for the UKAS/ANAB accredited certification body assessment. If a client is already certified, or following a successful certification project, ECSC can help clients to manage and maintain their Information Security Management System.

Cyber Essentials

Cyber Essentials is a cyber security standard introduced by the UK government in 2014 that aims to provide organisations of all sizes with basic, cost-effective protection against the most common Internet-based threats.

ECSC is a Certifying Body for the Cyber Essentials programme; this means it can conduct an assessment, report the outcome to the Accreditation Body (IASME), and ultimately, issue certificates.

Cyber Security Review

ECSC's Cyber Security Review is designed to assess the key aspects of an organisation's IT security related infrastructure, processes and technical management capabilities, and balance these against the cyber threats that are most relevant to a business. As well as identifying potential vulnerabilities, the review will also recommend targeted improvements.

An ECSC Cyber Security review utilises three essential components, all unique to ECSC:

- **ECSC Cyber Security Priorities** - areas of IT security protection that directly impact on an organisation's risks of a serious cyber security breach.

- **ECSC Cyber Security Matrix** - a scoring tool covering an organisation's current capability and the risks that it faces.

- **ECSC Cyber Security Quadrant** - an Executive level reporting system that provides management with a clear picture of an organisation's current position and enables resource decisions.

Payment Card Industry Data Security Standard (PCI DSS)
As Qualified Security Assessors (QSAs), ECSC's role is to:

- Help organisations understand their PCI DSS compliance obligations and options

- Support organisation through a development programmed to deploy compliant systems (and remove others from scope)

- Assess an organisation against the standard, either as a Merchant reporting to its bank, or as a Service Provider.

- ECSC also supports clients through to compliance following a breach of card data.

Exhibit 3: Accreditations

Payment Card Industry (PCI) DSS Level 1 Certified Managed Security Services Provider
A CREST Member Company – a recognised level of expertise in security and penetration testing
Certified to ISO 27001 in 2006 within one month of its release
ISO 9001 certification covering consulting and security management systems
ISO 20000 certification covering managed security services
PCI Qualified Security Assessor (QCA) accreditation

Source: Company

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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