Please find below our weekly update covering themes that we feel that are of interest to investors and participants in the small and mid cap TMT sector as well as commentary on recent newsflow. The cost of Allenby Capital's research on individual clients is paid for by our research clients.

For the purpose of MIFID II, the content of the following email qualifies as "non-substantive material or services consisting of short term market commentary on the latest economic statistics or company results" and so can be treated as 'acceptable minor non-monetary benefits' and not as 'chargeable research' per the European Commission's Delegated Directive of 7.4.2016.

TMT UPDATE - 02.07.18 (D4T4.L, IMO.L, RCN.L)

D4T4 plc (D4T4.L, 145p/£55.1m)
Finals: Impressive H2 performance (26.06.18)

- Revenue +13.7% to £20.1m (+18.5% on constant currency basis - 80% of revenue are dollar denominated) and adj. PBT +22.0% to £5.2m, as flagged in April's pre-close. Projects increased 31.1% to £12.4m and recurring revenue +6.5% to £4.8m whereas licence sales reduced 21.8% to £2.9m. Adj. EPS +10.4% to 11.0p and DPS +11.1% to 2.50p.
- FY18 performance was characterised by a very heavy weighting to H2 (78% of revenue) and to Q4. As a result, there was a substantial increase in working capital - trade receivables increased £16.2m to £20.5m and trade payables increased £12.8m to £18.1m - deferred income increased £9.8m to £12.4m. Consequently, operating profit cash conversion was low (£0.8m from £4.4m). Year-end net cash of £3.9m (FY17: £5.1m). Management reports an unwinding of working capital and expects FY19 to be more balanced H1/H2 and then move to a more traditional 45%/55%.
- Growth in demand for term/recurring licence sales of its Celebrus product set has pushed down perpetual licence sales but increased recurring revenue. Second, increase in demand for hybrid cloud data platform services, particularly in North America.
- IFRS15 - Management has flagged a potential impact from IFRS15 relating to revenue recognition on its project work and the meeting of performance obligations for FY18. Given the heavy weighting of trade to the end of H2, its initial assessment of the potential impact is a £1.5m to £2m reduction for revenue and £1m to £1.5m in PBT. Any adjustment would likely fall in FY19. There would be no cash implication to the adjustment.

Allenby Capital comment: Market for business intelligence and analytics remains one of the fastest remaining. Within this, Customer Data Platforms D4T4's target market for its Celebrus product that enables companies to communicate with a customer in real-time based on their current and historical activity across multiple channels is expected to grow to $1bn in 2019 from $300m in 2016 (Source: CDP Institute). D4T4's strategy is 'land and expand' offering its customers data capture, platforms, management and analytics. It also sells via partners including SAS, Teradata and Dell EMC. FY18 included 16 multi-year contract wins (12 in financial services and the balance in consumer enterprises) and the two largest contracts in D4T4's history. The heavy H2 weighting will create some distortion around the comparators in FY19 and there is also the potential IFRS15 restatement. Shares are trading on a pretty undemanding 12x FY19 and 10.7x FY20 PER, yielding c. 2% and FY19 should see a substantial increase in net cash as the FY18 working capital unwinds.

IMI Mobile plc (IMO.L, 260p/£160.2m)
Prelims: RCS potential (25.06.18)

- Revenue +46% (organic +7%) to £111.4m and gross profit +17% (organic +3%) to £50.7m. Strong organic growth in Europe & Americas (GP +37%) and India & South East Asia (+18%) partly offset by a decline in MEA (-17%) reflecting currency (Nigeria) and economic headwinds (South Africa) and the full year impact of the renewal of the contract with MTN. New contracts were secured across multiple sectors and multi-year renewal with its largest banking customer. Some momentum in the indirect channel (BT, KCom, InContact and SITA).
- Adj. EBITDA +17% to £13.4m, adj. PBT +4% to £7.8m and diluted EPS +2% to 11.2p. EBITDA margin picked up in H2 and management is targeting 35% over the next few years. Net cash of £4.3m (FY17: £5.2m) with operating cash flow of £9.5m (FY17: £10.0m) offset by the acquisition of Healthcare Communications UK (December). Healthcare (initial £9m and deferred consideration of up to £6m) has substantially increased IMO's position in the UK Public Sector. Sumotext was also acquired in November but the consideration (between $4.5m and $6m) is dependent on EBITDA performance. This has strengthened IMO's position in the US.

Allenby Capital comment: Management's strategy is to grow revenue from existing customers (33 customers now have revenue >£0.5m p.a.), accelerate organic growth via channel partners, introduce new technologies (AI, Google RCS and chat bots) and use acquisitions to increase distribution. IMO is an early launch partner for Google's RCS messaging platform, Google Chat. Rich Communications Services (RCS) is a GSMA standard that has been around for a number of years and uptake has been fairly limited to date. It upgrades SMS with branding, rich media, interactivity and analytics and offers a way for MNOs to regain control of the user experience (and revenue streams) that has been lost to the likes of WhatsApp, Facebook Messenger and native apps. Management expects proof of concepts this year and a few live deployments next and this could represent an interesting area of growth. In the interim, IMO has a substantial customer base that provides high levels of recurring revenue (c. 85%). Shares are trading on an FY18 PER of 21.2x and FY19 16.2x.

Redcentric plc (RCN.L, 85p/£126.5m)
Prelims: Work in progress (25.06.18)

- FY18 revenue down 4% to £100.0m (87% recurring) but adj. EBITDA increased 5% to £18.1m and strong operating cash flow conversion (125%) resulted in a £11.8m reduction in net debt to £27.7m. This is testament to a much stronger financial function (cash collection and cost control) and we expect further cost reductions as more function is relocated to Hyderabad. Adj. EPS down 2% to 4.35p. Dividend remains suspended.
- FY18 performance somewhat overshadowed by June's trading update on FY19. In April, RCN announced that it had won the Yorkshire and Humber Public Sector Network contract, one of the largest procurements in the ongoing Health and Social Care Network (HSCN) programme undertaken by the NHS, worth £70m over four years. Upfront investment and mobilisation costs will impact FY19 performance, however. Management had initially expected FY19 revenue from this contract of £1m to £3m but revised this down to £1.5m and consequently now expects a loss on the contract in the first year (c. £0.6m).
- The trading update also flagged the cancellation of two public sector hosting contracts as customers have opted for the much lower priced Crown Hosting, a JV between Ark Data Centres and the Cabinet Office. RCN is looking to win project revenue from customer migrations (Cloud Transformation Practice) as well as ongoing support and maintenance contracts, albeit at a lower rate. Management doesn't expect any further losses in FY19 but there are other potential migrations further out as contracts come up for renewal.

- New business order intake has also been below expected levels. On the plus side, no large private customers have left and the top four are contracted to 2021 at least although pricing negotiations remains keen. The sales team remuneration has been shifted to encourage new sales and upsell as well as client retention. A new sales head has also been in place since April. Overall, this equates to c. 5% reduction in FY19 revenue against previous expectation and 10% off EBITDA with revenue now expected to be down £0.9m on FY18 and EBITDA down £0.8m before seeing c. 15% revenue growth in FY20 and EBITDA +20%.

Allenby Capital comment: Redcentric remains a work in progress following 2016's accounting misstatements - the FCA investigation is ongoing - but the new management team has made a number of positive steps. The impressive cash collection has brought net debt down to much more manageable levels and the operating cost base will reduce further as functions are relocated to India and more automation is brought to bear. The Yorkshire and Humber contract win was significant in terms of scale but also the competition and there is scope to upsell additional services as well as other HCSN contracts but there needs to be evidence of smaller contract wins. Other losses to Crown Hosting look inevitable for RCN and other data centres but there is an opportunity if RCN can position itself as an expert in migrating and supporting organisations in complex hybrid cloud environments. Shares are trading on an FY19 PER of 17.5x falling to 11.9x in FY20 as Yorkshire and Humber kicks in.

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