Scale research report - Update

Max 21

Technology

28 June 2018

Growing profits and recurring revenues

Max 21's repositioning, with the sale of loss-making NECDIS at end 2017 and its refocus on creating recurring revenues from hybrid business communications specialist, Binect, and IT security system provider, KeyIdentity, helped sharply reduce EBITDA losses in Q118. Binect achieved a 21% y-o-y increase in revenues and positive EBITDA after break-even in Q417. At KeyIdentity, underlying revenues grew 61% y-o-y and losses at the EBITDA level were reduced by 22% to €451k, helped by cost-cutting and growth in recurring revenues. We see current management guidance for 27% underlying revenue growth and an EBITDA loss of no more than €2.5m, followed by EBITDA break-even in 2019 (one year later than forecast previously), as reasonable and achievable.

Binect emerges into positive EBITDA

During 2017, Max 21 laid the groundwork for bringing Binect to EBITDA profitability in Q118. It intensified its co-operation with Deutsche Post, expanded its partner network and product portfolio, and put in place direct sales operations. With a leaner organisation (staff cuts of 30% since year-end 2017) and focus on its scalable family of products, the group has the potential to profitably exploit the very large addressable German market, which Max 21 estimates at 6-8bn letters pa compared with the 97m processed by the company in 2017.

Strategic LinOTP revenues surging at KeyIdentity

During 2017, a reorientation in the KeyIdentity business towards highly strategically important LinOTP revenues was a notable success for the group. LinOTP generates unique passwords using an open-core model in which its proprietary modules are built around the LinOTP core. As such, it is a key element of the group's enterprise multi-factor authentication (MFA) platform and a highly scalable SaaS product, with strong recurring revenue and operational gearing potential. In Q118 KeyIdentity was able to achieve 71% recurring revenues vs 39% in H117.

Valuation: Still early stage

Lack of profits and consensus forecasts hamper any comparative valuation. On a historic 2017 EV/Sales basis, the group multiple of 3.3x compares with the average European TMT multiple of 2.1x. Over time, if the group can continue to translate current business growth into high levels of recurring SaaS revenues and exploit the market potential discussed above, we see potential for strong earnings growth and multiple expansion. Although no further equity issuance is planned or has been announced, a further capital increase may be needed before EBITDA break-even.

Historical financials

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	EV/Sales (x)	P/E (x)
12/15	3.3	(1.4)	(0.16)	0.0	6.6	N/A
12/16	6.4	(4.2)	(0.61)	0.0	3.4	N/A
12/17	6.6	(4.3)	(1.02)	0.0	3.3	N/A

Source: Max 21, Edison Investment Research

Price	€1.31
Market cap	€23m

Share price graph

Share details

Code	MA1
Listing	Deutsche Börse Scale
Shares in issue	17.4m
Last reported net cash at 31 December 2017	€1.1m

Business description

Max 21 is a technology investment company with 100% stakes in two core subsidiaries: Binect in hybrid business communication and KeyIdentity in IT security.

Bull

- Surface of hybrid business communication market barely scratched.
- IT security market growth driven by multiple threats.
- Highly scalable recurring revenue model for both businesses.

Bear

- Break-even deferred.
- Long sales cycles.
- Extra equity financing may be required.

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FY17/Q118 results summary

Earnings: During 2017 restructuring starts to pay off

In 2017 reported group revenues rose 3.6% to €6.6m. Stripping out revenues from NECDIS and abnormally high revenues from penetration testing (or pentesting, which involves testing software for security flaws) relating to LinOTP in 2017, underlying revenues grew 95% to €5.5m. Underlying EBITDA losses, excluding a €955k loss from IT distribution subsidiary NECDIS, which was sold on 31 December 2017, fell 19.3% to €3.4m.

In relation to earlier management guidance, revenues did not match expectations of figures approaching €10m, although the planned slight reduction in EBITDA loss was achieved. Management reported that 2017 earnings growth was below its expectation, partly due to lower than expected productivity at Binect and slower than expected large customer acquisitions at KeyIdentity.

Nevertheless, the group did perform slightly ahead of management expectations in Q118, helped by faster growth at Binect. Although reported group revenues declined 8.5% to €1.8m, stripping out NECDIS and the above-mentioned high pentesting revenues relating to LinOTP in Q117, annualised underlying revenue grew 27.9% y-o-y. EBITDA losses during the quarter were also cut 71% to €0.3m, reflecting the strong growth in revenues and the impact of high operating leverage in the Binect product family, and cost-cutting in 2017 and Q118.

Exhibit 1: First quarter 2018 results summary

€000s	Q117	Q118	Change (%)	FY16	FY17	Change (%)
Revenue						
KeyIdentity	**362**	**353**	**(2.5)**	**1,423**	**1,561**	**9.7**
of which LinOTP	N/A	N/A	N/A	310	853	175.2
Binect	**1,216**	**1,468**	**20.7**	**4,278**	**4,374**	**2.2**
Max 21	343	291	(15.2)	1,637	N/A	N/A
NECDIS*	419	0	(100.0)	1,742	N/A	N/A
Eliminations	(365)	(307)	0.0	(2,689)	N/A	N/A
Total group revenue	**1,974**	**1,806**	**(8.5)**	**6,391**	**6,623**	**3.6**
NECDIS/pentesting adjustment	(562)	0	(100.0)	N/A	(1,100)**	N/A
Underlying group revenue	**1,412**	**1,806**	**27.9**	N/A	**5,500****	**N/A**
EBITDA						
KeyIdentity	(581)	(451)	(22.4)	(2,420)	(2,123)	(12.3)
Binect	(190)	114	(160.0)	(1,470)	(836)	(43.1)
Max 21	(233)	5	(102.1)	(266)	(394)	47.7
NECDIS*	(134)	0	(100.0)	0	(955)	N/A
Group	**(1,138)**	**(332)**	**(70.8)**	**(4,156)**	**(4,308)**	**3.6**
Cash and cash equivalents**	2300**	1,896	(17.6)	677	2,322	243.0

Source: Max 21. Note: *Sold 31 December 2017. **Rounded to €0.1m.

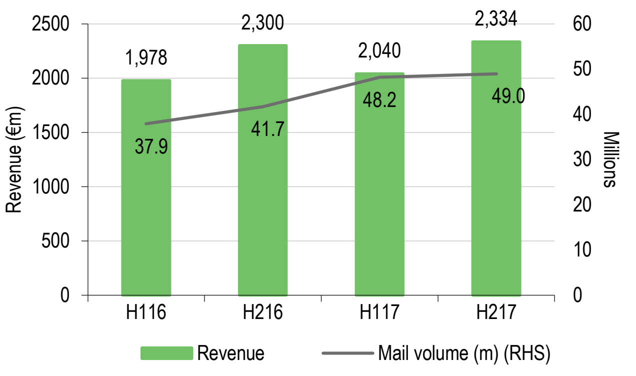
Binect's year of transition in 2017...

During 2017, Binect's top-line revenues grew 2.2% to €4.4m and its EBITDA losses fell 43% to €0.8m. Nevertheless, revenues from the most strategically important and scalable segment of its offering – the processing of mail using the Binect product family – tripled to €0.6m. In the less scalable click charge per letter segment, processed mail volume increased 22% to 97.2m units after 30% growth in the previous year. During 2017, Binect laid the groundwork for success in 2018. It intensified its co-operation with Deutsche Post, expanded its partner network and product portfolio and put in place direct sales operations. The group also implemented cost reductions including scaling-down the development team after the creation of more standardised products. Total staff numbers in the business fell 33% to 36.

...has led to positive EBITDA at the company in Q118

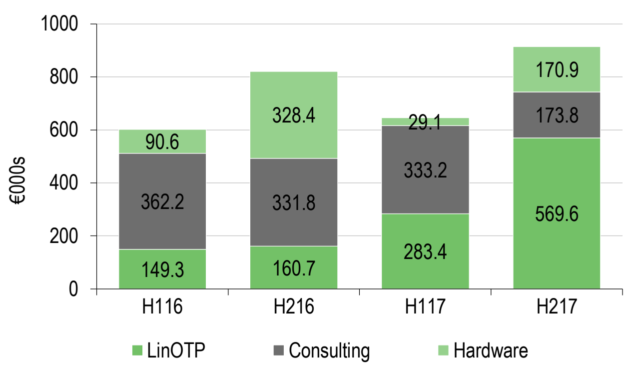
The fruit of the above-mentioned efforts played out in Q118. Total revenues, including mail processing by the Binect product family, grew 21% to €1.5m, boosted by the commencement of direct sales and the launch of the new Binect Enterprise Basic solution in mid-2017. Helped by the growth in revenues and the scalability of the product lines, Binect emerged decisively into positive EBITDA territory, remaining consistently profitable during each month in the quarter and contributing €114k EBITDA to the group. Growth in processed mail volume of Binect's legacy click charge per letter business continued to slow, rising 12.4% y-o-y to 29.1m.

Exhibit 2: Binect revenues and mail volume



Source: Max 21

Exhibit 3: KeyIdentity revenue structure



Source: Max 21

KeyIdentity: Scalable LinOTP revenue segment surged ahead in H217

In 2017, sales of the group's most strategically important product, LinOTP (**Lin**ux **O**ne **T**ime **P**assword), grew 175% to €0.8m. At the same time, low-margin sales of hardware and labour-intensive consulting revenues (except those supportive of the LinOTP product line) were allowed to decline. This was part of the group's decision to orient strongly to the LinOTP product and reduce exposure to lower-margin product sales and consulting. As a result, top-line revenues grew by only 9.7% to €1.6m, but the group was able to achieve a 16% decline in employee numbers to 27 and EBITDA losses were reduced from €2.4m to €2.1m.

As can be seen from Exhibit 3, LinOTP revenues doubled between the first and second half of 2017, growing to 62% of total H217 revenues, up from 44% in H117. Recurring revenue share grew likewise, to 79% in H217 from 46% in H117. A key driver was a surge in demand from large corporations, which led to a doubling in average contract size during the year.

In our view, this reorientation towards highly strategically important LinOTP revenues was a notable success for the group. LinOTP generates unique passwords using an open-core model in which its proprietary modules are built around the LinOTP core. As such, LinOTP is a key element of the group's enterprise MFA platform and a highly scalable SaaS product, with strong recurring revenue and operational gearing potential.

Continued strong trend in Q118 helped by major new insurance client

During Q118 underlying revenues grew 61% y-o-y to €353k after stripping out €143k in abnormally high pentesting revenues for the LinOTP solution in Q17, without which reported revenues fell 2.5%, y-o-y. At €83k per month, recurring revenues accounted for 71% of total revenues for the division.

The strong underlying top-line growth reflected expansion in service contract numbers (up by 43 in FY17 and a further 14 in Q118 to reach 302) and contract sizes over the course of 2017. In addition, the group commenced a major new contact with Basler Versicherung, providing secure portal access for tens of thousands of customers. KeyIdentity has recently introduced an improved demonstration version of the software, which should support sales, is seeing c.100 monthly leads from individuals and has several large customers in the pipeline.

Management earnings guidance: Group EBITDA break-even in 2019

Management published revised earnings guidance for 2018 and 2019 earlier this year, which it confirmed with the publication of its Q118 results, including the following key targets:

- Revenue of €7m in 2018. This represents a 27% increase based on adjusted 2017 sales of €5.5m excluding NECDIS and the high level of pentesting undertaken for clients on the LinOTP.
- EBITDA loss of €2.5m in 2018.
- EBITDA break-even in 2019 (with expectations of EBITDA profits late in the year).

Management states that the guidance is based on an expectation of stable competitive structures and market prices, and a lack of major customer losses.

We see management guidance as achievable

The outlook for this year's earnings was greatly enhanced by the year-end 2017 sale of NECDIS, which contributed €1.0m to 2017 EBITDA losses. Annualised first quarter 2018 revenues at €7.2m show that the group is already achieving a revenue run rate in excess of the full-year target of €7.0m.

Similarly, Binect's emergence from losses to an EBITDA profit of €0.1m in Q118 and the 22% y-o-y decline in EBITDA loss at KeyIdentity to €0.4m, combined with strong growth in revenues in the most scalable business areas of both divisions (ie with the strongest operating gearing/margin improvement potential), indicate a likely continuation of lower average quarterly EBITDA losses during the remaining three quarters. Nevertheless, annualising this first quarter EBITDA loss at €1.3m and very conservatively adding in €0.5-0.6m in eliminations (2017: €0.4m) indicates realistic prospects for the group to achieve a full-year EBITDA loss of below €2.0m.

Cash flow & balance sheet: Higher cash balances after equity issues in 2017

In 2017 Max 21 experienced €3,154k in operating cash outflows and made an additional €0.8m investment outlays. This was funded by €6.3m in equity issues: €4.3m in H117 and €2.0m in early September 2017. In addition to enabling the repayment of €0.7m in debt, it enabled the group to finish the year with €2.3m in cash reserves, up from €0.7m at end-2016.

Long-term financial debt fell during the year from €2.5m to €1.2m, resulting in a turnaround from net debt of €1.8n to a net cash balance of €1.1m. (We note that a restatement of the 2016 balance sheet prevents a reconciliation of the debt repayment data in the cash flow statement and the 2016 and 2017 balance sheets.)

The company did not publish debt or cash flow data for Q118. Nevertheless, EBITDA losses shrank dramatically from the quarterly average of €1.1m in 2017 to €0.3m, indicating a likely improvement in operating cash flows. No further equity issues took place and cash reserves fell by €0.4m to €1.9m.

Exhibit 4: Financial summary

€000s	Dec-15	Dec-16	Dec-17
Income Statement			
Revenue	3,308	6,391	6,623
Cost of materials	(1,367)	(2,665)	(2,151)
Payroll costs	(2,084)	(6,537)	(6,027)
EBITDA	(1,358)	(4,156)	(4,308)
Write-down in value of business	0	0	(10,998)
Depreciation and amortisation	(529)	(1,868)	(2,061)
Operating profit	(1,887)	(6,024)	(17,366)
Financial net	(29)	(1,264)	575
Profit Before Tax (as reported)	(1,916)	(7,288)	(16,791)
Net income (as reported)	(1,520)	(7,508)	(16,456)
EPS (as reported) (€)	(0.16)	(0.61)	(1.02)
Dividend per share (€)	0.00	0.00	0.00
Balance Sheet			
Total non-current assets	27,253	26,220	12,920
o/w intangible	21,546	25,708	12,675
o/w tax losses c/f	0	0	0
Total current assets	3,910	2,380	3,531
o/w cash and cash equivalents	1,616	677	2,322
Total assets	31,163	28,600	16,451
Total current liabilities	3,066	2,715	2,253
o/w Creditors	1,375	1,127	532
o/w tax debt	132	302	181
o/w other debt	1,560	1,287	1,540
Total long term liabilities	3,061	4,052	2,451
o/w LT Financial debt*	1,749	2,520	1,248
o/w deferred Tax	1,312	1,532	1,203
Shareholder equity	25,035	21,832	11,747
Net debt/(cash)	1,693	3,129	466
Cash flow			
Net cash from operating activities	(612)	(3,991)	(3,154)
Net cash from investing activities	(6,165)	(1,342)	(808)
Net Cash from financing activities	4,256	4,393	5,607
o/w Equity financing	3,434	4,610	6,295
o/w Debt financing	822	(216)	(688)
Net cash flow	**(2,520)**	**(940)**	**1,645**
Cash & cash equivalent end of year	1,616	677	2,322

Source: Max 21. Note: *A non-interest bearing financial instrument recognising Max 21's liability to make an earn-out payment to former KeyIdentity shareholders in 2021. Restatement of 2016 accounts affects reconciliation of 2017 debt and stated cash flows.

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