Sales Perspectives

Magnificent 7 for 2017

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Introduction

Magnificent 7 for 2017

Welcome one and all to the first Sales Perspectives of 2017. Whilst 2016 was a very challenging year, the FTSE Small Cap Index (ex-Investment Trusts) actually closed up 9.8%. It may still be some way below the 15%+ growth seen in the FTSE 100 Index, but not bad all in all. So what does 2017 have in store for us? Unfortunately, the answer is another difficult year, with both political and economic issues to overcome, wildly swinging market sentiment (usually massive over reactions in both directions), as well as the typical mix of corporate jiggery-pokery. Whilst some of this will be offset by further corporate activity (more M&A to come in our opinion), all of this makes it a very difficult job to select our stocks of the year.

Despite these factors, this Sales Perspectives runs through 7 stocks that we believe will offer significant upside potential. The Magnificent 7 as it were! These are stocks we know well and ones we believe can outperform in testing market conditions. The majority are growth plays, where the rating remains more than reasonable despite the stellar growth track record already achieved, and where we see excellent prospects for continued strong performance. This, we believe, will see these stocks outperform and offer shareholders excellent gains. A couple of our choices are recovery plays, which having disappointed in 2016, now offer superb upside as we remain confident on their fundamental positions and the ability to perform in line with expectations in 2017

As we all know, the key to the stock market and small caps in particular, is in picking the right stocks. We hope with this selection, we offer you some insight into our preferred plays. Some of these names may be new to you, whilst others we hope to test your opinion on. Either way, the best way to fully assess a stock is through meeting the management. As such, please do let your sales contact at finnCap know if you wish to meet any of the companies featured. We wish you all a prosperous 2017 and here's to our 7 performing well despite all of the headwinds.

Rhys

Note: The views expressed in 'Sales Perspectives' are solely those of the finnCap sales team.

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2016 Performance Review

Which stocks?

Last year we put out three editions of Sales Perspectives, promoting 23 different companies. To believe in our new 'Magnificent 7' of 2017, you probably want to know how well we performed in 2016. Well, 'pretty good' is how we would judge our track record. Whilst suffering just a couple of earnings downgrades, our worst performing stock was off 25%. However, our best performing was up 119%, and we also enjoyed a couple of take outs too. The average performance (from date of issue to end of the year) for issue 1 was ahead by an impressive and market outperforming 24%; for issue 2 we were up almost 14% and it was only issue 3, our growth stock special edition, that let the team down with an average performance of -2.6%. Taking each issue in turn below, we assess our performance and whether we still have confidence in the stocks we promoted.

We started the year with issue 1, published mid-January, and pushing 10 stocks for 2016. These, as the above table shows, performed well. Six ended in positive territory, whilst of the 4 that finished the year down, 3 were off by just 2.5% or less. Only Castleton performed particularly poorly, ending the year down 22%. We remain big supporters of Castleton, believing they are extremely well positioned in the social housing association market, and are now over the integration issues that plagued them in 2016. We also have long term confidence in CityFibre, a stock that provides a direct investment opportunity to benefit from the exponential growth in connectivity and data demand. Dotdigital is another name we have high expectations for in 2017, with its marketing automation platform offering global growth potential. Somero, as last week's trading update showed, continues to go from strength to strength, and we think solid profit growth and healthy cash generation will be maintained this year. In terms of recovery stocks, we still believe Norcros remains substantially undervalued, offering an attractive range of brands with strong market shares, which have the ability to be exported to new territories.

In addition, Utilitywise, under new leadership, are now over their cash flow issues and we believe will see earnings moving in the right direction this year. In terms of stocks we are less favourable on in 2017, Petra we feel has been on such a good run, it may struggle to make serious gains this year. Communisis, we believe, remains hampered by challenging underlying market conditions. Constellation Healthcare and Skyepharma were both taken out, offering us good returns.

In issue 2, published in the middle of May, we promoted 7 excellent small mid-caps, ones we thought could perform strongly in the second half of the year. Four out of the 7 did not let us down, with 4Imprint, Solid State, Telecom Plus and Victoria all up over 20%, with 2 of them ahead by more than 30%. We remain confident on all of these names, with Solid State one of our stocks for 2017. In terms of the remaining 3, Finsbury Food finished up 3% on the year, but should have a better year this year as the valuation remains highly attractive. Flowtech Fluidpower was off 7%, due to the tough market conditions post Brexit, but we remain supportive of management's buy and build model which will create good value in the long term. Last is Centaur Media, which remains hemmed in with challenging market conditions, and we will give the newly formed exec team time to bed down first.

Finally, is issue 3, published mid-September, we marketed 6 stocks where their growth characteristics would shine through in tougher market conditions post Brexit. Unfortunately we were only half right, with unfailing 4Imprint and firm favourite Clipper Logistics powering on, up 14% and 20% respectively. Both of these businesses are run with highly experienced management teams and have large market opportunities open to them, so we remain fans. Accesso and Tracsis strangely dropped 6% and 3% respectively, in the final quarter of the year. This we view as an attractive buying opportunity for both. If you are a lucky recipient of my colleague, Stephen Joseph's morning email, you will know he uses phrases like 'world domination' to describe the opportunity open to both of these stocks, and we would not disagree. Finally, is Majestic, which frustratingly had a profit downgrade a matter of days after our publication hit the screens. Last week's more positive Christmas performance was a huge step on the road to recovery, and we remain positive on the potential (and valuation uplift) that Naked Wine US has to offer. One to watch in 2017 in our opinion.

Issue 1 Share Price Performance

Stock	Ticker	Price at publication (22/01/16)	Price 30/12/16	Percentage change
Petra Diamonds	PDL	71.5	156.7	119.2%
Somero	SOM	137.5	222.5	61.8%
Constellation	CHT	148.5	229.0	54.2%
Utilitywise	UTW	168.0	199.5	18.8%
dotDigital	DOTD	49.8	57.5	15.5%
Skyepharma*	SKP	375.5	410.2	9.2%
Norcros	NXR	183.5	180.0	-1.9%
CityFibre	CITY	58.8	57.5	-2.2%
Communisis	CMS	44.5	43.4	-2.5%
Castleton	CTP	77.3	60.0	-22.4%
			Average change	25.0%

* latest price at take out

Issue 2 Share Price Performance

Stock	Ticker	Price at publication (09/05/16)	Price 30/12/16	Percentage change
4imprint	FOUR	1320.0	1775.0	34.5%
Solid State	SOLI	331.0	445.0	34.4%
Victoria	VCP	282.5	355.0	25.7%
Telecom Plus	TEP	951.0	1176.0	23.7%
Finsbury Foods	FIF	116.5	120.0	3.0%
Flowtech Fluidpower	FLO	137.1	127.5	-7.0%
Centaur Media	CAU	52.3	43.0	-17.8%
			Average change	13.8%

Issue 3 Share Price Performance

Stock	Ticker	Price at publication (15/09/16)	Price 30/12/16	Percentage change
Clipper Logisitics	CLG	315.1	380.0	20.6%
4imprint	FOUR	1550.0	1775.0	14.5%
Tracsis	TRCS	520.0	507.5	-2.4%
accesso	ACSO	1605.0	1500.0	-6.5%
SRT Marine	SRT	48.5	40.5	-16.5%
Majestic Wines	WINE	423.0	315.0	-25.5%
			Average change	-2.6%

Digital Barriers

Visually intelligent solutions

Digital Barriers is a world leader in the global surveillance, security and safety markets. It designs, develops and manufactures intelligent technology solutions, used to safeguard people, assets and infrastructure. The company specialises in the streaming and analysis of video and related intelligence. Demand for its solutions is growing rapidly, fuelled by a worldwide focus on mass-migration, international terrorism, and escalating regional tensions – the global security context is worsening. This is a huge opportunity for the group and should provide excellent upside potential to shareholders. In addition, 90% of its revenue is from outside the UK, with the group operating in over 40 countries, offering a Brexit free investment case.

Digital Barriers operates four product units: EdgeVis (low bandwidth video streaming and surveillance platform), ThruVis (body screening technology), SmartVis (video analytic solutions and automation) and CloudVis (cloud based intelligent video analytics). It has invested considerable amounts in terms of time and resources to create a set of unique IP backed solutions in these units. It has an un-paralleled reputation for providing effective solutions for even the most demanding environments. Whilst the bears of the stock will point out that getting to this position took much longer than originally assumed, we would point to the fact that it now has traction in the market and it is beginning to build a very impressive sales pipeline.

Looking at its latest results, the group delivered a positive set of interims to September, with revenue up 95% to £13m (H116: £6.7m), and organic sales growth ahead by an impressive 67%. In particular, US revenue was up 5x to £4.1m (H116: £0.6m) following the Brimtek acquisition. Group loss before tax remained unchanged at £4.2m, but with the top line now showing momentum we remain positive that the group will achieve profitability in FY18. Net cash at period end was £3.4m, and with a £10m facility secured in October, the group has the working capital to support future growth.

Turning back to its solutions, why do we believe the group will be so successful in such a large, demanding and fragmented market? Well, EdgeVis is a key technology; it enables live video streaming over multiple network types. But more importantly, its compression technology uses around 60% less bandwidth than standard streaming technologies. ThruVis utilises highly sensitive cameras to detect weapons, explosives and drug concealments under clothing - this technology has been described as a 'game-changer for public safety'. SmartVis helps with the efficient management of surveillance systems, making them more effective. Digital Barriers are market leaders with these unique core technologies and face little to no competition.

A previous weakness was its struggle to break into the lucrative US market. However, this was resolved last year with the c.£29m acquisition of a surveillance technology business, Brimtek. Brimtek counts US defence, federal law enforcement and intelligence communities as clients, providing an attractive platform to Digital Barriers. Indeed, the shock Trump election win is expected to provide considerable opportunities, and likely to bring strong growth from next financial year, as departments expect increased budgets moving forward.

Digital Barriers technology has always been unique, it has merely taken time to fully form its set of solutions and the platform from which to sell them on, as well as to prove to a conservative government based customer base its capabilities. This has now occurred, with losses reducing year on year and management predicting a first profit for Digital Barriers this year. The future of the business looks positive with its sales pipeline continuing to grow impressively, having more than doubled from last year, and now standing at over £250m. We believe 2017 will be a break out year for the group and that it should trade on a similar revenue multiple to other IP backed high growth tech small caps of c.3-4x, such as Blancco Technology Group, GB Group and Quixant. This offers 100% upside in our opinion.

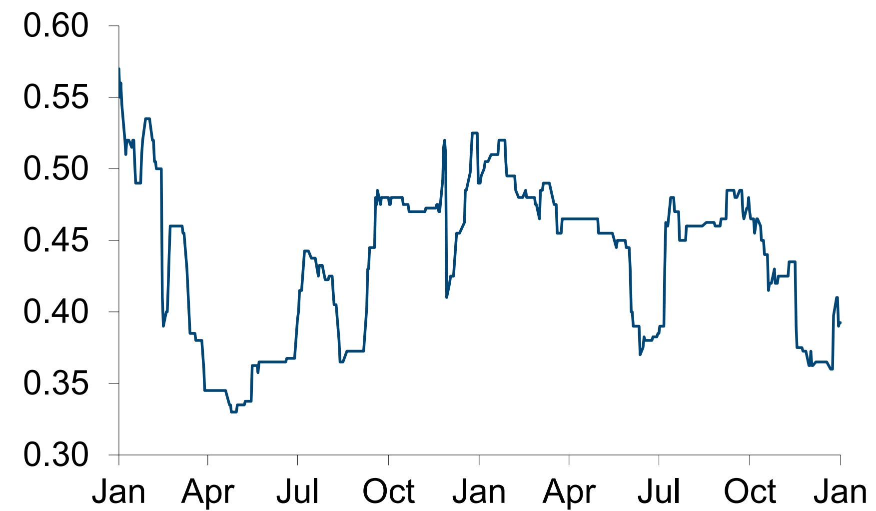
‘Demand for its solutions is growing rapidly”

Digital Barriers

BUY

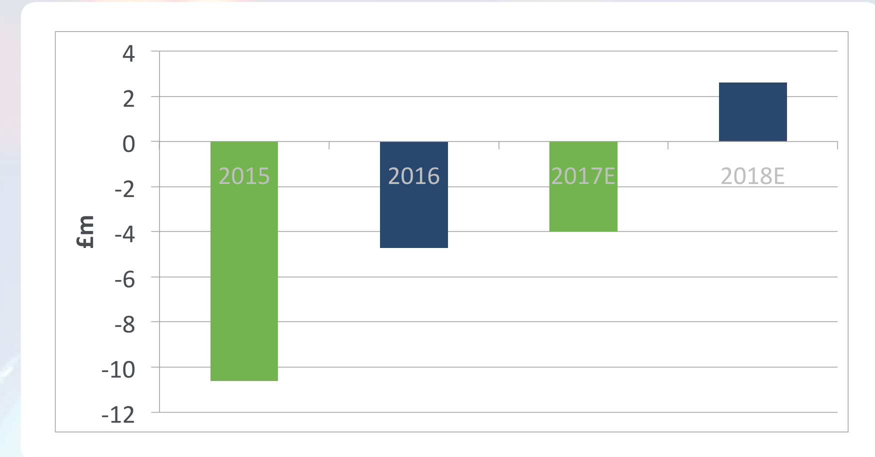
Ticker	DGB	%	1M	3M	12M
Price	39.3p	Actual	+5.4	-16.9	-19.1
Target Price	n/a	Relative	+0.2	-19.5	-29.8
Upside	n/a				
Market Cap	£64.8m				
Index	FTSE AIM All Share				
Sector	Software & Computer Services				
Net Cash	£1.0m				
Shares in Issue	165.1m				

Share Price Performance



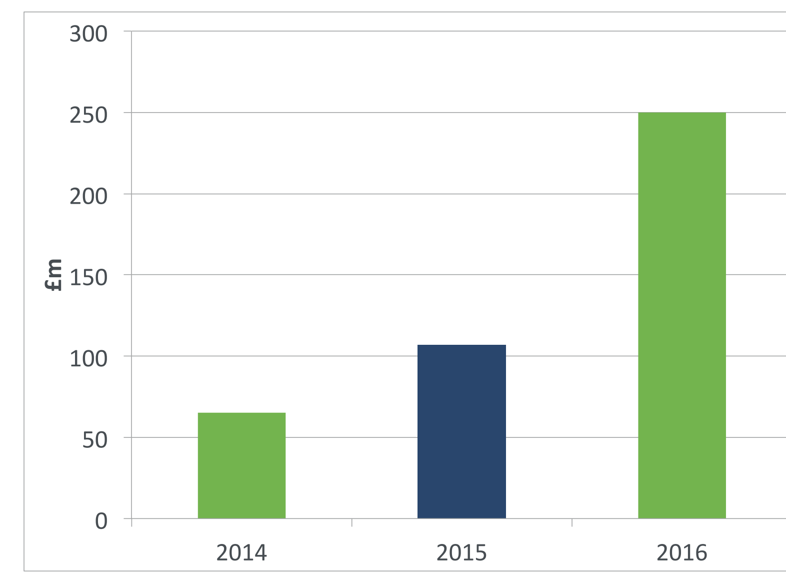
Source: Thomson Reuters

PBT



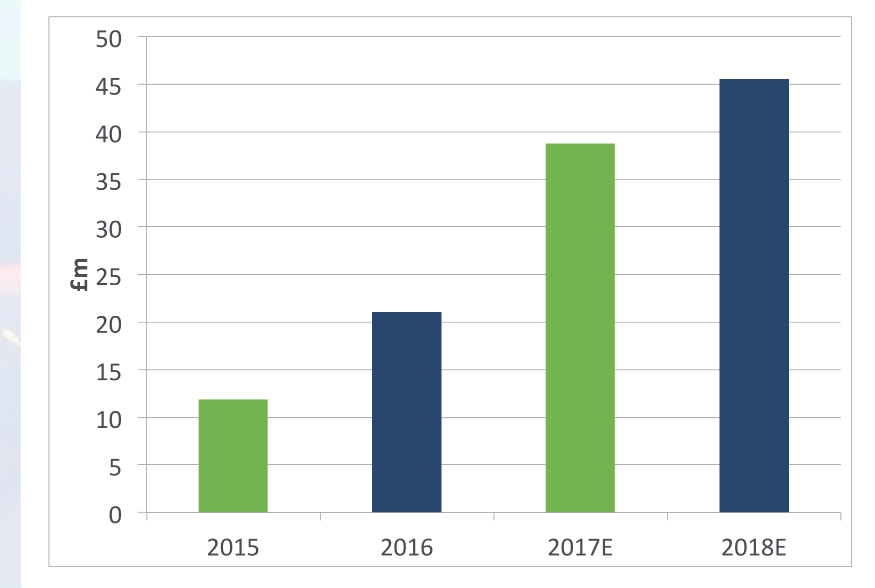
Source: Company accounts and Bloomberg

Pipeline



Source: Company accounts and Bloomberg

Revenue



Source: Company accounts and Bloomberg

MySale Group

Pick up a bargain with MySale

MySale is a FlashSale operator, providing a compelling proposition to both consumers and branded goods manufacturers alike. The premise is simple; it offers 72 hour promotions for branded goods, such as Gucci and Vintage Tiffany, at c.70% off the retail price to its global database of c.25m members. Not all these members are active, so there is great opportunity to convert an increasing number of this 25m database into active customers. There is also great potential to complement this flash business with other online retail offerings such as 'own-buy' and 'Marketplace' which are supplementary offerings that leverage their existing international platform. Management's long term ambition is to generate over A$1bn sales vs the A$250m generated in FY16.

MySale's flash business operates under 3 brands; MySale, Cocosa and Invitetobuy. The advantage to the branded goods manufacturers for using such a service, is that they can maintain price integrity whilst controlling stock levels (as search engines are unable to track these member-only offers). Additionally, the benefit of using MySale compared to any other operator is that as a global provider they can provide seasonal solutions, such as selling discounted winter goods that are sourced from the UK at the end of the season, in other countries at the start of their winter season. This core business affords minimal stock risk, as it collates customer orders before placing a large order with the brand supplier. This also provides a negative working capital model, since consumers pay at the time of ordering, well before MySale are billed by the branded goods supplier. At present, 80% of goods are purchased and sold this way, commanding c.30% gross margins. The remaining 20% of revenue is 'own-buy' – where they do take on the stock, hence gross margins are typically higher at c.50%.

We also feel there is real value in the distribution network – they own their warehouses (which are located around the world), and the technology platform is in place to handle so much more traffic - this is crucial in an increasingly online environment (think Ocado, Amazon). Also, this is how they can attract brands, and maintain their grip on sourcing.

Our investment case is predicated on faster top line growth than consensus is currently forecasting (c.10%) and a higher resultant drop through rate. Firstly, we believe sales growth can be driven by greater efficiency of marketing spend, chiefly through a focus on re-activating existing customers on its database. While MySale boasts a global database of 25m e-mail addresses, just c.800,000 of those have transacted in the last 12 months. It is also more cost efficient to re-activate an old customer vs attempting to drive a new customer to the site (eg via Google) and then converting them. Secondly, we see material top line upside from their 'Marketplace' concept (a drop-ship model where they make the sale and the manufacturer ships directly to the buyer). Marketplace is home to the recently announced partnership with Sports Direct (a 5% shareholder in MySale), which will provide Australian consumers with sports ranges in brands such as Dunlop and No Fear at c.40% cheaper than existing prices in the region. We also understand that this concept is proving particularly appealing to other brands looking to tap into the Australian market. Indeed, management recently told us that they had received a "staggering amount of interest" from other brands post announcing the Sports Direct deal.

If we are right on the above then greater volume throughput will drive economies of scale such as better freight rates and this is something which we believe is not being factored in by consensus forecasts. We particularly like that c.60% of costs are fixed, and the current warehouse network can cope with an increase in throughput that at least doubles revenues before further investment is required.

With clear top line drivers in the form of new concept initiatives, new tie ups and a focus on mobile customers, as well as the clear operational leverage the business offers, we believe MySale is well positioned to deliver a stellar performance. A recent trading update prompted upgrades in consensus numbers and analysts are now expecting 150% CAGR EPS growth over the next 3 years. We note that Boohoo trades on EV/EBITDA multiple of 37x. With MySale now at the beginning of what looks to be an exciting upgrade cycle, at 19x, MySale certainly should be worth putting in your basket.

'Management's long term ambition is to generate over A$1bn sales vs the A$250m generated in FY16'

‘Our investment case is predicated on faster top line growth than consensus is currently forecasting’

MySale Group

BUY

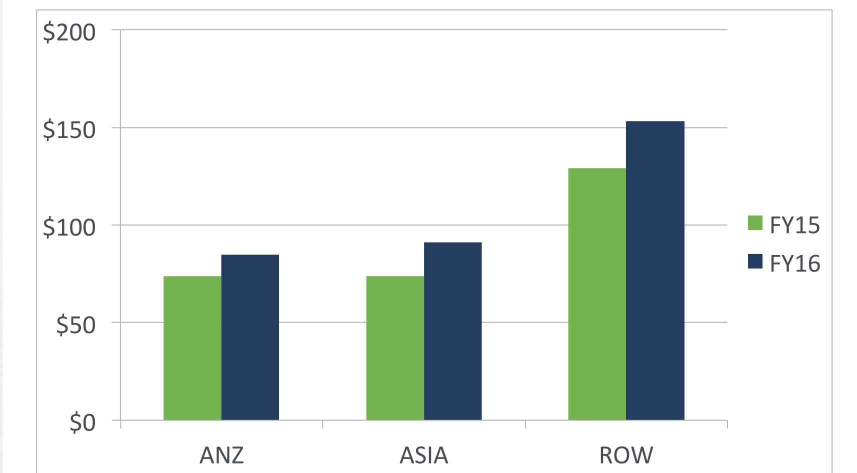
Ticker	MYSL
Price	112.0p
Target Price	n/a
Upside	n/a
Market Cap	£169.5m
Index	FTSE AIM All Share
Sector	General Retailers
Net Cash	A$34m
Shares in Issue	151.3m

%	1M	3M	12M
Actual	+ 10.6	+27.3	+148.9
Relative	+5.2	+23.3	+115.8

Share Price Performance

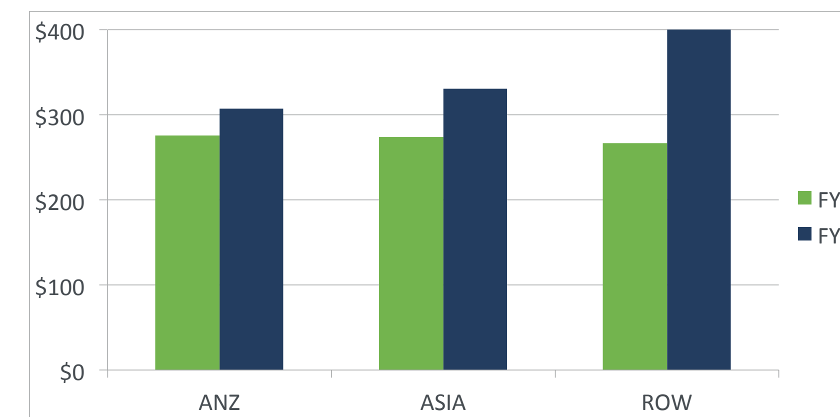
Source: Thomson Reuters

Average Order Value YoY



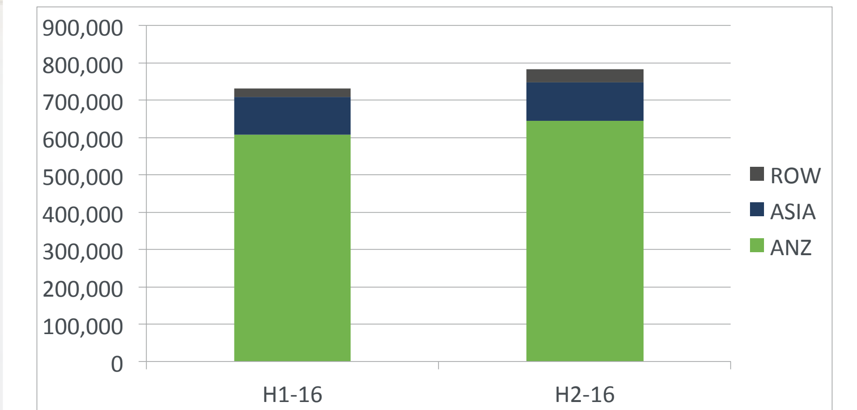
Source: Company accounts

Revenue Per Active Customer



Source: Company accounts

Active Base



Source: Company accounts

‘The company is capable of self-financing’

Shanta Gold

Reaping the rewards from a transformational turnaround

Shanta Gold is a producing gold company engaged in both exploration and mining projects in relatively under explored areas of Tanzania. Shanta’s portfolio includes their flagship New Luika Gold Mine (100% owned, Resource of 1.2m oz @ 3.9g/t) in the south west of the country and the Singida gold project in the north. Our investment case is predicated on the operational turnaround at New Luika which is yet to be fully reflected in the share price. Indeed, CEO Toby Bradbury was parachuted in in early 2015 and has already delivered a number of operational efficiencies and senior operational appointments. At a $1,200 gold price, and post a $10m fund raise in May 2016, the company is capable of self-financing both the completion of a movement to underground mining at New Luika and an on-going exploration and development program focused on low-cost high-grade deposits which are within trucking distance of New Luika.

At 3.9g/t the New Luika gold deposit boasts attractively high grades. However, during the first few years of the mine’s life the company was poorly managed and the costs associated with extraction failed to reflect the true quality of the resource. The arrival of Toby Bradbury in early 2015 changed all that and costs have decreased from $941/oz in FY2014 and are on track for $690/oz in FY16 vs the current spot gold price of c.$1,200. A recent site visit by our mining analyst Martin Potts revealed that the movement to underground mining at Luika is ahead of schedule and below budget. This is expected to extend the life of the mine following exhaustion of the main open pits in 2017. Elsewhere we see further upside on the cost front driven by the installation of a heavy fuel oil power plant to replace costly diesel generators. Again observations during the site visit revealed that the installation process was largely complete and were about to enter the commissioning phase.

On the exploration front the company continues to make new discoveries easily replacing the ounces mined each year. Indeed, Shanta recently released drilling results from its Singida gold project where it is about to commence a pilot plant project targeting the Gold Tree 1 ore body ahead of a full scale development plan. Highlights from the drilling programme include 1m at 12.45g/t gold and 12m at 9.24g/t gold. The most recent resource estimate for Singida identified 432,000oz of measured resource at a grade of 4.1g/t and a further 327,000oz of indicated & inferred resource at between 2.0 and 2.2g/t.

With production to date at the Q3 stage of 68,817 ounces the company remains on track to meet guidance for the year end Dec of 82,000 to 87,000 ounces. Our 20p target price assumes $1,300 gold, $1.3/£ and production consistent with the most recent mine plan of c.80k oz/year.

In summary, Shanta offers investors exposure to an established gold producer at New Luika with high grade resources, low all-in sustaining costs and with the expansion to underground the potential for extending the mine life. The development of the Singida project offers further upside.

‘An established gold producer with high grade resources and low all-in sustaining costs’.

Shanta Gold

BUY

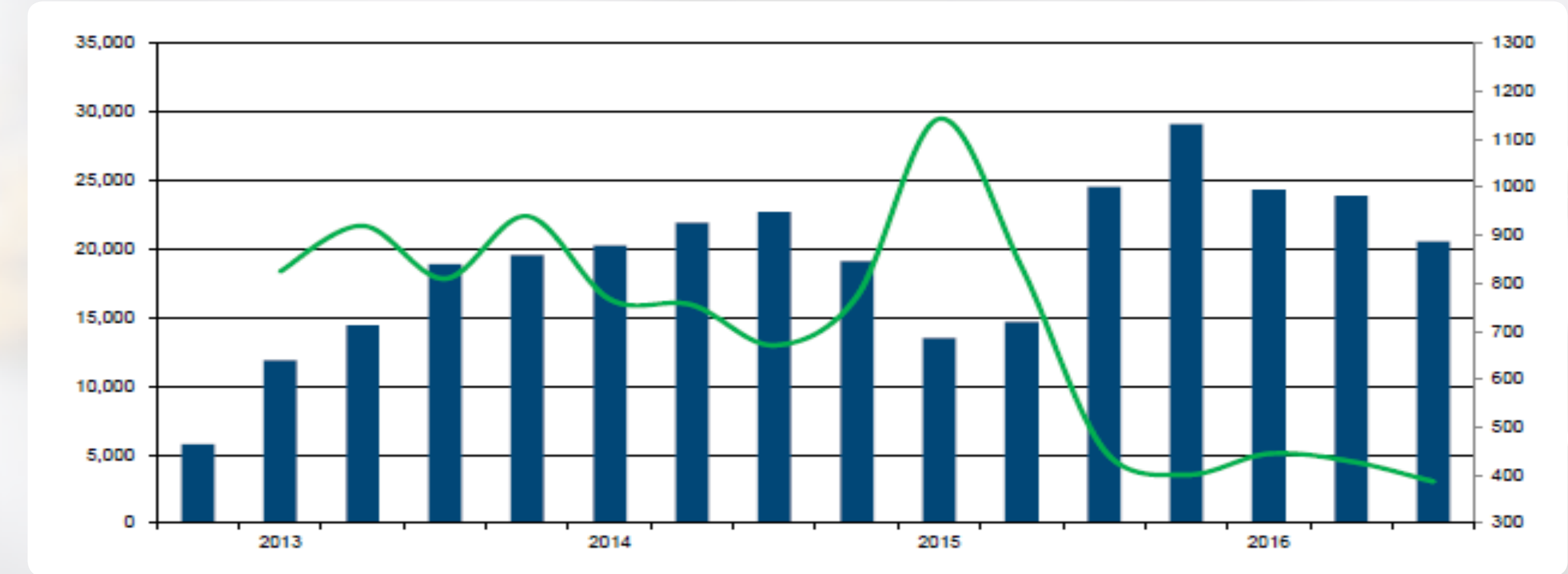
Ticker	SHG
Price	11.0p
Target Price	20.0p
Upside	82.0%
Market Cap	£64.1m
Index	FTSE AIM All Share
Sector	Mining
Net Debt	$38.4m
Shares in Issue	582.9m

%	1M	3M	12M
Actual	+17.3	-1.2	+137.6
Relative	+11.5	-4.3	+106.0

Share Price Performance

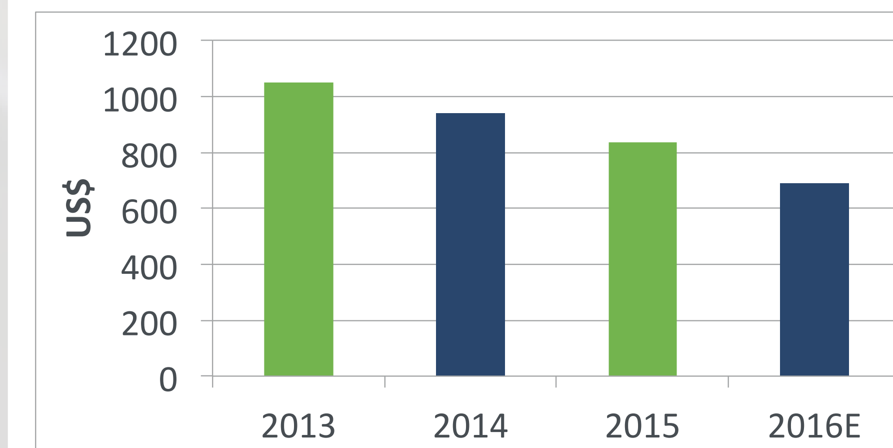
Source: Thomson Reuters

Gold Production



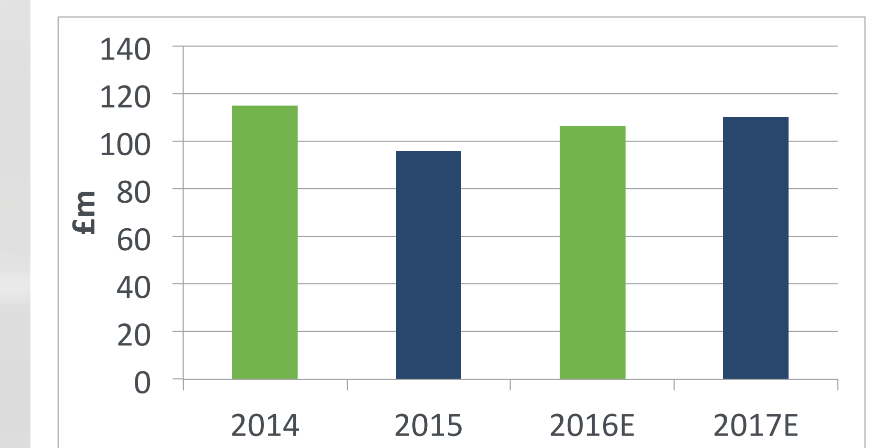
Source: finnCap note 18/10/16

YoY All In Sustaining Costs Graph

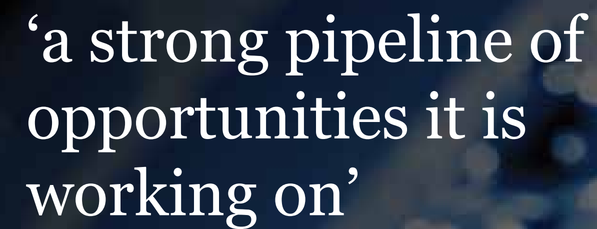


Source: Company presentation 1 December (www.shantagold.com/investors-and-media/presentations/2016)

Revenue



Source: Bloomberg



Solid State

A niche player in a nascent market

Solid State is a value added manufacturer and design-in distributor of ruggedised electronic and battery solutions. It focuses on providing specialist solutions to customers in niche markets including aerospace, environmental, government, oil & gas and transportation markets. The group has had a mixed recent past, following the loss of a significant contract, but with the business valued at £30m, and trading on a highly attractive single digit rating, we believe Solid State offers real value for a growing business with an experienced management team targeting solid long term returns.

Solid State operates through two divisions: Solid State Supplies, which distributes components to UK OEMs; and Steatite, which designs and manufactures products and solutions, including bespoke lithium battery packs, rugged mobile computing/radio solutions, microwave antennae, and industrial computer hardware and software. The company prides itself on doing the ‘difficult things that smaller companies can’t do, and that larger manufacturers don’t want to do’. Its value added nature is shown in that c.85% of its revenue is based on high margin, custom designs that meet demanding customer requirements, helping push group gross margin up from 26% in 2013 to c.32% this year.

So why do we like the company? First, its diversity of both product and end markets, we believe, will allow it to outperform challenging markets, since its revenues are not predicated on any one customer or industry. Secondly, we see a defined general trend towards electronic based solutions and away from mechanical based solutions in multiple industries – its target market continues to expand. Finally, within its space, Solid State is protected by a number of competitive advantages/ high barriers to entry, such as regulatory requirements, as well as IP protected products. The group has UN approval for shipping hazardous material including lithium batteries, whilst the company is one of only a handful that can work with the MOD regarding encrypted data.

The group has an impressive track record of growth, having seen revenue rise from under £26m in 2012, to £44m in 2016, and forecast to reach £45.8m in 2018. However, the last 18 months have been difficult for the stock. Having seen the shares double on the news of winning a major Ministry of Justice contract, and the likely follow on this order offered, the group’s performance was impacted by a delay to the contract roll out, and then again, when the contract was subsequently terminated (through no fault of its own). Whilst Solid State benefited financially from a sizeable compensation payment, its share price has never fully recovered, creating the opportunity we see today.

In terms of its underlying performance, its last trading update was positive, stating it was trading in line with market expectations. It also reported a healthy order book of some £14.8m. Whilst this was down marginally, post Brexit, customers continue to spend as before but have reduced the long term visibility they used to provide. We expect this to return as the shock of political change wanes.

We also believe the group will continue to boost underlying growth through further acquisitions, and that it has a strong pipeline of opportunities it is working on. Management have an impressive track record with acquisitions and look to acquire targets on a prescribed basis to reduce risk – this being a 3 year weighted post tax profit multiple of 6x or less. In addition, it has debt facilities of £5.5m, which are currently undrawn, so it has the ability to leverage the balance sheet before requiring any additional shareholder funds.

Solid State has a diverse and global customer base that should allow it to grow steadily over the medium term. It also has a strong record of expansion through acquisition, and we see this continuing too. We have visited its main operating sites, and were impressed by how well invested in the group was. We were also pleasantly surprised by the structure and professionalism of the operational management team, which was a step up compared to most £30m market cap companies. Operating in niche markets, its reputation, design capability and clear barriers to entry provide key attractions in our opinion. Trading on a FY17 P/E of 13.3x, 10.6x EBITDA and offering a 2.8% dividend yield, the shares look well placed. With a trading update expected at the end of this month (we expect it to be positive), a pre close statement in April, and prelims planned early in July, we expect the shares to recover as momentum returns to the stock. We would put a TP of 575p on the stock.

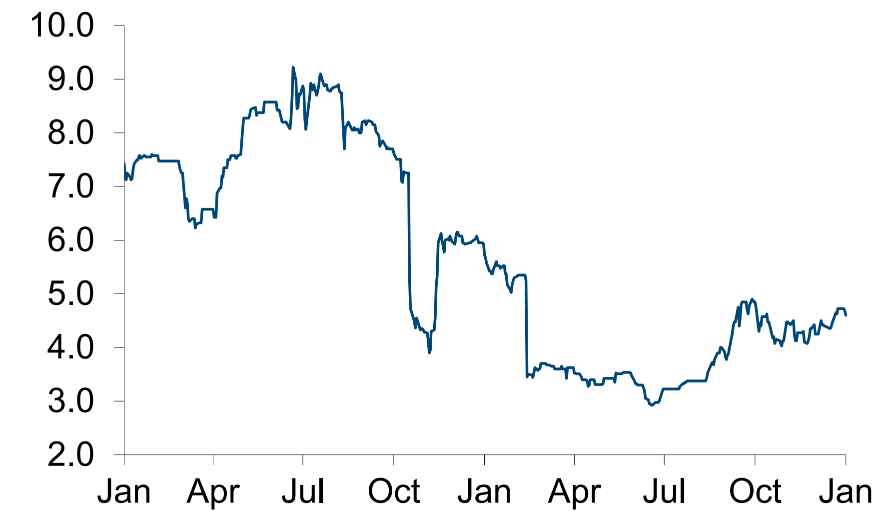
Solid State

BUY

Ticker	SOLI
Price	460.0p
Target Price	n/a
Upside	n/a
Market Cap	£38.9m
Index	FTSE AIM All Share
Sector	Electronic & Electrical Equipment
Net Cash	£1.0m
Shares in Issue	8.5m

%	**1M**	**3M**	**12M**
Actual	+5.7	-6.1	-23.0
Relative	+0.5	-9.1	-33.2

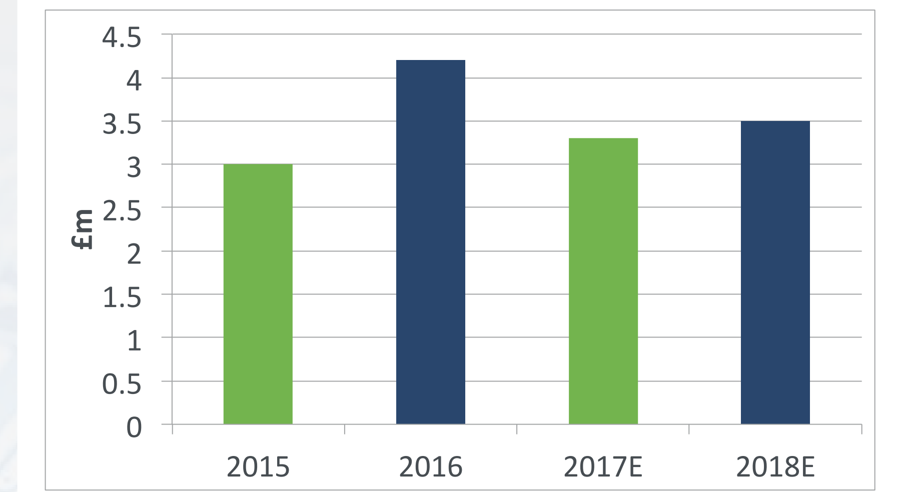
Share Price Performance



Source: Thomson Reuters

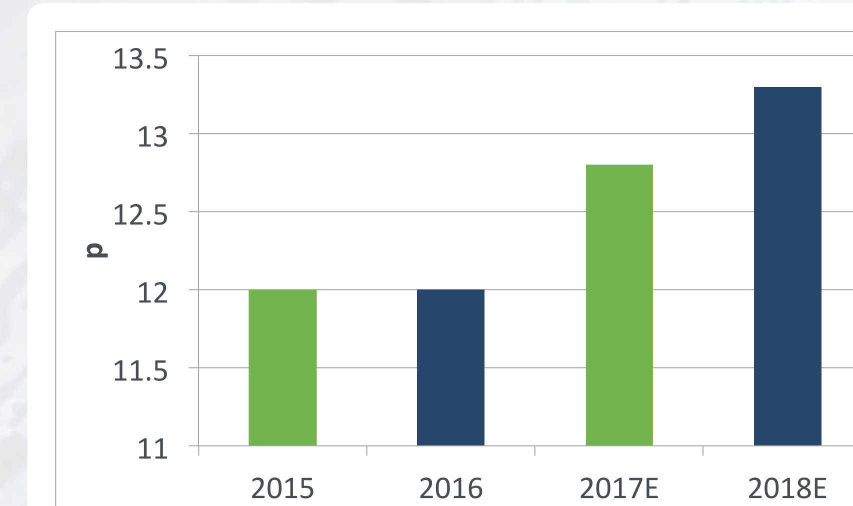
‘Solid State’s diversity allows it to outperform challenging markets’

PBT



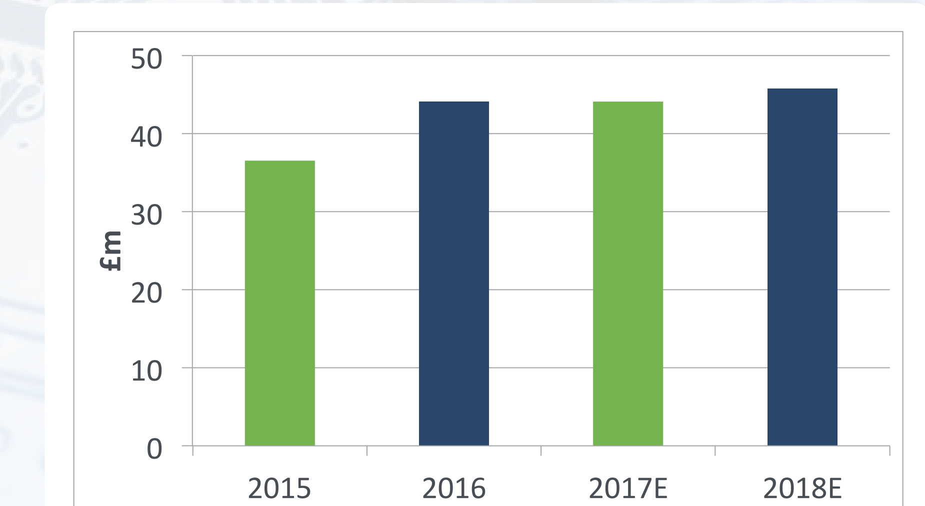
Source: Company accounts and Bloomberg

DPS



Source: Company accounts and Bloomberg

Revenue



Source: Company accounts and Bloomberg

Staffline

Cheap entry into a proven gem

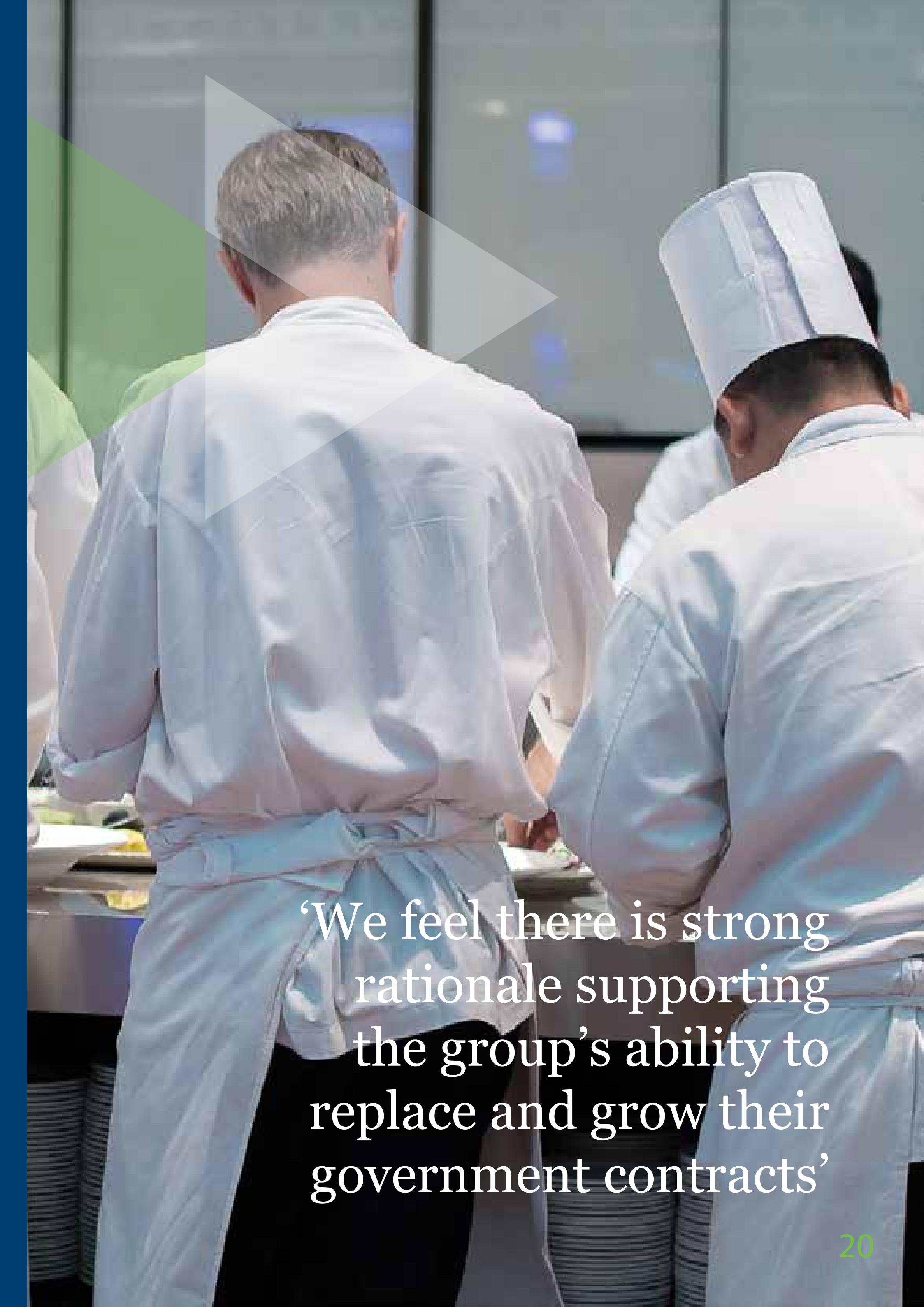
Outsource staffing business Staffline has seen its share price decline by 34% in the last 12 months, and the shares now trade at just 8x FY16 earnings against a sector range of 7.5x to 19.1x. We feel this rating is too low for a group with such a solid track record and a well publicised target of hitting a billion in revenues next year.

So why has the share price been so weak? Staffline operate two core divisions; a staffing services business which supplies flexible staff (contractors) to industries such as manufacturing, agriculture, food processing and logistics and an employability business, which runs government programmes such as Welfare to Work and a Ministry of Justice rehabilitation and probation service. Initially, upon the result of the EU Referendum, concerns arose about the availability of staffing once Britain left the EU, and the market began to feel nervous about Staffline's core staffing business. However, since the vote, we have seen no reduction in demand for flexible contractors – in fact, in times of uncertainty; demand for temporary labour typically strengthens as companies want to keep their costs manageable.

Another concern that has been weighing on the share price is the re-tendering of a number of government contracts under the employability division. Many of these contracts, which include contracts for the retraining and placement of people on welfare or probation, are due for renewal in March this year (having been extended by 12 months). At the time of the interims management highlighted they were awaiting overdue decisions on 14 existing tenders and the publishing of 28 other new potential contracts. There has been some fear that these contracts may be taken in house by government or substantially changed in scope. However, the retendering process is now underway and we expect Staffline's good track record and the improvements it has made at A4E post acquisition to support a positive outcome.

Some reassurance on this should stem from the trading update which confirmed that full year performance was on track with expectations (we are forecasting for £820m of revenues and £42.7m in ebitda in 2016). Encouragingly the statement also highlighted particular strength in the Work Programme (part of the employability business). Moreover, the update also underscored excellent growth in the core staffing business confirming that Brexit has not had any negative impact on demand for flexible labour.

We value the staffing division at a 20% premium to Hays and SThree given the track record at £223m, and the employability business at a 20% discount to the outsourcers at £212m assuming a successful outcome on the rebids, which gives a group value of £435m. Accounting for £14m of forecast net debt in 2017 leaves an implied market value of £421m, which suggests a sum of parts based share price of 1615p and excellent upside. The main difference in our sum of parts, and the current valuation is probably the Employability division, which at these levels, is valued by the market at an EV of £23m – or just 1x EV/EBIT – which clearly evidences the market's concerns on these government contracts. We feel there is strong rationale supporting the group's ability to replace and grow their government contracts and this rating is unwarranted. We would also highlight that Staffline's management team have successfully navigated through periods of uncertainty well in the past (including effectively passing on minimum wage increases), and this only lifts our confidence.



'We feel there is strong rationale supporting the group's ability to replace and grow their government contracts'

‘The main difference in our sum of parts, and the current valuation appears to be in the employability business, which at these levels, is valued by the market at an EV of £23m – or just 1x ev/ebit’

Staffline

BUY

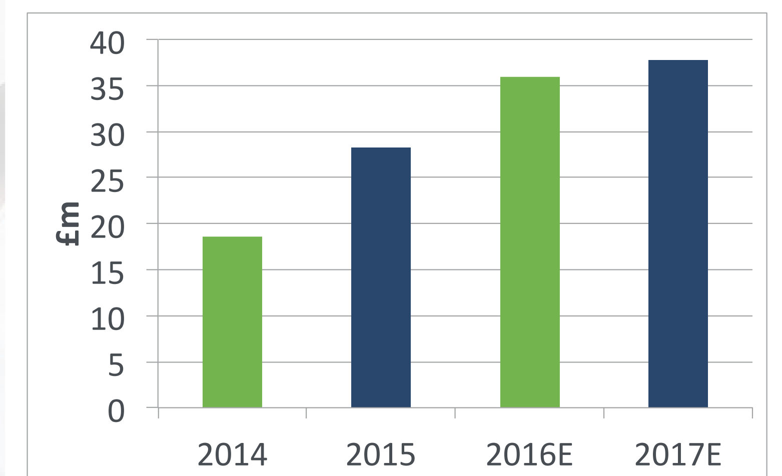
Ticker	STAF
Price	1,010.0p
Target Price	1,615.0p
Upside	60.0%
Market Cap	£280.3m
Index	FTSE AIM All Share
Sector	Support Services
Net Debt	£43.7m
Shares in Issue	27.7m

%	1M	3M	12M
Actual	+15.7	+25.5	-29.4
Relative	+ 9.3	+21.5	-40.0

Share Price Performance

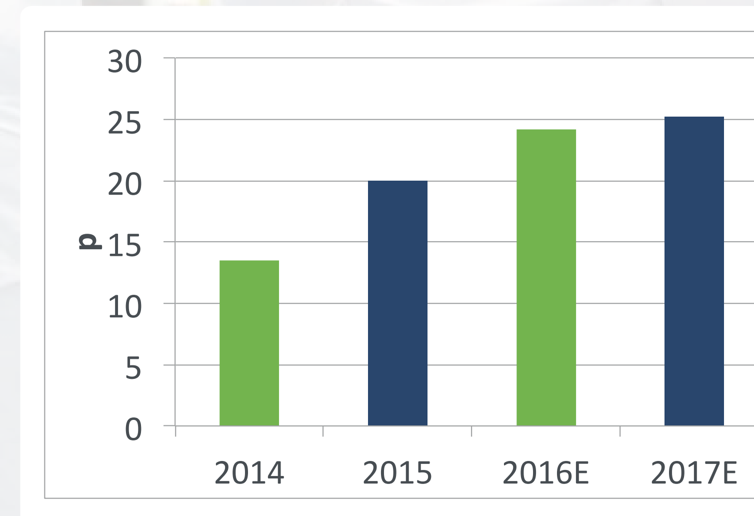
Source: Thomson Reuters

PBT



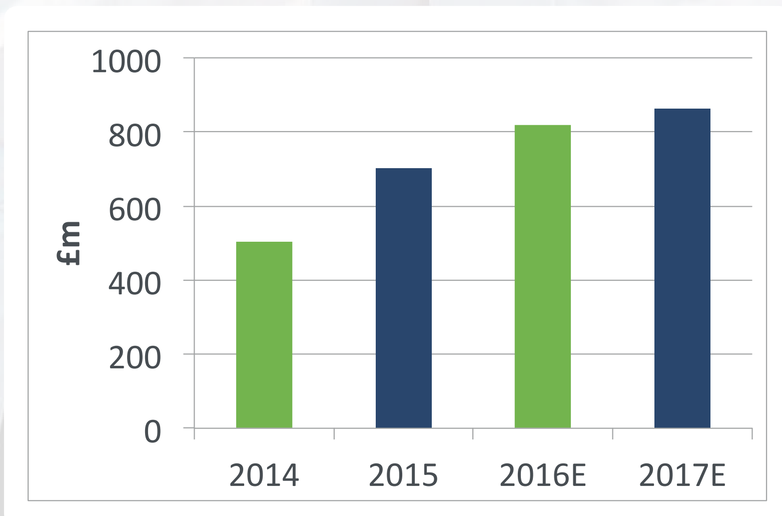
Source: Company accounts and Bloomberg

DPS



Source: Company accounts and Bloomberg

Sales



Source: Company accounts and Bloomberg

Tracsis

Organic growth set to accelerate

Tracsis is a transportation technology and services company which helps train operating companies (TOCs) control their cost base by improving performance and easing capacity issues. finnCap organised a site visit to their Derby headquarters late last year, hosted by CEO John McArthur. The visit allowed us to hear from each divisional head; giving us deeper insight into each of the 3 main business areas: Operations & Planning Systems, Remote Condition Monitoring (RCM) and Traffic & Data Services. We concluded that investor concerns over future levels of organic growth have been overplayed, and we believe that the rate of organic growth looks set to accelerate from here.

Within the Operations & Planning Systems unit, there is also scope to grow wallet share with existing software clients. Roughly half of the division's revenue (which totals c.£15m) comes from their TRACS scheduling software, which enables crew scheduling, rolling stock planning, and base rostering for all the main TOCs. Tracsis has recently launched TRACS Enterprise which allows the TRACS suite to be deployed across the whole enterprise, and includes functionality such as work allocation and recording of time and attendance. The current penetration of the Enterprise product is just c.5% (vs 50-100% for some of its other products), whilst average sales revenue is c.£100-150k - double that of its other products. Therefore, there is significant potential for TRACS software revenues to double in just UK alone.

There also exists significant upside within the company's RCM division. The company signed its first North American Class 1 railroad customer for their RCM technology in August. While the total order value was 'in excess of $400k' we believe this sum is enough to cover just 5% of this particular network (i.e. in total it is an $8m opportunity).

On top of the hardware sale, Tracsis lease their Centrix software platform which provides advanced graphical replay, analysis and fault detection capabilities for the data generated by the black box. The reference that this contract affords them gives us confidence that other freight companies will soon follow (there are 8 Class 1 freight operators in the US). There also exists opportunities with the metro/passenger operators too.

Within the Traffic & Data Services division (c.50% of the business) there is room to lift operating margins via the use of new technologies. The division is now the UK's largest traffic data collector with c.45% market share. Whilst the work is mainly project based, there is longer term visibility through just under 50 framework agreements - the largest of which is £1.7m annually. The biggest opportunity in terms of lifting the margin is with APC – automatic passenger counts, and their investment in Citi-Logik which provides mobile network data that can be aggregated with manual or automated survey data. The business currently earns a 7% margin and the plan is to double that in the medium term by using technology to get the same revenues more quickly and efficiently.

Finally, and with c.£11.4m of net cash on the balance sheet, M&A is set to remain a key facet of the investment story and will further supplement accelerating levels of organic growth. While it's difficult to give any company the benefit of the doubt until a deal is done, it's worth noting that the company has already successfully integrated 8 acquisitions which have typically been acquired on an EV/EBIT of c.6x. If they can carry on acquiring at that multiple then every £10m spent adds c.20% to June 17e numbers. On that basis, the current PE ratio of 21x July 2017 could still offer value to those willing to take a medium term view.

'There exists significant upside within the company's RCM division'

‘Within the Traffic & Data Services division there is scope to lift the margin via use of new technologies’

Tracsis

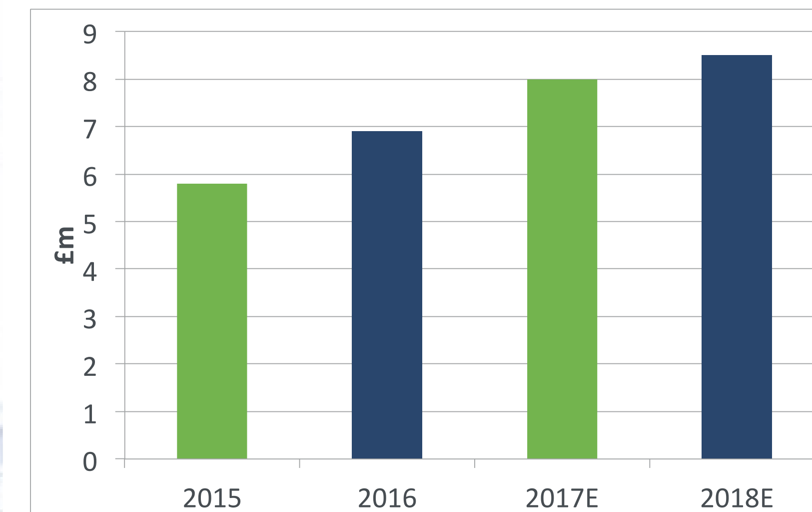
BUY

Ticker	TRCS
Price	520.0p
Target Price	n/a
Upside	n/a
Market Cap	£144.4m
Index	FTSE AIM All Share
Sector	Software & Computer Services
Net Cash	£1.0m
Shares in Issue	27.8m

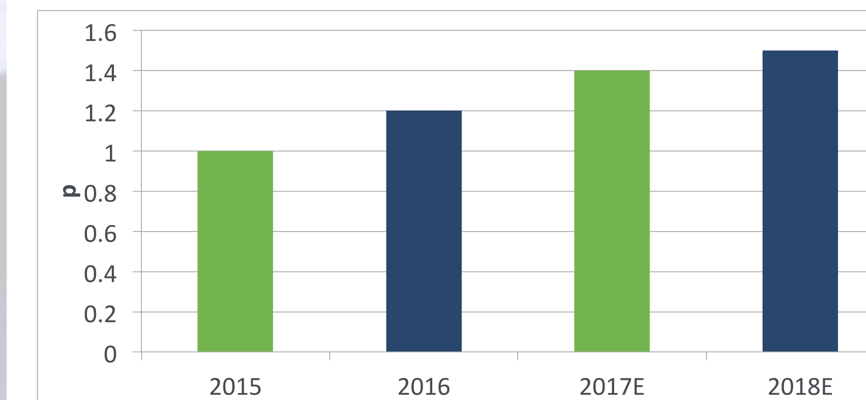
%	1M	3M	12M
Actual	+0.0	-1.4	-1.9
Relative	-4.9	-4.5	-14.9

Share Price Performance

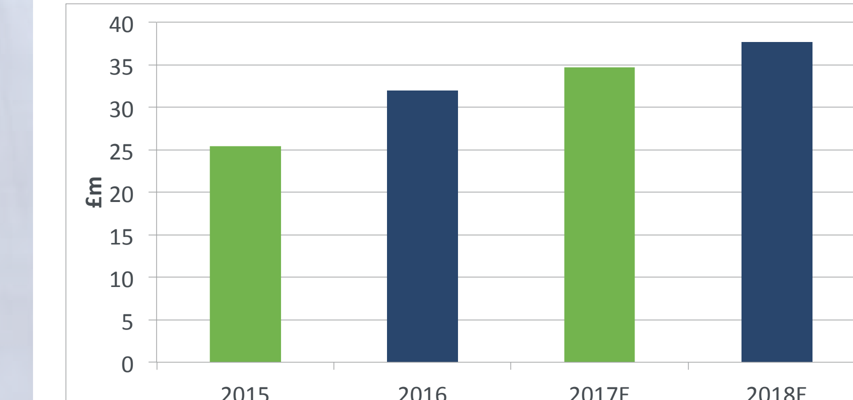
Source: Thomson Reuters



Source: Company accounts and Bloomberg



Source: Company accounts and Bloomberg



Source: Company accounts and Bloomberg

ULS Technology

Disrupting the conveyancing sector

ULS is an exciting technology business looking to disrupt traditional markets. Its lead product is conveyancing platform, eConveyancer, which supports the process of identifying and selecting a solicitor to undertake conveyancing for property transactions. The system is able to filter by price, location, service rating, solictor's availability as well as the user's requirements, and then instructs the selected solicitor directly. The solicitor pays fees to ULS on completion, whilst solicitors can also generate additional revenues for ULS by using the platform to perform legal searches and ID checks. ULS operates on a B-2-B platform used by a host of banks, building societies, mortgage brokers, estate agents and comparative websites. We like ULS as it offers a clear proposition, helping those that are moving house to source optimal local services, in a fast and cost effective manner, with savings on conveyancing averaging more than £500 per customer. It has gained market share rapidly, and we believe it has a lot more to go for.

As mentioned above, its platform is used by a number of mortgage providers across a range of sectors. Looking at each sub sector will show the potential for growth. Banks, Building societies and specialist mortgage lenders account for 35% of distribution, with names such as Lloyds, Bank of Scotland and Yorkshire Building Society leading the way (Lloyds remains at c.50% of divisional revenue, having been its first customer, but this is already down from 80% previously, and we expect it to continue to reduce rapidly). However, eConveyancer has also become the platform of choice for new challenger lenders such as Aldermore, Lighthouse and New Leaf. Management believes there are 50+ new lenders to target, including big names such as Barclays and HSBC. Winning one of the big lenders, could double turnover in time, so the opportunity remains vast.

Intermediaries, such L&G, John Charcol, and London & County accounts for 57%. The company targets increased penetration rates within existing relationships, as well as winning new accounts. Direct to consumer is currently 7%, which is moneysupermarket and HomeOwners Alliance. The recent acquisition of a 35% stake in HomeOwners Alliance we believe will allow ULS to capture far more conveyancing traffic, since the website has c.5m hits per year and is growing rapidly. ULS has the right to acquire the remaining stake in the business, if it proves to be successful.

The final area, which last year accounted for 1% of distribution, is estate agents and housebuilders. With Barratts now using the eConveyancing platform we believe others in the sector will follow suit. With regards to estate agents, its latest acquisition made both financial and strategic sense. Financial, in that it was accretive, boosting group earnings by some 18% for FY17, even before any synergies or technology platform benefits are taken into account, which we believe could be sizeable. But also strategic, in that management of ULS had talked about targeting an increased presence in the estate agency market, and this transaction supports this, with 50% of its revenue coming from independent estate agents.

Since 2007, ULS has grown rapidly to now account for sub 2% market share of the convenyancing market. Management's long term target is to grow this to c.10%, which would be over £100m of turnover per annum. Given the relatively fixed nature of operational costs, such growth should lead to significant operational gearing, driving exponential growth in profits and cash.

Whilst the core business looks well positioned to us, the company is also working on an exciting new proposition; estateagent4me. This is a newly launched proprietary technology platform that enables home owners to compare the performance of local estate agents based on success rates, proximity to asking price, etc, and instruct them. ULS will ultimately capture and monetise this data once a database has been established. We expect this website to gain traction as consumers seek to differentiate between high street and online estate agent offerings, especially as it can use HomeOwners Alliance to promote it. Moreover, as the user numbers build up, it allows ULS to capture potential homeowners earlier in the house buying/selling process. So, it is not unreasonable to expect ULS to offer more related services in the future, such as comparisons of energy providers, broadband, home insurance or will writing (all new home ownership related) so they will be able to own the customer journey from sale to purchase.

The vision in the immediate future is to grow its conveyancing market share to over 10% via organic growth and potential acquisitions, driving top line from a current £20m to over £100m, without requiring the housing market transaction rate to recover. Meanwhile, estateagent4me will broaden and enhance their proposition, and also opens up a direct to consumer channel for them. The stock is beginning to become more known and has started to rise. However a rating of 20.2x remains very reasonable for a fast growing, truly disruptive tech business.

'Winning another big bank, such as HSBC, could effectively double revenue to c. £40m.'

‘Whilst the core business looks well poised to digitise the age old conveyancing process, there is also an exciting new proposition that has been developed by ULS; estateagent4me’

ULS Technology

BUY

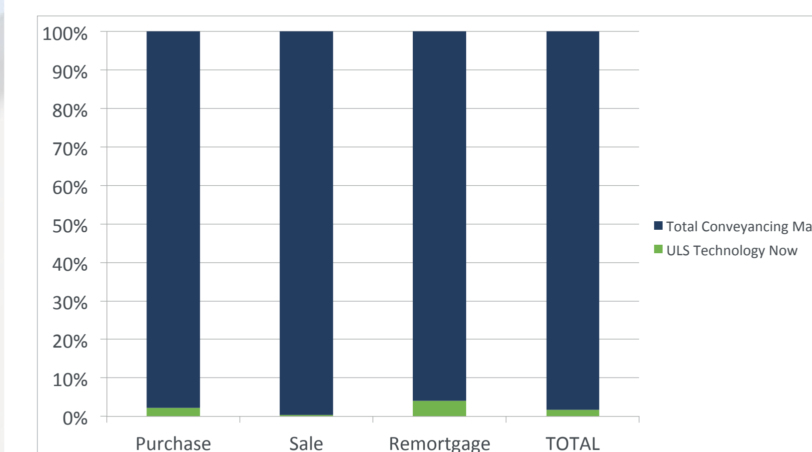
Ticker	ULS
Price	93.3p
Target Price	n/a
Upside	n/a
Market Cap	£60.5m
Index	FTSE AIM All Share
Sector	Media
Net Debt	£6m
Shares in Issue	64.8m

%	1M	3M	12M
Actual	+25.6	+40.8	+49.2
Relative	+19.4	+36.4	+29.4

Share Price Performance

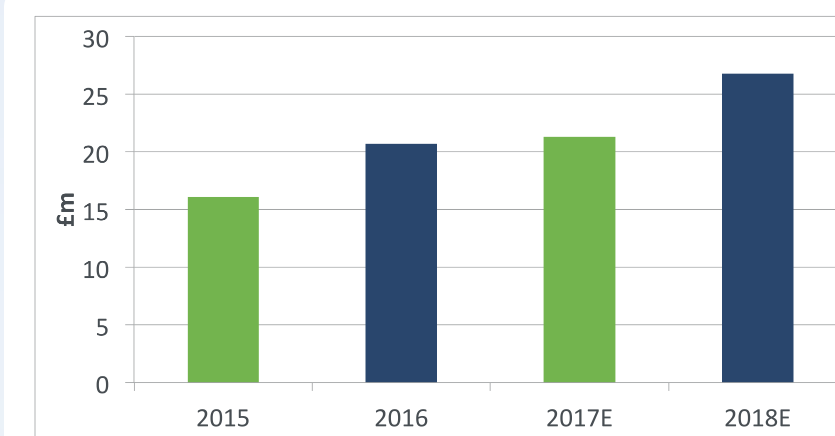
Source: Thomson Reuters

Potential Conveyancing Opportunity



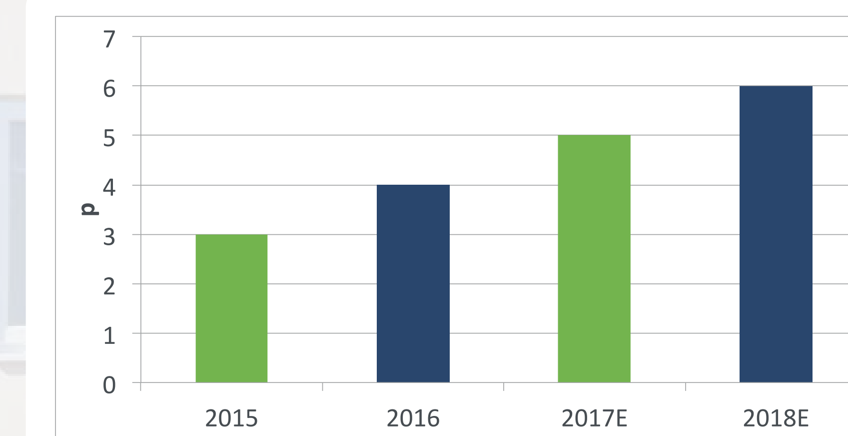
Source: Company accounts

Revenue

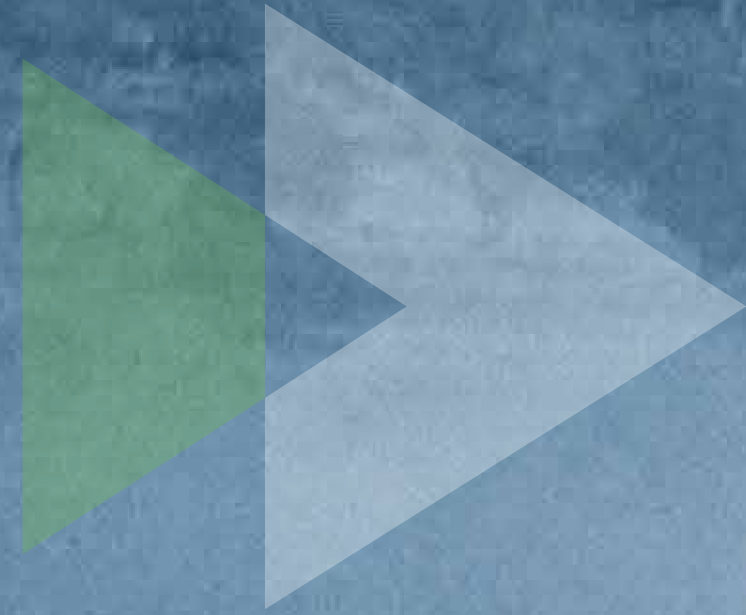


Source: Bloomberg

EPS



Source: Bloomberg



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