Growth Company Seminar Report - October 2014

ShareSoc held another Growth Company Seminar on the 23rd October. What follows are some brief notes on the companies presenting, what the speakers said and the questions/answers given. This needs to be read in conjunction with their Powerpoint presentations which are present in a Forum on the ShareSoc Members Network and give the context for the notes below. The questions are often penetrating in nature but are reported here for completeness.

First a preamble. It's noticeable that the share prices of UK smaller companies have generally suffered in the last few months. AIM is down over 20% since its peak in March, a much larger decline than the main indices. This is a symptom of a worldwide aversion to small cap stocks as investors have moved to more defensive holdings as economic headwinds loom in many countries. Perhaps smaller stocks became overblown by speculation in some cases in their re-rating in the last couple of years, but the fact remains that the longer term returns from good quality smaller stocks are likely to exceed those of large cap stocks. ShareSoc will therefore continue to run seminars where interesting smaller growth company stocks can present, and surely investors should be looking again at such stocks now that prices have fallen back to lower levels.

Communisis

The first company presenting was Communisis, fronted by Andy Blundell, CEO , and Mark Stoner, Financial Director. Mr Blundell said he had been CEO for 5 years and before that had worked for Bemrose and De La Rue. He said he loved what he does.

Communisis provide personalised customer communication services. The business has three main segments: 1) Design/agency; 2) Production (the traditional "heartland") which is about 55% of revenue and typically involves transaction billing and statements; and 3) Deployment which includes such items as P.O.S. material.

The challenge now is to address multi-channel communication, i.e. digital and print combined. They recently took on a big contract with Lloyds Bank for both inbound and outbound transactions. Outsourcing is now common. They are expanding overseas activity and are looking for one third of sales to be outside the UK.

The net margin was 3% five years ago but is now 6% and they hope to get to 10% in a few years. When Mr Blundell joined the business, 80% of revenue came from financial services but it is now 45% - they have diversified into other areas. The company wants to be a strategic supplier to companies. As regards the 2014 interims, Mr Blundell said there was a good cash flow story which has been a bit of a debate about Communisis in the past.

Mr Stoner then took over and said the first half results were strong. Communisis has a progressive dividend policy and it was increased 12% in the first half. There was positive free cash flow but debt was raised in comparison to the prior year. This mainly arose from the equity raising in the first half of 2013 which was subsequently spent on acquisitions. Acquisitions were done to build their capabilities in the design area.

They are increasing margins by focussing on the right customers and reducing the proportion of revenue from "production". The focus is on FMCG companies who want to grow their brand and he expects the design element to grow. Legacy issues were too many sites and a big pension deficit. A lot of cash was used in the last 5 years on those, but less recently.

A question was asked as to whether the company was comfortable with the level of debt and gearing. The answer was yes - they need the debt to finance development.

Mr Blundell concluded the presentation by saying they are well into delivering the forecasts for the second half and said that he talks to the larger customers first hand.

M.B. questioned the return on the £135m of capital invested in the last few years (in terms of the increased profits resulting). Was that a good return? Another questioner also raised the issue of the apparent low return on capital. The answer given was that the figures are improving, particularly in terms of the free cash flow.

Lok'nStore

The presenter was Ray Davies, Group Financial Director. Lok'nStore is a self storage company and has been on AIM for 12 years. The revenue is split one third from businesses and two thirds from households. Customers often use self-storage after a negative event (e.g divorce, eviction) so it is important to have empathy with them. The company has a high ebitda margin and a diversity of customers. It requires low to no capital reinvestment once the sites are established, i.e. there is no need to "refresh" the properties every few years like retailers. Mr Davies emphasised the relatively low usage of self-storage in the UK in comparison with mature markets such as the USA, so there is clearly a lot of potential remaining (see the ppt presentation for background data).

The occupancy rate is 70% on average and there is a mixture of freeholds and leaseholds. They are progressively increasing the dividend.

Recent results for the year ending July are summarised by: Record turnover up 7.2% to £13.91 million; Record profit (EBITDA) up 11.6% to £4.62 million; Self-storage occupancy up 12.4% and pricing up 5.8%; Annual dividend up 16.7% to 7 pence per share; 5 new stores opened/opening.

A question was asked about the reduction in normalised e.p.s. last year. This arose apparently from a write down on a store that was not developed after all - so the site was devalued to an "alternative use" basis. Note: properties are valued apparently on the basis that they are used by self-storage operators and on the likely revenues/profits resulting, not on a totally "open market" value. If not useable by self storage operators then they would be classed simply as warehousing with a lower market value (although the planning classification is the same). Mr Davies said all the properties would be valued at less on an alternative use basis.

M.L. asked how high do you think the company could get the occupancy rate. Mr Davies said if you get above 75% then the focus tends to change to increasing prices.

Another questioner asked about the return on assets in comparison with their competitors but Mr Davies declined to comment on competitors.

Mr Davies then covered some of the new store developments. He was asked how long it took a store to get to their target occupancy level. The response was that new stores tend to be cash breakeven in 6 to 9 months when they would be 30% full.

Optimal Payments

The presentation was from Jessica Stalley, Head of Investor Relations. She ran a corporate video to start with which gave an overview of the business. It has two main elements: Netbanx which is a payment processor (i.e. handling credit card payments for merchants) and Neteller - a virtual wallet (or stored value account) primarily used to help customers to pay money into on-line gambling sites.

Ms Stalley noted that the company had recently acquired two companies in the USA, Meritus and GMA. These were complementary to Netbanx - Meritus had more small to medium sized customers though. The company was debt free in June but had taken on debt to finance those acquisitions in July - they expect to pay it down in two to three years.

Netbanx is focussed on "high risk" clients in comparison with other payment processors, for example travel companies.

Recent improvements in the Neteller business have arisen from a focus on high-rollers (VIPs) and they have a conversion rate of 78%. Historically 80% of revenues in 2005 in Neteller came from the USA, which disappeared after on-line gambling was outlawed and they subsequently had to focus on other counties. But the US market is now opening up again. There is only one significant competitor in Europe which is Squirrel. The UK is their largest market for Neteller even though it's a "white" market. Note: Neteller basically allows people to pay in money to gambling companies that they could not normally do directly via a debit or credit card due to restrictions by the card companies in certain jurisdictions, but there is no such restriction in the UK.

M.B. asked about future growth and where it was coming from and the use of cash (for example in possibly paying dividends - there are no dividends paid at present). Ms Stalley said there were good opportunities to reinvest in the business and that the dividend policy was unchanged.

Another question was the current situation regarding freeing up of the US market (an obvious significant growth opportunity). The response was that three states had already legalised on-line gaming but only residents of those states could participate. It depended on individual state politics and was under consideration in California - perhaps for 2015.

The company is also developing "white label" propositions for card solutions for launching in the new year.

There was a question about moving to the main market but it was suggested that the time was not yet appropriate, and about the need to continue to hold AGMs in the Isle of Man where the company is registered - apparently only one ordinary shareholder turned up last year.

Ideagen

The presenter was David Hornsby, CEO. The company is an information management software business specialising in: Governance, Risk and Compliance in the Healthcare, Life Sciences, Complex Manufacturing, and Banking & Finance sectors and also has a focus on Clinical Content applications in NHS Trusts and the Private Healthcare sector.

Mr Hornsby said that during his time the share price had moved from 10p, to 22p and to 33p now. He originally invested in the business in 2009 when the company was challenged. They had no particular market focus and so he immediately focussed them on compliance solutions. Since then he had broadened the proposition to cover "risk and audit" and they also saw an opportunity in the NHS - they had acquired a couple of companies in that sector. Last year they achieved 38% revenue growth of which 13% was organic growth. Ebitda was up 39% and the ebitda margin was 13%.

The company has a strong focus on recurring revenues which now cover a high proportion of the fixed cost base. The company is aiming for 20% e.p.s. growth each year.

A question was asked about the doubling of shares in issue. The response was that they use equity to buy companies - typically by issuing shares to institutions in placings and using the cash then for the acquisitions. They typically do earnings enhancing acquisitions which raise e.p.s. and they don't acquire companies at high valuations.

Mr Hornsby discussed the GRC market (Governance/Risk/Compliance) which is growing at 16% per annum according to Gartner. He noted that lots of corporations don't have adequate internal audit and compliance systems (could be have been referring to major supermarkets bearing in mind the recent events there?).

He was asked how the company was going to grow - the answer was by more acquisitions, but he does not want to use debt. Some attendees raised the issue of the high risk involved in acquisitions.

A question was asked about the development staff. Mr Hornsby said they have 50 developers. They do capitalise some development costs as required by accounting standards but they try to keep it to a minimum, e.g. £500k of £1.5m spent last year.

In response to another question he said it is a traditional software sales model - upfront license fee plus 20% for maintenance annually. They can offer SAAS but they are not an SAAS company.

He also covered the historic failure of the NHS IT initiative where £10bn was spent. But now NHS Trusts can select their own applications. Such deals have grown from being £20k to £30k deals to up to £1m now. The biggest driver to such sales is the failure of the national programme to deliver but it is also a question of a good financial return on the investment (e.g. by moving to paperless systems that save staff). He also quoted a Government Minister as saying "a paperless NHS could save lives". Some 75% of trusts (there are 150 trusts) do not have system (e.g. for electronic patient records). Eleven out of 40 trusts who have implemented such systems use the Ideagen products and he thinks they are winning 1 out of 2 new deals. Kainos is their largest competitor.

M.B. asked what lessons can be learned from the VA deal (this was somewhat of a problem a couple of years ago when Ideagen acquired a company who had a large contract with the US Department of Veterans Affairs which was subsequently cancelled). Mr Hornsby joked "never to go to Chicago again" but also said that it emphasised the importance of having a contingency in your forecasts, and that he would be wary of doing business with the US Government (their contracts are very onerous in comparison with elsewhere). But it demonstrated the strength of the Ideagen business that they soon recovered from that setback.

A question was raised about the inability of private investors to participate in the aforementioned placings. Mr Hornsby said they will consider whether they can include an "open offer" in future.

The meeting then concluded with refreshments when attendees could ask individual questions of the presenters. The next ShareSoc Growth Company Seminar will take place on the 26th November - see http://www.sharesoc.org/seminarnov2014.html for more information and registration.

Roger Lawson 25/10/2014