Date: 4 November 2014

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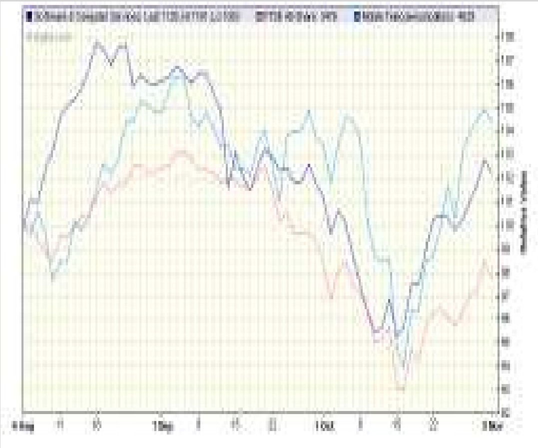
# Tech valuations descending from the cloud?



| Fixed Line Telecommunications | | |
|---|---|---|
| | **Latest** | **F'cast** |
| P/E | 20.61 | 27.65 |
| PEG | 1.53 | 1.53 |
| Pr/Revenue | 4.49 | n/a |
| Pr/Book | 3.58 | |
| **Software & Computer Services** | | |
| | **Latest** | **F'cast** |
| P/E | 27.35 | 18.83 |
| PEG | 1.31 | 3.35 |
| Pr/Revenue | 4.12 | n/a |
| Pr/Book | 9.32 | |
| **Mobile Telecommunications** | | |
| | **Latest** | **F'cast** |
| P/E | 16.22 | 23.37 |
| PEG | n/a | 0.1 |
| Pr/Revenue | 3.68 | n/a |
| Pr/Book | 1.86 | |

***Source: Digital Look***

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The tech sector has been in the spotlight throughout 2014 and as ever, has produced moments of sheer glory and of course some utter horror stories. Monitise, Quindell, Blinx, Outsourcery, MoPowered have caused many a sleepless night. The sector performance is edging ever closer to their biotech cousins whereby company performances have ranged from 200% gains to a peer's 90% share price loss over a period of a year. This vast disparity in performance within the sector is making investors nervous, from all walks of life; from the retired retail investor right up to the award winning small cap fund manager. And that is simply because in its current state, the sector is becoming very hard to call.

Amongst all other sectors, tech is the one which dominates the headlines – who remembers the last engineering IPO or support services deal? Ask the same question in tech you will have Alibaba, Facebook, Snapchat, Twitter, LinkedIn, amongst others thrown right back at you. Sentiment around these companies inevitably trickles down – not only for IPOs but also in the secondary market when we see what has happened to the likes of Quindell and Monitise. AIM market veterans are familiar with 70% or 40% share price drops in a short period of time – but these are very often (but not exclusively) in the sub £50m market cap arena, rather than companies who are edging on a £1bn market cap. The company valuation revolution in tech has kicked up an unprecedented storm and is (quite rightly) here to stay. It is this issue of valuation that has caused the tech sector to be clouded in mystery. To the bulls, they are investing in the "companies of tomorrow", to the bears; "how can a loss making company be valued at close to a £1bn?!" This statement has quickly been reprimanded by the bulls damning the bears that they simply do not understand the buzz words or the market potential of "cloud" or "SaaS".

We can't all point the finger at the corporates that have suffered this sector upheaval – it is also the advisors, the dreaded sell side, that promote these deals to the unsuspecting in the first place. Unfortunately, bear markets create nodding donkeys; advisors saying yes to everything for a quick corporate finance fee and their quality control for deals goes straight out the window. When spikes in the market happen, advisors are quick to take advantage of sector waves and rush the IPO process, not paying attention to thorough due diligence on business models, pricing and ultimately, valuation. Just look at the performances of certain tech deals coming on stream from Q4 2014.

Even now as we near the end of 2014, investors are offering a scornful reception to new technology companies. Wanting ever greater clarity on market positioning and how they stack up against their peers. This change in sentiment should start to host a new breed of company. The days of loss making tech stories are over. It's time for tech companies to learn from their comrades in the engineering sector – business models that are built on real revenues, real customers, and dare I say it…a bottom line.

***By Niall Pearson***

## Economic outlook

Economically the UK snapshot looks mixed to positive, it is the political situation that is most concerning. The UK economy is still growing around the "twin pillars" of a fast recovering financial services sector and consumer spending. The latter of which has been encouraged by rising house prices and windfall PPI payments; which averaged over £440m per month in 2013 but which is tapering off now. Inflation is in decline; across the board and not just reflecting oil prices. Real earnings are still in negative territory, so no imminent pressure from that front either. On the negative side many European economies – particularly the French - are, we are told, stagnating though in reality they are almost certainly receding, which is an increasing drag on the UK.

The "twin pillars" mentioned above are the same two segments that caused most of the trouble in 2008; so it would seem not much has been learnt or changed since then either. As for "austerity": Though the word appears a lot in political headlines, and NHS debates there is precious little visibility of it in any economic data and the deficit elephant still crowds the room.

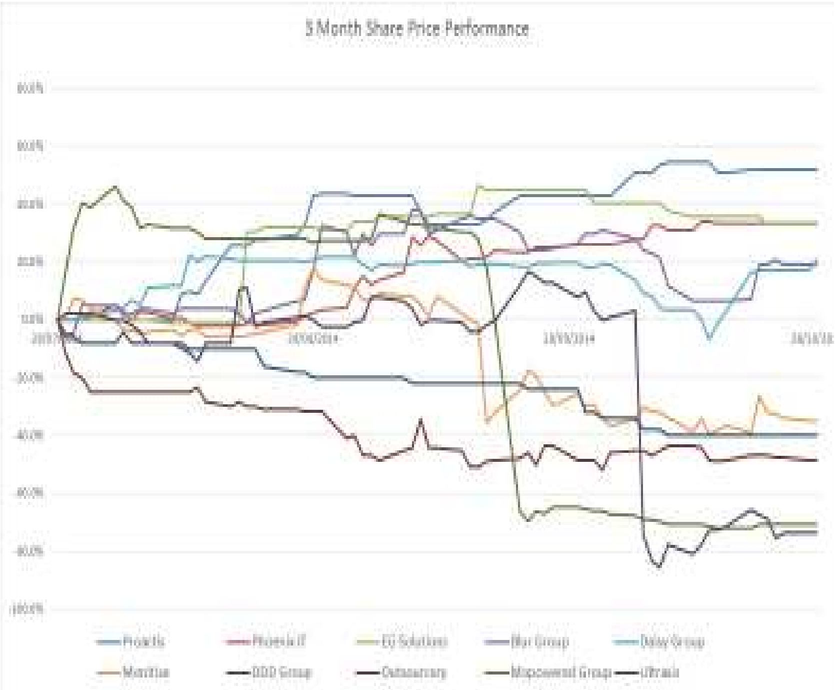
However, the single biggest upcoming hazard to the economy is surely the general election. As we saw with the Scottish referendum there is nothing that stalls an investment decision like a close fought referendum, and the spring poll is already set to be that: What would happen if labour loses 20 seats to the SNP? What if UKIP takes multiple seats from both Labour and Conservative? Would Labour or Conservative want to press on with a minority? Is there any appetite for another coalition? You could even end up with a coalition minority or worse still a second election in the autumn. While all that is going on there will be no investment internally or from overseas and that has to be a concern to small growth stocks.

***By William Lynne***

### Top 5 risers and fallers

| *As at 9 am on 28 October 2014* | *1 month Share price movement* |
|---|---|
| Proactis | 51.79% |
| Phoenix IT | 33.33% |
| EG Solutions | 33.03% |
| Daisy Group | 20.80% |
| Blur Group | 19.20% |
| Monitise | (34.88%) |
| DDD Group | (40.00%) |
| Outsourcery | (48.33%) |
| Mopowered | (70.73%) |
| Ultrasis | (73.60%) |

*Source: Fidessa*




*Source Fidessa*

**PROACTIS Holdings (LON: PHD 85p/£33.09m 3mth +51.79%)**

On 4th August, PROACTIS, the specialist Spend Control software provider, announced the acquisition of Intelligent Capture Limited (IC), a provider of document scanning and optical character recognition services, to support the launch of PROACTIS' new offering, 'Activate'. The objective of Activate is to create a Global Trading Network between PROACTIS' customer base and their vendors. The Global Trading Network will encourage electronic trading, which is currently poorly adopted, creating efficiencies within the buy/sell transaction process. The total consideration was £1.55m. For the year ended 31 March 2014, the unaudited accounts of IC showed turnover of £1.41 million on which it made an operating profit of £0.21 million.

On 6th October, PROACTIS reported its preliminary results for the year ended 31 July 2014. Revenue increased by 26% to £10.2m. Adjusted EBITDA increased by 64% to £2.0m. Recurring Annualised Revenue increased by 143% to £13.1m. The order book at 31 July 2014 increased by 131% to £14.3m. Adjusted earnings per share increased by 59% to 2.7p and the proposed final dividend increased 10% to 1.1p per share. Rod Jones, CEO commented: "PROACTIS is now effectively double the size of a year ago as a result of its three acquisitions and the Group is trading well in advance of today's reported results. Acquisition integration programmes are progressing well, and the opportunities to offer our clients a wider service are being realised. The Board continues to review appropriate M&A opportunities as part of its growth strategy."

**Phoenix IT Group (LON: PNX 120p/£99.55m 3mth +33.33%)**

The UK IT Services most recently updated on trading on 2 October for the 6 months ended 30 September 2014. The interims are due for release on 25 November. As previously stated, trading at a Group level continued broadly in line with market consensus for profit. The level of net debt at the Half Year, at £56.1m, is somewhat better than the Board's expectations. The Group also updated on a number of business developments. The company announced the first of its customers to migrate to a Service Level Agreement from a resource basis. This supports Phoenix's ability to add value and innovation in the way its service is delivered in the future. Good progress is also being made in discussions regarding similar commercial amendments to other customer contracts in the Partner business. The Company's new strategy also calls for improvements in the efficiency of delivery in the Partner business. Good progress has already been made on this activity, with contractors replaced by existing full time employees and some movement of contractor-staffed project work to existing Field Engineering resources. Further opportunities for improvement are planned for the second half.

**EG Solutions (LON: EGS 72.5p/£11.94m 3mth +33.03%)**

The back office optimisation software company announced in August that trading during the six months ended 31 July 2014 has continued strongly and, following a significant new contract win and strong momentum in trading, now expects to report financial performance for the full year to 31 January 2015 ahead of current market expectations. The contract is with an existing client, a major third party outsourcing company. Revenues under the initial contract are expected to be in excess of £1.2m, of which £0.63m will be recognised in the current financial year. The company subsequently reported interim results to July on 17 September. Revenues were up 78% to £4m with a £2m swing to profit before tax of £0.6m vs a loss of £1.4m. Net cash generated from operations was £0.7m (2013: outflow of £0.1m). There were nine contract wins in the period from new and existing customers demonstrating strong momentum in the market for eg's product suite.

**Daisy Group (LON: DAY 184.13p/£490.55m 3mth +20.80%)**

On 13 August, the independent UK supplier of cost-effective services and bespoke unified business communications solutions to SME and mid-market businesses confirmed that it had received a preliminary approach regarding a cash offer for Daisy at 190p per Daisy share. The consortium consisted of Toscafund, Penta Capital, and CEO of Daisy Group Matthew Riley. On 20 October, a revised offer of 185p was unanimously recommended by the Group's Independent Directors. The Offer Price represents a premium of approximately 16.4% to the Closing Price per Daisy Share of 159.0 pence on 25 July 2014 (being the last Business Day prior to the Consortium's approach to Daisy), 31.3% to the volume weighted average Closing Price per Daisy Share of 141.0 pence for the month ended on 25 July 2014, and, 5.7% to the Closing Price per Daisy Share of 175.0 pence on 12 August 2014 (being the last Business Day prior to the announcement by the Company that it was in preliminary discussions with the Consortium). The Offer values the entire issued and to be issued share capital of Daisy at approximately £494 million.

In addition, the Offer implies an enterprise value multiple of approximately 11.0 times Daisy's Adjusted EBITDA of £57.9 million for the 12 months ended 31 March 2014 and an equity value multiple of approximately 13.4 times Daisy's Adjusted EPS of 13.85 pence for the 12 months ended 31 March 2014.

**blur Group (LON: BLUR 74.5p/£35.08m 3mth +20.80%)**

The international e-commerce company providing a better way for businesses to buy or sell services released in September, its interim results to 30 June 2014. Under a revised revenue recognition policy revenues were up 303% to $5.7m. Bookings were up 206% to $16m. Adjusted EBITDA losses nearly doubled to $4m. Following a $21m net fundraising in June at 75p the company finished the period of with cash of $24.4m that is planned to take the Group through to profit. The fundraising will also be used to accelerate new customer acquisition, technology development, and regional expansion into Asia. Subsequently on 16 September Stephen Harvey was appointed as CFO. With over 20 years in the software sector, Stephen was CFO of Microsoft UK until 2004. More recently the group reported that it continues to gain new business from enterprise customers as it moves into the final months of 2014. Argos and Tesco are the latest blue chip companies to kick off services projects via the blur 4.0 platform, joining Regus, Danone, Solvay, Amazon, Sabre and Menard who are already active repeat blur platform users.

**Monitise (LON: MONI 29.25p/£576.17m 3mth -34.88%)**

Monitise, a company specialising in Mobile Money (banking, paying and buying) updated on trading in July issuing FY 2014 revenue growth guidance of 31% to 33% vs expected 40%, due to a faster shift to the subscription model, with lower up-front revenue. Monitise expects revenue growth of at least 25% in FY 2015. Longer term guidance was maintained, including the intention to achieve profitability in FY 2016. Later in July MONI announced an expanded, multi-year global alliance with IBM to deliver cloud-based mobile commerce solutions to help financial services institutions embrace the mobile channel and better engage with customers and in August entered into an agreement to transfer UK Professional Services staff to IBM. Teams from Monitise's UK development and integration business known as Professional Services -- including a number of contractors -- will be transferred into IBM; IBM will in turn deliver services back to Monitise.

On 15 September, FY June 2014 results were released showing revenue growth of 31% to £95.1m. Group EBITDA loss was £31.4m for the year (FY 2013: £19.3m). The increase in loss, in line with management expectations, was driven by investment in product and sales in particular in the second half of the year as the strategy to accelerate user growth was put in place. Group net cash was £146m as at 30 June 2014 (FY 2013: £86m)

On 18 September, Monitise confirmed that Visa was assessing its 5.5% in Monitise in line with "Visa's investment practice to seed emerging players and, over time, taper that influence as the partner company grows." The shares were down over 30% on the day. Since then Monitise has announced a number of product launches and director share purchases.

**DDD Group (LON: DDD 4p/£5.75m 3mth -40.00%)**

On 31 July 2014, the advanced imaging and 3D solutions company announced that it was raising up to £2.1m through the issue of Convertible Unsecured Loan Notes with firm commitments from related parties (including directors) amounting to £535k. The notes have an annual interest of 7% and a conversion price of 10p. The Company has the option to redeem the Notes at any time at a 5% premium to their nominal value plus accrued interest. Any Notes outstanding on 30 January 2016 will at the option of the Company be repaid in cash or settled by the issue of Shares at the conversion price; in both cases accrued interest will be payable in cash.

In September, the Group announced interim results to 30 June 2014. Revenues approximately halved to $1.19m due to previously reported contraction in the 3D PC market. The adjusted EBITDA loss was $460k vs $132k absorbing $694k cash from operations vs $22k. The company has reduced headcount by circa 30% since the beginning of 2013. Looking ahead the 'The expansion of the Group into new 2D markets is progressing well and is expected to produce initial revenue contributions in early 2015. The growth projections for 3D sensors into the PC, tablet and mobile phone markets are well in excess of 200% average per year until 2018 and are a key reason for the sustained research and development efforts within the Group for new product solutions.' The Chairman commented that 'Most recently, the Group changed its patent licensing advisor due to slower than expected progress. The new advisor has already met the agreed objectives with key licensees in the consumer electronics market and presentations and discussions with prospective licensees have commenced.'

**Outsourcery (LON: OUT 15.5p/7.33m 3mth -48.33%)**

On 31 July, the Cloud Services Provider updated that the Board had been prudently reviewing a range of options that would improve the Group's cash resources and confirmed that discussions regarding a combination of debt and equity funding options as outlined in its trading update on 27 June had progressed quickly and positively in recent weeks. Subsequently on 14 August, Outsourcery announced a £1.5m placing at 20p (an 11.1% discount to the previous day's mid-price). In spite of the growth in the pipeline of opportunities faced by the Group, the large-scale pipeline build of its strategic partner channel has taken longer to ramp up due to delays in finalising the necessary organisational, system and salesforce readiness. This has had an impact on the short term growth of the Group's recurring revenue and consequently, pushed out the Group's monthly cash flow break-even point despite enacting additional identified cost savings. The Group will seek to continue to activate new partners to achieve revenue momentum that will contribute towards allowing the Group to reach break-even. The Directors believe that continued tight control of its costs will allow the Group to benefit from further operational leverage in the medium-term. The placing was part of a £4.5m financing package which also comprised £1m annualised cost savings, a directors' salary sacrifice of £0.5m and a rescheduling of £1.5m of debt service by debt providers. A further £1m was raised by an investment by Encore Capital at 20p as announced on 10 October. That followed the June 2014 interim results on 24 September which showed 65% revenue growth to £3.4m. Adjusted losses from continuing operations fell 12% to £3.6m. The outlook statement commented that "the outlook for revenue growth has improved, due to a strong pipeline of large enterprise and mid-market end-customers, through both direct sales and strategic partnerships. This, combined with a strategic realignment and reorganisation to reduce costs, is expected to result in the Group becoming EBITDA positive on a monthly basis by the end of 2015 and operational positive cash flow in the same time frame."

**MoPowered Group (LON: MPOW 6p /5.34m 3mth -70.73%)**

On 19 September the mobile commerce specialist announced June 2014 interim results showing a 39% increase in revenue to £753k. Adjusted EBITDA losses came to £1.53m (from £0.84m) reflecting planned levels of investment. Within the announcement a £3.5m proposed placing was announced subject to shareholder approval. Three days later it was announced that the money had been conditionally raised at 5p, a 75.31% discount to the mid-price of 19 September. On 7 October, the company announced that a wholly owned subsidiary had conditionally acquired 'the Cortnan platform' from rounded Labs. Cortana is a technology asset which allows for the rapid construction of mobile commerce applications for £170K. This prompted a further £157k placing also at 5p. On 15 October, it was disclosed that Robert Keith had picked up a 23.74% stake in the company, presumably in the recent placing.

**Ultrasis Group (LON: ULT 0.16p /2.86m 3mth -73.6%)**

On 19 August, the provider of complementary health and social care related services updated on FY July 2014, a year which had comprised three acquisitions and several significant contracts. As at the date of the announcement the Group had £1m undrawn on its debt facility with Paul Bell, a significant shareholder. Ultrasis guided that invoiced sales for the year will be approximately £2 million (2012/13: £0.7 million). On 29 September, the Group announced a partnership with BMI Healthcare and Benenden Wellbeing Limited to offer a range of health screening and health care services to members of Benenden and the general population. This will be branded Benenden Health Assessment. The health assessments will be available to c.900,000 members and priced at priced from £89 to £499.

On 7 October, it was announced that two of the company's non-executive directors were stepping down and that John Smith, CEO, will become interim Executive Chairman following Gerald Malone's departure and the Company will now seek an alternative Chairman and non-executive director to provide an appropriate board structure. In the same announcement it was revealed that Paul Bell had informed the company that he may be prepared to improve his loan facility to Ultrasis, subject to, inter alia, a review of the Company's short and medium term working capital requirements and the Board seeking cancellation of the Company's shares to trading on AIM. Consequently, the Board intended to send a circular to shareholders seeking the cancellation of the Company's shares to trading on AIM.

On 20th October, Ultrasis announced that it had entered into further discussions with Mr Paul Bell. In the event that these discussions did result in an agreement for Mr Bell to provide further funding over and above the current loan facility the company stated that it would be likely that any such funding would result in shares in the Company being issued at a discount to the current share price. If this was to happen, it is the intention that other ordinary shareholders in the Company would be able to participate on comparable terms in respect of any equity investment. The issue of a circular has been postponed for now and in the meantime Mr Bell continues to provide working capital to the Company under the terms of the existing loan arrangements.

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