OXFORD METRICS

TECHNOLOGY

6 December 2022

OMG.L

90.5p

Market Cap: £117.4m

SHARE PRICE (p)

12m high/low	127p/77p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£67.7m *(at 30/09/22)*
Enterprise value	£49.7m
Index/market	AIM
Next news	AGM, Feb. '23
Shares in Issue (m)	129.8
Chairman	Roger Parry
Chief Executive	Nick Bolton
Finance Director	David Deacon

COMPANY DESCRIPTION

Oxford Metrics develops smart sensing software that enables the interface between the real world and its virtual twin.

www.oxfordmetrics.com

OXFORD METRICS IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Yotta cash to invest for lotta returns?

Oxford Metrics has today reported a strong set of FY22 results particularly given the supply constraints set out in the September trading update. Demand is clearly strong with another record order book – over £24m at the year end. The statement discloses that management see the supply chain constraints relaxing, but they are not taking this for granted. We see it as too early to upgrade our FY23 trading forecasts to include the £3.5m of revenues delayed in FY22 on top of existing forecast volumes, although we are upgrading interest income expectations. Location Based Entertainment has performed particularly well – accounting for 9% of revenues. We note that the recent commentary from the semiconductor majors and the strong order book balance the risk in our forecasts to the upside – and investors are rightly focussed on what can be achieved with the £67.7m in cash.

- **Results in line with revised expectations.** Revenue of £28.8m was 4.5% ahead of FY21, little different to our estimate of £28.9m, and up 0.5% on a constant currency basis. The principal drivers were the strength in the sales to Location Based Entertainment and the return to growth in Life Sciences. The Adjusted PBT result was £2.6m, just ahead of our estimate from October of £2.5m, but down on the FY21m results of £4.0m. The decline was mainly due to deferment because of supply constraints of £3.5m of orders guided to in September, but there was also a heavier spend as part of the five-year plan for growth and some impact on gross margins from higher component pricing.
- **No increases to trading forecasts at present.** Management comments and electronics industry newsflow suggest that supply chain constraints are easing, but we are not raising our trading forecasts for FY23 to reflect the delivery of the deferred £3.5m shipments on top of our existing forecasts. We see this as creating an upside risk to forecasts.
- **Yotta cash pile – don't forget where it came from.** Year-end cash was £67.7m, a considerable increase on £23.0m FY21 following the disposal of Yotta in May. In addition to giving Oxford Metrics a clearer operational and strategic story, the disposal provides management with considerable firepower to drive their Sense, Analyse and Apply strategy and achieve their five-year goals. Management state that, despite declining, private market valuations remain unrealistic. We admire the cautious approached, and point to the fact that the reason for these substantial funds is management's ability to make timely investments and disposals.

FYE SEP (£M)	2020	2021	2022	2023E	2024E
Revenue	30.3	27.6	28.8	36.9	41.6
Adj EBITDA	5.6	5.0	5.3	8.2	9.1
Fully Adj EBIT	2.7	4.1	2.4	5.1	6.0
Fully Adj PBT	2.6	4.0	2.6	5.9	6.8
Fully Adj Dil EPS (p)	2.0	3.6	2.5	4.1	4.7
EV/EBITDA (x)	8.8x	9.9x	9.4x	6.1x	5.5x
PER (x)	44.8x	25.4x	36.0x	22.0x	19.1x

Source: Company Information and Progressive Equity Research estimates.

In line with constrained expectations

The results were in line with expectations, but this was following the trading update in September which set out the shortfall due to supply constraints causing a £3.5m deferral of shipments. The results described here are ex-Yotta, following its disposal in May for £52.0m in cash. The clear message is that overall demand is strong and that management have a busy and productive 2023 ahead of them.

FY22 results vs forecasts and FY21

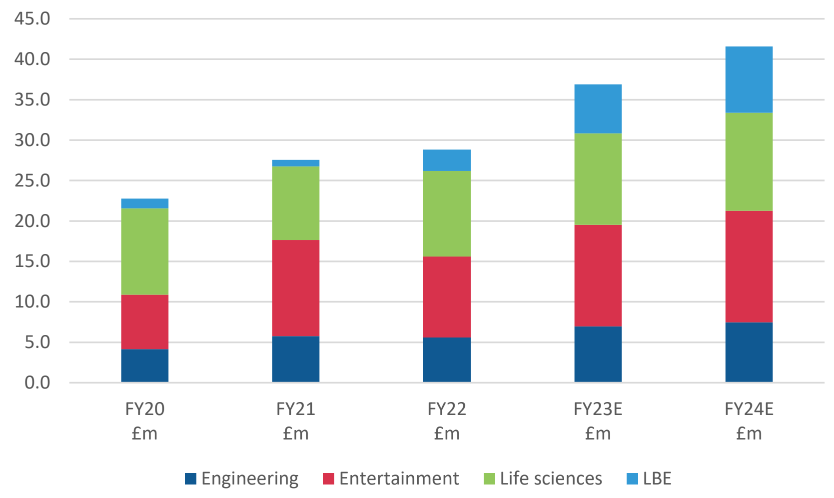
	FY22A	FY22E	Difference %	FY21A	Change %
Revenue (£m)	28.8	28.9	-0.3%	27.6	4.5%
Adj. PBT (£m)	2.6	2.5	4.0%	4.0	-35.0%
Adj. EPS (p)	2.6	1.7	50.0%	2.7	-6.6%
Y/E Net Cash (£m) ex leases	67.7	66.9	1.2%	23.0	194.3%
Dividend (p)	2.5	2.2	13.6%	2.0	25.0%

Source: Company

Revenue

Revenue £28.8m was 4.5% ahead of FY21, little different to our estimate of £28.9m, and up 0.5% on a constant currency basis. The principal drivers to this were the strength in the sales to Location Based Entertainment and the return to growth in Life Sciences.

Sales by market (£m)



Source: Company, Progressive Equity Research

Entertainment

Oxford Metrics' revenues from Entertainment, including animation, special effects, virtual production and video games, were down 15.7% on FY21. We do not regard this as problematic as there is some rise and fall due to the video games market driven by console launches and FY21 was also a strong year for newer film and TV production technologies. That said, as discussed below, the strong order book is heavily weighted to Entertainment. Interesting customer activity in the year included ByteDance (owner of TikTok), which purchased a large entertainment system as part of its work on nurturing viral dance moves, and Industrial Light & Magic's use of Vicon as part of the Abba Voyage experience.

In a market where sceptics have expressed concerns that mobile phones might erode some of the opportunity for movement capture, it is interesting to see the very opposite happen. Of late there has been a significant increase in VTubing – where virtual characters are streamed live to fans. The management statement refers to the statistic that in 2020 38% of YouTube's most profitable channels were from VTubers. As the phenomenon has grown so some of the more popular VTubers are now using Vicon capture technology to drive their full 3D characters.

Life Sciences

Revenues from Life Sciences in FY22 were up 16% on FY21. These include the use of Oxford Metrics products by NASA, ESA (the European Space Agency) and DLR (the German centre for space, aerospace and transportation).

Engineering

Engineering revenues were broadly flat on the prior year, with management citing the contract win with Delft University of Technology's Department of Cognitive Robotics as a contract win of note.

Location Based Entertainment

As noted above, the main positive relating to revenue was growth in Location Based Entertainment, where sales grew from £0.8m in FY21, to £2.6m in FY22, growth of 221%.

In addition to the references to Sandbox VR and Immersive Gamebox, these results also refer to MackNeXT. A designer and developer of high-end entertainment park experiences, MackNext installed its second Yullbe VR experience at Miniature Wonderland in Hamburg (www.yullbe.com).

Our view of the prospects for Location Based Entertainment remains positive and we see this business area as having the potential to drive Oxford Metrics' revenues, profits and valuation materially higher in coming years. We also regard it as an important validation of the management's strategy of seeking ways in which it can embed Oxford Metrics' technology within the products of others.

Record order book and positive outlook

The record order book of £24.0m at the year-end is stated as underpinning over half of revenue expectations for FY23. This is a considerable increase in the £5.9m at the end of FY21. This should be seen not only as an indication of the strength of demand, but also as a change of behaviour amongst customers, willing to place orders to ensure supply. Management have previously stated that the order book build has been accompanied by earlier and better engagement with customers; something that may well outlive the supply constraints.

As can be seen in the charts below the mix of the order book does not reflect the make-up of the FY22 revenues and some the orders, mainly in Entertainment, may relate to requirements for equipment in FY23. So it should not be taken as an indication of the mix of FY23 revenues either, although the strength in Entertainment does provide reassurance on the underlying health and prospects of this market after the decline in FY22.

Revenue vs Year End Order Book mix (FY22)

Source: Company

FY23 has started strongly and has seen the company's single largest order to date. However, we note the management's caution in describing the supply situation as gradually improving and so are not, for now, increasing our forecasts for FY23 and FY24 in anticipation that all of the £3.5m deferred from FY22 will be deliverable in FY23 on top of our prior forecasts.

The generally weakening outlook commentary from the semiconductor major in recent months also suggests that demand is abating, and the management's comment that Valkyrie's more leading-edge componentry may mean that its sourcing is less exposed to the technology pinch points. Against the backdrop of the record order book this could mean that the risk to forecasts is more on the upside as strong demand may coincide with improving supply of product.

Gross margin temporarily impacted by supply

The gross profit margin of 67.5% was lower than we had expected. Although the statement discloses that there was a favourable mix impact, this was outweighed by the increased cost of components. We expect that gross margins will move back to the 72% guided rate, and we have retained this in our forecasts for FY23 and FY24.

Operating costs – expanding but more slowly than planned

Operating costs were up on last year, £16.7m FY22 vs £15.3m FY21, but lower than we had forecast and less than management had initially planned because they held back on some of the extra spend planned as part of the five-year plan. The statement refers to the need to increase the current cost base by £0.8m in FY23 and another £1.0m in FY24 on an annualised basis. Our forecasts for FY23 and FY24 factor in these increases and more.

Investment in technology and products

Investment in both products and the underlying technology remains core to the Oxford Metrics strategy and ethos. Research and Development expensed in the Income Statement was £3.5m, with Amortisation and Impairment of Development spend £1.4m and R&D capitalised £3.4m (vs £3.5m, £2.2m and £2.8m respectively in FY21).

The most important product launch in the year was the new flagship Valkyrie motion tracking system, which replaces the Vantage offering. Management anticipate that this system's ability to measure smaller movements more accurately, and to do so in larger volumes and at higher speeds will find application across the visual effects, sports performance and engineering markets.

Interest income

A welcome by product of the near £70m in cash is that Oxford Metrics is now reporting useful income from interest, £0.3m. Revisiting our forecasts to factor in this, and other items, we have increased our interest income figures by £0.9m and 0.6p at the EPS level for both FY23 and FY24.

Tax positive

The tax figure of £0.7m credit was significantly different from our estimate of £0.4m charge and the net positive principally stems from the disposal of Yotta. As a result of this, and to a lesser extent interest income, the achieved Adj. EPS, 2.6p was markedly above our forecast, 1.7p. We expect that for FY23 and FY24 the tax charge will be a more normal figure. The charge will, however, remain below the standard UK level of corporation tax, helped by R&D tax credits but pushed higher by the increasing activities in the US.

Inventory – temporarily raised by deferred orders

The increased inventory position at the year-end (4.5m vs 2.5m) was in large part due to the costs of goods associated with the £3.5m of deferred orders. Management expects that these orders will be shipped within H1.

Cash, dividends and M&A potential

The FY22 year-end net cash (ex-leases) was £67.7m, a considerable increase on FY21 £23.0m following the disposal of Yotta. The net cash generated from the Yotta transaction was £47.1m – with a profit on disposal (after costs) of £43.6m

In addition to making Oxford Metrics a clearer operational and strategic entity, the disposal provides management with considerable firepower to drive their Sense, Analyse and Apply strategy as described in our initiation note, Value in motion, and their five-year goal of growing revenues by 2.5x and an Adjusted PBT margin of 15%.

Most, if not all, the suitable targets for Oxford Metrics lie in the private markets. The management note that whilst public market valuations have reduced in recent months, those in the private arena have are lagging somewhat. Prices are declining, but many potential vendors still hold onto unrealistic expectations. Whilst Oxford Metrics' public market investors might be impatient for management to apply these funds inorganically, we believe that they will be equally anxious for management not to overpay.

However, we note that in many ways the ability to identify an opportunity and then build a business and sell it for a significant profit is very much part of the Oxford Metrics Group management skillset. We would not be expecting this management to being making acquisitions based purely on considerations of earnings accretion, nor for them to be betting the farm on a single blockbuster deal.

Progressive dividend policy remains

The management has proposed dividend of 2.5p per share, vs FY21 2.0p, and has restated the objective of delivering growing dividends with average dividend cover of approximately 2.5x Adj. EPS over time.

Yotta cash could provide lotta returns

The £67.7m of cash at the year-end makes Oxford Metrics' valuation appear somewhat anomalous. It stands on a FY23 P/E of 22.0x but an EV/EBITDA of 6.1x. Our forecasts show strong earnings growth for this year and next with potential for upside, but the cash inevitably begs the question as to what the management have planned.

Few investors would reward them for validating the detached expectations of a private market that has not yet seen a real downswing in valuations, and we expect the Board to remain cautious and prudent.

We would highlight that is was management's previous timing and decision-making that created the cash balance – and suggest that investors allow the team the time and latitude to find the right acquisition(s) in coming periods. In the meantime the business is performing well in what appear to be steadily improving markets.

Financial Summary: Oxford Metrics

Year end: Sep (£m unless shown)

PROFIT & LOSS	2020	2021	2022	2023E	2024E
Revenue	30.3	27.6	28.8	36.9	41.6
Adj EBITDA	5.6	5.0	5.3	8.2	9.1
Adj EBIT	2.7	4.1	2.4	5.1	6.0
Reported PBT	1.6	3.6	2.7	5.5	6.4
Fully Adj PBT	2.6	4.0	2.6	5.9	6.8
NOPAT	2.6	4.5	3.3	5.4	6.2
Reported EPS (p)	1.3	2.4	2.7	3.8	4.5
Fully Adj Dil EPS (p)	2.0	3.6	2.5	4.1	4.7
Dividend per share (p)	1.8	2.0	2.5	2.8	3.0
CASH FLOW & BALANCE SHEET	**2020**	**2021**	**2022**	**2023E**	**2024E**
Operating cash flow	7.0	14.5	3.7	7.9	7.9
Free Cash flow	6.9	14.4	3.4	7.4	7.3
FCF per share (p)	5.5	11.4	2.7	5.7	5.7
Investment / Acquisitions	(3.1)	(4.2)	(4.1)	(3.6)	(3.9)
Disposals	0.0	0.0	47.1	0.0	0.0
Shares issued	0.3	0.7	0.6	0.0	0.0
Net cash flow	1.1	8.0	43.9	0.1	(0.7)
Overdrafts / borrowings	(2.3)	(2.1)	(1.5)	(1.0)	(0.5)
Cash & equivalents	14.9	23.0	67.7	67.7	67.0
Net (Debt)/Cash	12.6	20.8	66.2	66.7	66.5
NAV AND RETURNS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Net asset value	30.7	32.4	78.4	80.2	82.4
NAV/share (p)	24.4	25.6	60.4	61.8	63.5
Net Tangible Asset Value	18.2	18.9	68.3	68.5	69.0
NTAV/share (p)	14.5	14.9	52.6	52.8	53.1
Average equity	31.0	31.6	55.4	79.3	81.3
Post-tax ROE (%)	8.4%	14.0%	4.2%	6.8%	7.6%
METRICS	**2020**	**2021**	**2022**	**2023E**	**2024E**
Revenue growth	(14.3%)	(9.0%)	4.5%	28.1%	12.6%
Adj EBITDA growth	(31.3%)	(11.2%)	5.7%	54.8%	10.7%
Adj EBIT growth	(51.1%)	53.2%	(42.3%)	116.1%	17.2%
Adj PBT growth	(53.2%)	57.4%	(35.5%)	128.1%	14.8%
Adj EPS growth	(48.2%)	76.2%	(29.4%)	64.1%	14.7%
Dividend growth	0.0%	11.1%	25.0%	10.0%	9.1%
Adj EBIT margins	8.8%	14.8%	8.2%	13.8%	14.4%
VALUATION	**2020**	**2021**	**2022**	**2023E**	**2024E**
EV/Sales (x)	1.6	1.8	1.7	1.3	1.2
EV/EBITDA (x)	8.8	9.9	9.4	6.1	5.5
EV/NOPAT (x)	19.3	11.0	15.2	9.2	8.0
PER (x)	44.8	25.4	36.0	22.0	19.1
Dividend yield	2.0%	2.2%	2.8%	3.0%	3.3%
FCF yield	6.0%	12.5%	3.0%	6.3%	6.3%

Source: Company information and Progressive Equity Research estimates

6 December 2022

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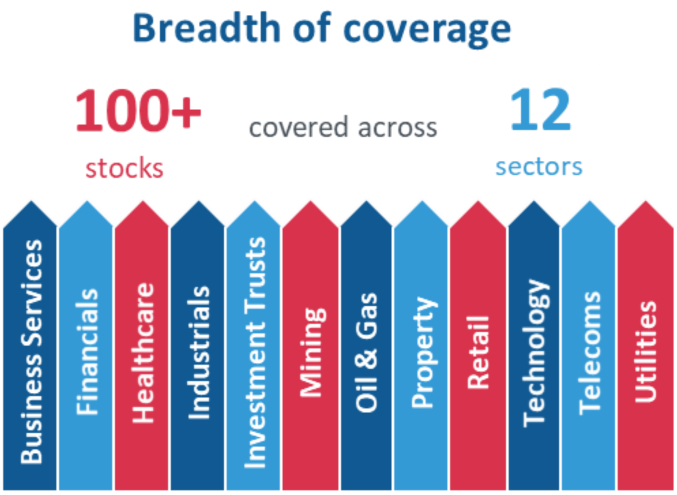

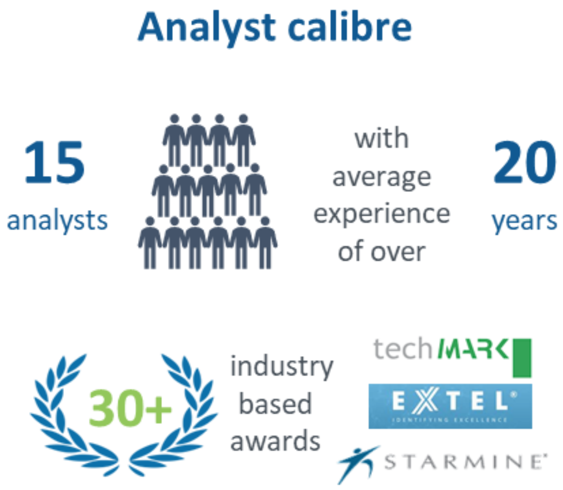

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