

OXFORD METRICS TECHNOLOGY

6 June 2023

OMG.L

97.5p

Market Cap: £127m

SHARE PRICE (p)



12m high/low 113p/79p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£63.6m (at 31/03/23)
Enterprise value	£63.4m
Index/market	AIM
Next news	Trading update, October
Shares in Issue (m)	130.2
Chairman	Roger Parry
Chief Executive	Nick Bolton
CFO	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

Ian Robertson

+44 (0) 20 7781 5318

i Robertson@progressive-research.com



www.progressive-research.com

Excitement builds

Oxford Metrics' interim results, published today, show strong performance with a very encouraging outlook. Revenue of £21.3m is an increase of 69.6% on H1 FY22, 62.5% on a constant currency basis, while adjusted PBT of £4.1m is a significant advance on the £0.3m reported in H1 FY22 and the £2.3m in H2 FY22. It is clear from the results and statement that supply chain issues have receded. These results include the £3.5m of output that could not be delivered in FY22 due to component shortages. The outlook statement is positive and guides to year-on-year revenue growth in H2, with a full-year performance ahead of current market expectations; we raise our FY23 revenue and adjusted EBITDA forecasts to reflect this. Despite the strong operational performance, the destination of the £63.6m of cash (as at 31 March) remains a focus of much investor attention – management's track record on acquisitions and disposals gives us confidence on this front.

- **Strong growth in key markets.** Engineering and Life Sciences both demonstrated good growth: 15.8% and 25.5% H1 on H1, respectively.
- **Impressive Entertainment growth.** Entertainment revenue growth was dramatic at 178% H1 on H1, much of it fuelled by progress in Japan and Asia Pacific, with the new Valkyrie product receiving an enthusiastic reception in the region.
- **LBE in the foothills on the path to volume growth.** Location-based Entertainment customer roll-out continues, driving growth of 6.7% H1 on H1, although this market is still in development and remains pre-volume.
- **Cash pile and acquisitions.** With £63.6m of cash, the potential for acquisitions remains a major factor for investors and management alike. The statement confirms that management is very active and that private market valuation expectations are now becoming more realistic.
- **Growth and value, with deal potential.** The shares trade on relatively lowly EV multiples and on a P/E that is distorted by the cash holding. The EV multiples appear more relevant and, in our view, do not to reflect the clear strength of the business. We expect considered transactions in more than one area of the business, potentially taking Oxford Metrics deeper into industries and applications far larger than media production. We believe that management's track record on acquisitions and, just as importantly, disposals provides an exciting investment case on the basis of both value and growth.

FYE SEP (£M)	2020	2021	2022	2023E	2024E
Revenue	30.3	27.6	28.8	38.9	41.6
Adj EBITDA	5.6	5.0	5.3	8.3	9.1
Fully Adj PBT	2.6	4.0	2.6	6.1	6.9
Fully Adj Dil EPS (p)	2.0	3.6	2.5	4.0	4.5
EV/Sales (x)	2.1x	2.3x	2.2x	1.6x	1.5x
EV/EBITDA (x)	11.2x	12.6x	12.0x	7.7x	7.0x
PER (x)	48.3x	27.4x	38.8x	24.5x	21.8x

Source: Company Information and Progressive Equity Research estimates.

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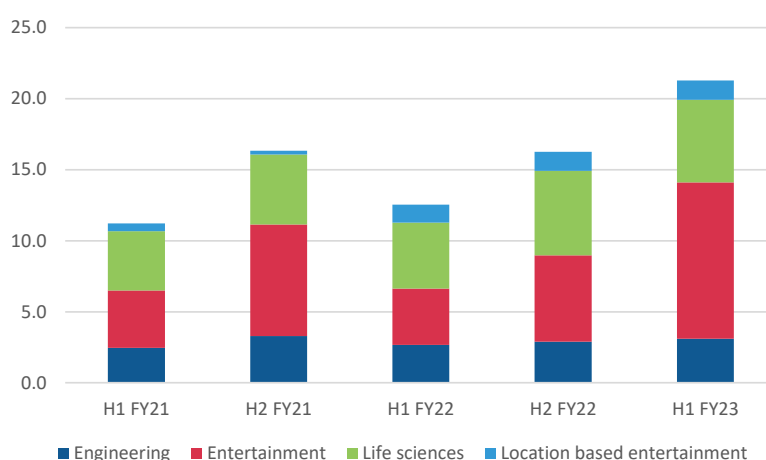
Please refer to important disclosures at the end of the document.

Strong results in buoyant markets

Oxford Metrics’ interim results for the six months to 31 March 2023 show strong performance with a very encouraging outlook. At the revenue level, £21.3m is an increase of 69.6% on H1 FY22 (£12.6m), 62.5% on a constant currency basis. This impressive result was driven by a number of positive factors, with all end markets showing encouraging growth.

Adjusted PBT of £4.1m was also a significant advance on the £0.3m reported in H1 FY22 and the £2.3m in H2 FY22.

Oxford Metrics – Revenue by market (£m)



Source: Oxford Metrics

Perhaps more impressive still is the period-end order book of £22.0m, up from £13.1m at the end of H1 22, £24.0m (including £3.5m deferred) at the end of FY22 and £5.9m at FY21’s close. This is important not only because it demonstrates the health of the business but also because it reflects the change in nature of the business and its relationship with its customers. Prior to Covid and the semiconductor industry supply issues, this was a metric that was barely mentioned as OM operated a business model based on short-term orders.

It is clear from the results and statement that the supply chain issues of recent years have receded. These results include the £3.5m of output that could not be delivered in FY22 due to component shortages. If we were to assume that delivering these £3.5m of sales in H1 had no impact on pushing other sales into H2, then the H1-on-H1 growth reported today would be 42%.

Revenue growth across all markets

Engineering

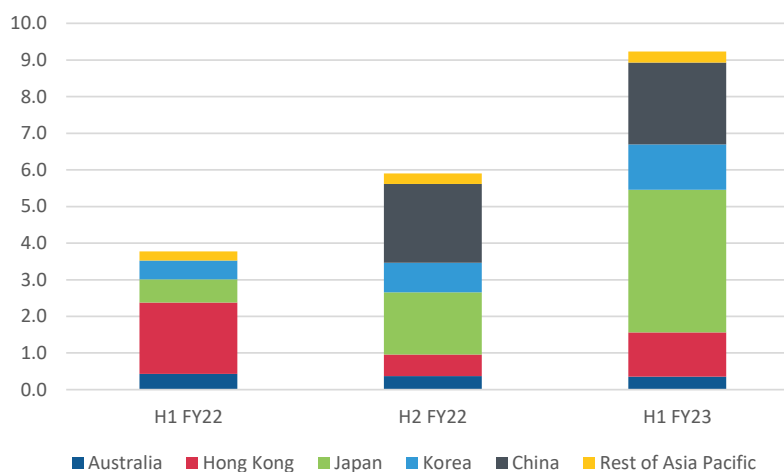
Engineering revenue of £3.1m showed growth of 15.8% on H1 FY22's figure of £2.7m. More significant than the revenue growth is the orders in hand of £7.2m. The statement notes the segment's exposure to the development of robots and robotic applications, along with mention of the purchase by University of Manitoba of an extensive Valkyrie system related to the training for unmanned aerial vehicles (UAVs) in agricultural applications.

Entertainment

Strong demand across the film, TV and video game industries drove Oxford Metrics' entertainment revenue to £11.0m, up 178% from £4.0m in H1 FY22. This increase included most of the £3.5m of orders deferred from FY22 due to component shortages. Stripping out all the £3.5m from this result and assuming that no orders were pushed from H1 into H2 still suggests revenue growth of 90% H1 on H1.

From the statement and geographic revenue split, it is clear that the new studio for Cover in Tokyo was a significant driver to this growth. This new facility has 200 Valkyrie cameras and is used for a wide range of content creation. However, the management commentary, geographic spread of revenues in H1 and £8.1m order book going into the second half suggest that this is not an isolated pocket of strength, either by geography or by sector.

Evolving Asia Pacific revenues – driven by Entertainment (£m)



Source: Oxford Metrics

Life Sciences

Life Sciences revenue grew by 25.5% H1 on H1, to £5.8m (H1 FY22: £4.6m). Orders in hand at the end of the first half were £6.1m, with the strong performance looking set to be repeated in the second half.

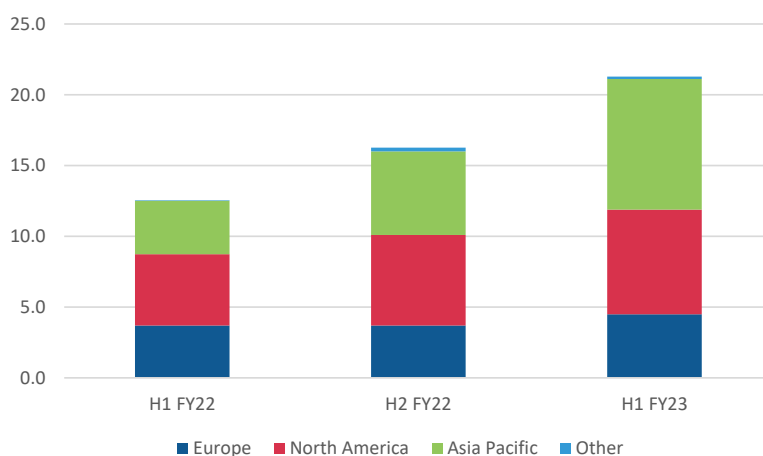
Location-based Entertainment

LBE revenue remains relatively modest, with 6.7% growth H1 on H1 yielding a figure of £1.4m (H1 FY22: £1.3m). The roll-out programmes of both SandboxVR and Immersive Gamebox continue apace, but this industry would appear to have moved to a stage where, as the roll-outs progress, operators are simply drawing down on the headline orders that were broadcast earlier in the market’s development. Set against the scale that is envisioned by some for this market in the long term, this could be seen as a frustrating result. However, the market is still driven by start-ups and VCs. With the number of locations worldwide not into four figures, and investors and operators still in learning mode, LBE is still in the foothills on its path to volume growth, but we expect the slope to steepen soon.

Gross profits – negative mix impact, for now

Gross margin is down from historical norms at 66.5% in H1, from 69% in H1 FY22, which was itself impacted by component pricing pressure. We believe that the move seen in H1 FY23 is due to a shift in the geographic sales mix (with the increased level of sales to Asia Pacific, which are made via partners rather than directly by OM), along with some change in product mix (new products achieve slightly lower gross margins at first and hardware is slightly lower than the group average). Management expects that this dynamic will continue in H2 FY23 but reverse in FY24. We have adjusted our FY23 forecasts to reflect this, with the expectation of an improvement in FY24.

Oxford Metrics – Revenue by geography (£m)



Source: Oxford Metrics

Costs – R&D cash increase not a dramatic as income statement change

‘Sales, support and marketing costs’ and ‘Administrative expenses’ were above H1 FY22 levels by 17.6% and 23.8%, respectively, but broadly level with H2 FY22 – reflecting what management describes as a normalisation of cost and activity levels.

The Research and Development costs for H1 FY23 in the income statement were significantly ahead of both H1 and H2 FY22; 100.8% and 79.7%, respectively. However, the change at cash spend levels has not been anywhere near as significant.

Valkyrie was launched in autumn 2022, just after the FY22 year-end. From this point, R&D spend has been less specific, meaning less is capitalised. Because the FY22 figures for capitalisation include Yotta, it is not possible to get an exact figure, but we estimate that Vicon's capitalisation of development spend was well into six figures in each half.

Amortisation of the £3.3m development costs of Valkyrie also began at this point, straight line over seven years meaning approximately a £235,000 per-half increase.

There was also an intangible impairment of £217,000 in H1 FY23. Brought together, our back of the envelope calculations suggest that while the increase in the income statement figure H1 FY23 on H1 FY22 was £1.7m, the actual cash spend increase was closer to £0.7m.

Cash and cash generation

Cash (ex-leases) at the end of the period was £63.6m vs £67.7m at the end of FY22 and £19.6m the year before. This was after the payment of the final dividend of £3.3m and the £2.0m inventory build and £0.7m increase in trade debtors since the year-end.

As detailed below, we have adjusted some of the key components to the cashflow and balance sheet. However, our forecast figures for year-end cash remain broadly flat year on year at £66.4m for FY23 and £66.6m for FY24.

Trade debtors

The increase in trade debtors is ahead of our year-end figure, but given the strong H1 performance and nature of the business we would expect this to be more a reflection of strong trading and Q2 billing rather than as a cause for concern.

Inventory build

The inventory level at end H1 FY23 was £6.4m, above the £4.5m at end-FY22 and £2.8m at H1 FY22. Management had previously highlighted this as part of a deliberate policy.

Given the level of the order book, we are not concerned by this, and with the supply chain issues now in the past for both Oxford Metrics and most of the electronics industry we expect that inventories will trend down. Management believes that the group's ability to deliver in recent years has been a competitive advantage in some of its markets and identifies international supply chain disruption as a concern going forward. As a result, we expect management to maintain inventories ahead of historical norms and have raised assumed inventory levels in our financial model – although the trajectory remains down in days-stock-held terms.

Acquisitions

Against the backdrop of strong demand, continuing innovation in the application and understanding of motion metrology and, of course, the £63.6m of cash, OM's progress on acquisitions remains a major issue for investors, and for management.

Management has a set of strictly defined and clearly stated criteria. From the statement, it is evident that there are a significant number of opportunities. Reference is made to hundreds of possibilities now whittled down to around 50 defined targets, of which a number are being actively engaged with. As always, pricing is a primary consideration and, encouragingly, management has stated that private market valuation expectations are now subsiding.

There is no reason to expect an imminent transaction, but we would be surprised to not have seen one, or perhaps more, before the company reports again in December.

Forecasts revisions

The outlook statement is positive and guides to year-on-year growth in revenue in H2, with a full-year performance ahead of current market expectations.

We raise our forecasts for FY23 to reflect this, but our adjusted EBITDA forecast is not rising by as much as revenue because of the increase in cost base, much of it headcount related, which per the outlook statement has increased by £1.6m on a full-year run-rate basis compared to the first half.

At a non-trading level, in light of these results we have increased our estimate of financial income for both years by £0.1m and raised the assumed tax charge on PBT from 9% to 15%, helping PBT but impinging upon PAT. The increase in tax charge versus our original estimate is primarily due to the changes in the standard UK corporation tax rate.

On the balance sheet side, we have edged up our assumptions for inventories and for PPE capex, while reducing our forecast for capitalised development spend in FY23 and FY24 – although the FY24 figure does reflect a return towards FY22 group levels.

Forecast revisions

£m unless stated	FY23E			FY24E		
	Old	New	Change	Old	New	Change
Revenue	36.9	38.9	5.5%	41.6	41.6	0.0%
Adj EBITDA	8.2	8.3	1.0%	9.1	9.1	0.0%
Fully adj PBT	5.9	6.1	3.5%	6.8	6.9	1.2%
Fully adj Dil EPS (p)	4.1	4.0	-2.8%	4.7	4.5	-4.7%
Net cash (pre leases)	66.7	66.4	-0.5%	66.5	66.6	0.1%

Source: Progressive Equity Research

Conclusion

The shares trade on relatively lowly EV multiples and on a P/E that is distorted by the cash holding. Of these headline metrics, the lowly EV multiples would appear to us to be the more relevant, and we believe they do not reflect the clear strength of the business and its markets. In our view, the market may be overly focused on use of cash and potential deals, and may not fully appreciate the positive news and operational progress being made.

What management does with the cash is undeniably very important, but we point to the many options available. We do not expect a single large transformational deal, but rather considered transactions in more than one area of the business, potentially taking Oxford Metrics deeper into industries and applications far larger than media production. Furthermore, we believe that, as the considerable payback on Yotta in 2022 and 2D3 in 2015 demonstrated, this management team's deals should not be assessed on short-term earnings accretion (see *Yotta cash to invest for lotta returns?* and our initiation note *Value in Motion*).

Financial Summary: Oxford Metrics

Year end: Sep (£m unless shown)

	2020	2021	2022	2023E	2024E
PROFIT & LOSS					
Revenue	30.3	27.6	28.8	38.9	41.6
Adj EBITDA	5.6	5.0	5.3	8.3	9.1
Adj EBIT	2.7	4.1	2.4	5.2	6.0
Reported PBT	1.6	3.6	2.7	5.7	6.4
Fully Adj PBT	2.6	4.0	2.6	6.1	6.9
NOPAT	2.6	4.5	3.3	5.3	5.9
Reported EPS (p)	1.3	2.4	2.7	3.7	4.2
Fully Adj Dil EPS (p)	2.0	3.6	2.5	4.0	4.5
Dividend per share (p)	1.8	2.0	2.5	2.8	3.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	7.0	14.5	3.7	6.8	8.1
Free Cash flow	6.9	14.4	3.4	5.9	7.1
FCF per share (p)	5.5	11.4	2.7	4.6	5.5
Investment / Acquisitions	(3.1)	(4.2)	(4.1)	(2.5)	(3.2)
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	(0.3)	(0.3)
Overdrafts / borrowings	(2.3)	(2.1)	(1.5)	(1.0)	(0.5)
Cash & equivalents	14.9	23.0	67.7	67.4	67.1
Net (Debt)/Cash (post leases)	12.6	20.8	66.2	66.4	66.6
NAV AND RETURNS					
Net asset value	30.7	32.4	78.4	80.0	81.9
NAV/share (p)	24.4	25.6	60.4	61.4	62.9
Net Tangible Asset Value	18.2	18.9	68.3	69.6	70.5
NTAV/share (p)	14.5	14.9	52.6	53.5	54.1
Average equity	31.0	31.6	55.4	79.2	80.9
Post-tax ROE (%)	8.4%	14.0%	4.2%	6.6%	7.2%
METRICS					
Revenue growth	(14.3%)	(9.0%)	4.5%	35.2%	6.7%
Adj EBITDA growth	(31.3%)	(11.2%)	5.7%	56.3%	9.3%
Adj EBIT growth	(51.1%)	53.2%	(42.3%)	119.6%	14.9%
Adj PBT growth	(53.2%)	57.4%	(35.5%)	135.1%	12.7%
Adj EPS growth	(48.2%)	76.2%	(29.4%)	58.6%	12.4%
Dividend growth	0.0%	11.1%	25.0%	10.0%	9.1%
Adj EBIT margins	8.8%	14.8%	8.2%	13.3%	14.3%
VALUATION					
EV/Sales (x)	2.1	2.3	2.2	1.6	1.5
EV/EBITDA (x)	11.2	12.6	12.0	7.7	7.0
EV/NOPAT (x)	24.6	14.0	19.4	12.1	10.7
PER (x)	48.3	27.4	38.8	24.5	21.8
Dividend yield	1.8%	2.1%	2.6%	2.8%	3.1%
FCF yield	5.6%	11.6%	2.7%	4.7%	5.6%

Source: Company information and Progressive Equity Research estimates

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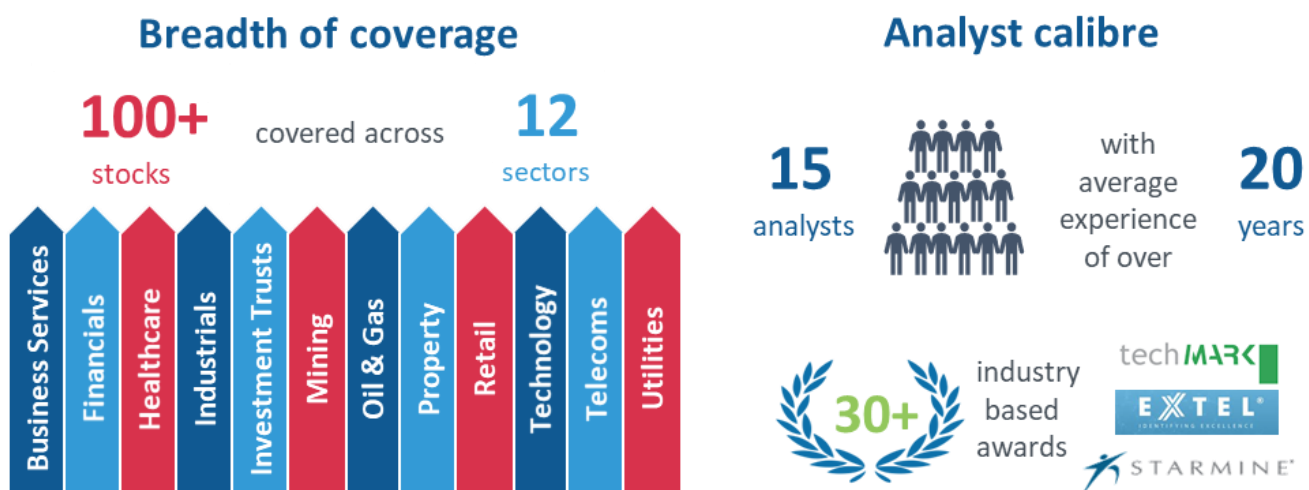
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To arrange a meeting with the management team, or for further information about Progressive, please contact us at:
+44 (0) 20 7781 5300
info@progressive-research.com