

Stock Data

Share Price: 2.95p
Market Cap.: £7.7m
Shares in issue: 261.9m

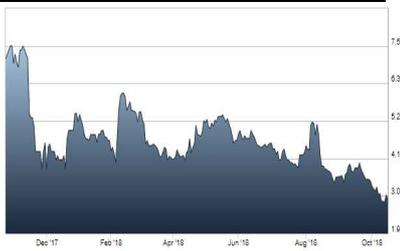
Company Profile

Sector: Support Services
Ticker: FLX.L
Exchange: AIM

Activities

Provider of cyber defence, security and global intelligence services to both commercial and government customers.

Share price performance



Source: LSE

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Falanx Group Ltd

With the run rate of recurring revenue expected to increase in the current year and revenue contributions from the acquisitions of First Base in March 2018 and Securestorm in July 2018, Falanx has outlined that it has the potential to at least double revenue in 2019. However, the company's longer term growth profile could be further transformed by SolarWinds® MSP's recent appointment of Falanx as its key threat monitoring provider, a deal which could provide Falanx with access to a vast number of new potential customers in the UK market in particular and exposure to significant revenue upside.

On 19 September 2018, the company announced that SolarWinds had selected Falanx as its first Threat Monitoring Service Provider™ (TMSP) in the UK and South Africa whereby Falanx will support SolarWinds as it looks to leverage more advanced cyber security to SolarWinds' global customer base.

Falanx estimates that the partnership could provide the company with first mover advantage with a total addressable market of over 2,000 SolarWinds Managed Service Providers (MSPs) in the UK. Assuming an industry average of at least 50 customers per MSP, Falanx estimates that its partnership with SolarWinds could expose the company to approximately 100,000 SolarWinds end customers in the UK alone.

In its role as TMSP, Falanx will provide Security Operations Centre (SOC) services in support of SolarWinds' sales of Threat Monitor software to its MSPs and onwards to end customers. Falanx expects that the MSPs will assume increased responsibility for installation over time although Falanx will retain exclusive control over the monitoring role.

Falanx believes that an entry level price to new customers of £200 per month per customer could support mass adoption of its services although pricing will be determined by the size of end customers IT estate and incremental services would be charged separately.

Falanx has identified an addressable market of over 2,000 MSPs in the UK implying approximately 20,000 target end customers. Assuming that only 10% of these entities are early adopters at entry level pricing, we calculate that successful exposure to only 2,000 SolarWinds' UK customers (c.2% of the available market) could be worth at least £4.8m annually with the upside case as much as £7.2m per annum for Threat Monitor SOC Services alone. (See additional information on page 2).

Falanx notes that the design and implementation phase of its programme with SolarWinds is in the early stages and delivery of support services will commence in the first quarter of 2019 and this will have a limited impact on revenue in the current year ending 31 March 2019. However, Falanx has agreed to provide its full suite of cyber security services to SolarWinds' for onward resale providing the potential for significant future revenue upside post the 2019 financial year.

Falanx has increased and diversified the customer base across all service lines in recent months and significantly strengthened the management team. With the potential to more than double group revenue in the current year from recent acquisitions coupled with organic growth, the company is moving towards an EBITDA breakeven position in the current year and net profitability thereafter. This position could be augmented significantly when Falanx gains market traction in its exciting relationship with SolarWinds

Appointment by SolarWinds

On 19 September, Falanx announced that it had been selected by SolarWinds MSP as the first SolarWinds Threat Monitoring Service Provider™ (TMSP™) for the UK and South Africa. SolarWinds MSP is a global leader in delivering comprehensive and scalable IT service management solutions to IT solution providers and managed service providers (MSP).

In this new role, Falanx will support SolarWinds MSP as it seeks to enable its MSP customers to leverage more advanced security services. Specifically, Falanx will serve as a threat monitoring service provider for the delivery of SolarWinds' Threat Monitoring Service™, which is designed to enable proactive security monitoring, in conjunction with Falanx's combined cyber security services to MSPs.

Potential impact on Falanx

SolarWinds is a huge global player with annual revenue approaching US\$1.0 billion and is highly profitable. Although a private company for the time being, SEC documents confirm that SolarWinds is planning a US IPO valuing the company at over US\$5 billion.

Consequently, we believe that the potential value of Falanx' partnership with SolarWinds could underpin highly significant long term revenue earnings and cash growth for Falanx should the UK company deepen its relationship with the larger player over the long term.

SolarWinds has more than 22,000 partners providing services to more the 450,000 organisations around the world. The UK is one of the largest markets after the US for cyber security and we estimate that at least 2,000 of SolarWinds MSP partners are located in the UK. If we assume that each MSP has an average of 50 customers which we believe to be conservative, this provides Falanx with potential exposure to a market comprised of up to 100,000 businesses.

Assuming that Falanx only focuses its efforts on 20% of the potential UK MSP market, this reduces the target market to 20,000 businesses. Again, we can reduce this targeted population by assuming that only 10% of these entities are prepared to be relatively early adopters of Falanx cyber security services, providing a market of 2,000 potential customers.

On the assumption that a typical customer may spend £200-£300 per month on cyber security, this equates to a potential market of £4.8m to £7.2m per annum. This per customer pricing is based around published rates by companies on Gloud for similar services to government (which can typically be at a discount to commercial rates). On the assumption of a 50% margin, this equates to profitability of £2.4m to £3.6m from only 2% of the market made available by Falanx's relationship with SolarWinds.

We note that this potentially available market covers predominantly Falanx cyber monitoring services and that the company's other solutions including Assessment, Consulting and Awareness services could add further multiples to this core market value assessment.

Results summary for the full year to March 2018

Falanx's revenue increased by 10% to £3.0m in the full year ended 31 March 2018. This growth was driven by the Cyber division which demonstrated an 18% increase in sales from £0.94m to £1.1m. The sales contribution from larger monitoring deals was relatively limited in the full year given that these are typically multi-year contracts which were only implemented towards the end of the reporting period. As such, Cyber demonstrated a segmental loss of £1.28m for the full year. The Intelligence business contributed a solid segmental profit of £0.2m on sales growth of 5.1% driven primarily by a high proportion of recurring revenue within the sales mix.

Recurring revenue

The proportion of revenue generated from recurring contracts across both divisions increased from 55% in 2017 to 62% in 2018 and recurring revenue accounted for £190,000 of sales per month in 2018 compared to £146,000 per month in 2017. This metric has now increased to £240,000 per month as of the end of July 2018. At the period end, the company had approximately £2.3m of future revenue under contract and the impact of recent acquisitions has added several larger accounts spending more than £100,000 per annum in addition to increasing the customer base to 322 clients, up from 118 in 2017.

Historical segmental analysis, 2017A – 2018A

Year end 31 March 2018 (£m)	Intelligence	Cyber	Other	Total
Revenue from external customers	1.89	1.11	0.02	3.02
Operating expenses	-1.68	-2.11	-1.48	-5.26
Segmental EBITDA	0.22	-1.00	-1.46	-2.24
Finance costs net	-0.00	0.00	0.00	-0.00
Depreciation and Amortisation	-0.01	-0.28	-0.00	-0.30
Segmental profit	0.20	-1.28	-1.46	-2.54
Year end 31 March 2017 (£m)	Intelligence	Cyber	Other	Total
Revenue from external customers	1.80	0.94	0.01	2.74
Operating expenses	-1.53	-1.56	-0.87	-3.96
Segmental EBITDA	0.27	-0.63	-0.87	-1.22
Finance costs net	0.00	0.00	-0.11	-0.11
Depreciation and Amortisation	-0.00	-0.34	-0.00	-0.35
Segmental profit	0.27	-0.97	-0.98	-1.68

Source: Company

Margins and costs

Falanx reported an increase in the gross margin from 20% in 2017 to 31% in 2018 as both divisions benefitted from a favourable revenue mix and firmly controlled employment costs. Administration costs increased from £1.7m to £2.5m as the group increased its headcount through acquisitions and organic change. Additionally premises costs escalated with the relocation from London to Birmingham coupled with the additional space required for the company's expansion.

The group reported several exceptional items amounting to £0.65m in 2018. The largest elements within this include £0.2m of acquisition costs and £0.3m of board restructuring costs which can be considered non-recurring. The exclusion of these cost elements reduces the headline segmental EBITDA loss from £2.24m as reported to approximately £1.6m on an underlying basis.

Financing costs are now negligible given that the company's convertible loan note issued to Darwin Capital was repaid in full in the previous financial year.

Falanx income statement, 2017A - 2018A

Year end 31 March (£m)	2017A	2018A
Revenue	2.7	3.0
Cost of sales	-2.2	-2.1
Gross profit	0.5	0.9
Operating expenses	-1.8	-2.5
EBITDA	-1.2	-1.6
Non-underlying and exceptional items	-0.0	-0.7
Depreciation and amortisation	-0.4	-0.3
Operating profit	-1.6	-2.5
Finance income	0.0	0.0
Finance expense	-0.1	-0.0
Profit before tax	-1.7	-2.5
Taxation	-0.0	0.0
Profit for the period	-1.7	-2.5

Source: Company

Balance sheet and cash flow

At the end of March 2018, non-current assets increased from £0.9m to £4.6m. This reflects the impact of three acquisitions (Cloudified, AuditSec and First Base) completed during the period although most of the uplift is attributed to the acquisition of First Base Technologies for a cash consideration of £3.2m in early March 2018.

The company raised £6.3m of net equity during the financial year through the issue of new shares. Of this amount, approximately £3.0m (net of acquired cash balances) was used to expedite the acquisition of First Base with the remainder used for investment in product, working capital and M&A support. At the end of March 2018, Falanx held cash balances of £0.9m with zero debt.

Falanx balance sheet, 2017A - 2018A

Year end 31 March (£m)	2017A	2018E
Intangible assets	0.8	4.5
Property, plant and equipment	0.1	0.1
Total non-current assets	0.9	4.6
Inventories	0.0	0.0
Trade receivables	0.6	1.5
Cash and cash equivalents	0.4	0.9
Total current assets	1.1	2.4
Total assets	2.0	7.0
Trade creditors	1.2	1.4
Current tax liability	0.0	0.7
Deferred tax liability	0.0	0.0
Total current liabilities	1.2	2.1
Total non-current liabilities	0.0	0.0
Total liabilities	1.2	2.1
Net assets	0.8	4.9

Source: Company

Five year financial summary, 2014A – 2018A

Year ended March (£m)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Revenue	4.44	1.92	1.82	2.74	3.02
Profit before tax	0.01	-2.21	-2.65	-1.69	-2.54
Basic EPS (p)	-0.12	-4.75	-3.79	-1.52	-1.56
Net cash (debt)	0.21	0.43	0.43	0.43	0.91

Source: Company

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