



IndigoVision (B)(A)

Software & Computer Services

BUY

Prelims

IndigoVision last week reported yet another year of impressive growth, with revenues up 37% to £18.4m (2007: £13.4m), gross margin improving to 71% (2007: 66%), operating profits tripling to £2.1m (2007: £0.7), and our adjusted EPS increasing circa 200% from 8.6p to 25.7p. These figures are in-line with our expectations subsequent to IndigoVision's post-close trading update (07/08/08) which indicated that signs of slower spending by corporate end users had been witnessed and would lead to a shortfall in sales (we were previously forecasting £20.0m sales and £2.0m PBT for FY2008). We have trimmed our 2009 forecasts in light of the previous statement, though we highlight that order intake in the first 7 weeks of this year is reported to be "well ahead" of last year, and we are currently predicting 36% sales growth in 2009. Though we are reducing our target price for IndigoVision to 617p, this represents a reflection of deflation of market prices and current macroeconomic reality, rather than a substantive downgrading of IND's long-term market opportunity, which remains attractive. We believe that the drop in IND's share price over recent months has created an opportunity and are therefore increasing our rating to BUY (from ADD).

Highlights

- Revenues improved 37% as prior investment in sales and distribution infrastructure generated tangible returns. Investment in this area continued in 2008 with customer facing staff and retained agents increasing from 55 last year to 70 this year and selling and distribution costs increasing 29% to £5.6m. A newly developed training programme for sales staff will leverage the effect of the staff increase in driving sales growth through 2009.
- Gross Margins increased to 71% from 66% in the previous year due to a combination of an improved sales mix and lower build costs. We are not forecasting a repeat of this sales mix in 2009 and are therefore forecasting gross margins to soften to around 65% next year.
- Net operational cash inflows were £1.5m, with investment in working capital utilising £1.2m. Net cash increased by £1.2m, resulting in a year end cash balance of circa £1.4m. We expect cash to continue to improve going forward. The group's £3m overdraft facility is currently unutilised.
- The company recognised their remaining deferred tax credit this year; we had forecast that it would be recognised over the course of the next two years. The asset now amounts to £7.1m on the balance sheet. In light of the fact that we expect IndigoVision to pay no tax until beyond our forecast period, our adjusted EPS numbers include a zero tax rate (and are therefore effectively calculated from PBT figures).

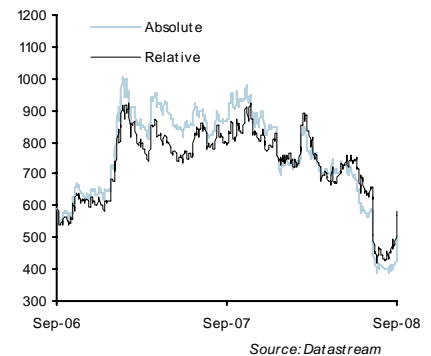
Valuation

IndigoVision is inexpensive compared to peers, and were it to achieve comparable ratings, it would still be undervalued on both a DCF and a historic basis. Our target price is based solely on eliminating the gap between the rating IND achieves and the ratings enjoyed by IND's peers: a feat we believe achievable within the constraints of our 12 month target price, under existing market conditions. Investors with mid- to long-term horizons should benefit from further upside than that offered by the current short-term discount.

Date

29th September 2008

Share Price:	495p
12m Price Target:	617p
Upside:	25%
Fundamental View:	Positive
Forecast Sensitivity:	3
Shares in Issue:	7.2m
Market Cap:	£35.4m
Forecast Cash/(Debt):	£2.6m
Enterprise Value:	£32.8m



Reuters:

IND.L

Analyst:

Greig Aitken

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Year End July	Sales £m	PBT* £m	Tax %	EPS† p	PE Ratio x	EV/EBITDA x	FCF/Share p	DPS p	Yield %
2007(A)	13.4	0.7	n/a	8.6	57.6	35.6	-15.4	0.0	0.0
2008(A)	18.4	2.0	n/a	25.7	19.2	14.9	15.7	0.0	0.0
2009(E)	25.0	3.0	0.0	37.9	13.1	9.9	15.8	5.0	1.0
2010(E)	32.5	3.6	0.0	45.8	10.8	7.8	17.4	10.0	2.0

*Figures pre-exceptionals, goodwill amortisation and deferred tax credit, † Fully diluted, Source: Company Accounts/BD Forecasts



Background

IndigoVision manufactures complete end-to-end IP (Internet Protocol) video and security management systems. The solutions which IndigoVision sell are high quality offerings and the company constantly innovates to remain at the forefront of the market: 36 staff work currently work in R&D and this figure is expected to increase.

IndigoVision is completely focused on the security market. Within this market, major customer segments include but are not limited to: airports, rail, city installations including crime prevention projects, major events, banks, ports, police and prisons, casinos, oil, gas and petrochemicals, and universities.

Key operational strengths:

- Does not sell through distributors or direct to end users; sell to system integrators and installers.
- Offer complete end-to-end solutions.
- Excellent video quality.
- Minimal bandwidth required through use of H.264 compression standard and sophisticated analytics at the camera.
- High speed accessing of recorded video.
- New High Definition (HD) cameras operating at very low bandwidth.
- “Control Centre”
 - Highly praised by customers.
 - Enables remote monitoring, regardless of location.
 - Can be integrated into existing 3rd party analogue CCTV systems.
 - Allows users to control cameras, view feeds, search recordings.
 - Includes advanced analytic functions.
- Open Architecture / Open Standards
 - Integrate with analogue, alarms, perimeter detection, etc.
 - Integrate with both hardware and software.
 - Integrate with 16 third-party access control systems with further integration planned.
 - Software Developer’s Kit (SDK) is available to anyone who wishes to integrate with IndigoVision.
 - Members of Open Network Video Interface Forum (ONVIF) and currently joining Physical Security Interoperability Alliance (PSIA).

IP Video/ CCTV Market

The IP video market continues to grow due to the performance and cost benefits of IP systems:

- Easily scaleable.
- High levels of redundancy.
- Provide cutting edge analytics.
- Better flexibility.
- More able to be integrated into wider security solutions.



According to iSuppli¹, global video surveillance camera revenue will grow by more than \$9bn between 2006 and 2011, a CAGR of 13.2%. iSuppli also predicts that IP cameras will grow from a relatively small base to become the dominant technology during this time. European-focused surveys by Frost and Sullivan and Key Note support these findings.

Competitors

With perhaps as little as 5% of the total CCTV market currently being attributable to IP Video solutions, not all analogue CCTV suppliers have yet made the digital crossover. IndigoVision continues to drive its growth through a combination of leading-edge product development and investment in sales, marketing and distribution infrastructure. IndigoVision is successfully recruiting key sales staff from major competitors in a bid to maximise growth of market share.

Analogue

- **GE, Honeywell** and **Pelco** (acquired by Schneider Electric for \$1.5bn in 2007) are major players in the analogue market but have yet to seriously enter the IP Video market.
- **Panasonic** also falls into this category, though it recently announced its intention to offer more integrated solutions.
- **Tyco** is also known mostly for its analogue offerings, however it acquired analytics maker IntelliVid during the summer and combining this business with its American Dynamics subsidiary will likely lead to an improved IP offering.

Analogue/IP Video

- **Bosch Security Systems Inc** (2006 turnover US\$1.7bn) was a major player in the analogue CCTV market, and is now making headway with IP Video solutions.

IP Video

- **IndigoVision** is one of a number of smaller companies, such as **March Networks** and **Axis**, who are at the forefront of the IP video market. IndigoVision considers **Verint** and **Bosch** to be its major competitor, with Verint being similarly focused on high-end end-to-end IP solutions.

New Entrants

With IP Video able to be integrated into wider systems, traditional IT network companies are taking an interest and perhaps pose the greatest threat to the status quo. Cisco Systems in particular has made a series of acquisitions which indicate that it is poised to become a serious player in enterprise IP Video applications.

¹ As reported on securitysolutions.com

Valuation

We considered IndigoVision from three valuation perspectives: historical ratings, DCF and peer group comparisons. IndigoVision is undervalued on all three metrics and therefore offers both short and long term value opportunities. We have ascribed our valuation based on peer multiples as we believe this best represents the price that investors will currently pay for access to the fast-growing IP Video market, though we note that IndigoVision looks even better value from a DCF perspective, therefore when the macroeconomic environment improves and liquidity returns to small cap, we expect further outperformance from IND.

Historical Multiples

In recent years, IndigoVision has been well supported. Investors are keen on the growth opportunities available to a well-managed early leader in the rapidly expanding IP Video Market. If IND were to achieve a similar PER to those which it achieved immediately subsequent to its 2006 and 2007 final results, it would trade on c.x 2009 EPS, equivalent to 1430p per share.

We accept that a rating of this magnitude is unlikely to be achieved – IndigoVision's rate of growth has slowed, whilst the macroeconomic environment and IndigoVision's warnings on how it will impact them has justifiably reduced the premium on IND's shares, particularly given the flight from risk currently being experienced within the markets. We reiterate, however, our belief that the extent of downward rerating on IndigoVision's shares over the course of the last year has been excessive.

DCF

Our DCF valuation of IndigoVision generated the following underlying valuations:

IndigoVision DCF Valuation

WACC	Value
10.0%	1061p
11.6%	825p

Source: BD Estimates

Our explicit forecast period extends until 2018 and forecast turnover growth for this period is charted below.

Forecast Turnover Growth

Year	Growth (%)	Year	Growth (%)
2009	36	2014	13
2010	30	2015	13
2011	25	2016	12
2012	20	2017	12
2013	20	2018	10

Source: BD Estimates

We have made the following assumptions

- Perpetual growth of 2.5%
- 11.6% WACC based on $R_f = 4.464$, $R_p = 7008$, $Beta = 1.02$. (All figures taken from Bloomberg. IND Beta not available on Bloomberg, so average of competitor Betas used as a proxy).
- Gross margins remain at 65%. Though new entrants will enter the market and push margins down across the industry, we expect IndigoVision to remain at the cutting edge of the industry where margins will be higher.
- Operating Margin improves gradually year-on-year to 14.5% in 2018. IND, like any high growth company, faces a constant dilemma between investing in future growth and allowing profits to fall through to the bottom line. We expect that as IND grows it will allow operating margins to improve to around 15% (the impact this will have on sales growth is considered in our forecasts)
- R&D will continue to grow.



- Working capital will increase.
- Tax at 28% will first be charged in 2013 when the existing deferred tax asset is exhausted.
- Capital expenditure will remain modest – no major investment in land, plant or machinery will be required to service the enhanced sales requirements.

Peer Group

Our peer group valuation considers IND's listed peers.

Listed Peers

Company	Listed	Year End	Mkt Cap (GBP)	PE08	PE09	EV/Sales 08	EV/Sales 09
March Networks	Toronto	April	36	n/a	48.8	0.2	0.9
Mobotix	Frankfurt	June	95	23.8	16.3	2.7	0.7
Verint Systems*	New York	Jan	285	10.3	7.7	0.8	0.9
Axis	Stockholm	Dec	449	20.1	15.3	2.7	0.8
Nice Systems	Tel Aviv	Dec	946	16.3	13.3	2.3	0.9
Average				17.6	20.3	1.7	0.8
Average (Adj)				20.0	15.0	2.6	0.8
IndigoVision	AIM	Jul	35	16.1	12.0	1.6	0.7

Source: Thomson Consensus

All ratios are calendarised

Our adjusted average excludes Verint Systems and March Networks

*Verint Systems was delisted from NASDAQ in 2007 and now trades on the pink sheets.

IndigoVision is trading at a discount to its peers on all metrics. We have adjusted the average to exclude the high and low values. This excludes Verint Systems and March Networks. We believe Verint are currently receiving a low rating due to factors external to the IP Video market: issues surrounding backdating of stock options and non-compliance with financial reporting procedures led to Verint being delisted from NASDAQ in January 2007. They are currently traded via the OTC pink sheets. March Networks are expected to be loss making this year and are trading on an abnormally high 2009 forecast multiple.

Valuing IndigoVision in accordance with our adjusted average peer multiples results in a target share price of 617p (figure is identical for 20x 2008 and 15x 2009 calendarised earnings). Though this figure is lower than both the DCF and historical multiple implied valuations, we believe it represents a realistic 12 month share price target.



FINANCIALS

Income Statement	2007(A)	2008(A)	2009(E)	2010(E)	Cash Flow	2007(A)	2008(A)	2009(E)	2010(E)
Year End July	£m	£m	£m	£m	Year End July	£m	£m	£m	£m
Sales	13.4	18.4	25.0	32.5	Operating profit	0.9	2.1	3.0	3.6
EBITDA	1.0	2.3	3.3	4.0	Depreciation/Amortisation	0.1	0.2	0.3	0.4
Depreciation	0.1	0.2	0.3	0.4	Working Capital	-2.1	-1.2	-2.0	-2.5
Operating profit	0.9	2.1	3.0	3.6	Interest	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0	Tax	0.0	0.1	0.0	0.0
Interest	-0.2	0.0	0.0	0.0	Exceptionals				
PBT (normalised)	0.7	2.0	3.0	3.6	Other Operating Cashflows	0.1	0.3	0.3	0.3
Exceptionals					Cash flow from Ops	-1.1	1.5	1.6	1.8
Goodwill					Net Capex	-0.3	-0.3	-0.3	-0.4
PBT (reported)	0.7	2.0	3.0	3.6	Acqs/Disposals				
Tax Rate (%)	n/a	n/a	0.0	0.0	Other Investing Cashflows				
Minority Int					Cash Flow from Investing	-0.3	-0.3	-0.3	-0.4
Pref Dividends					Ord Div	0.0	0.0	0.0	0.0
Av. No. Shares	7.0	7.1	7.1	7.1	Share Issues	0.1	0.0	0.0	0.0
F. Dil. No. Shares	7.8	7.9	7.9	7.9	Other Financing Cashflows				
EPS(nm - F.Dil.) (p)	8.6	25.7	37.9	45.8	Cash Flow from Financing	0.1	0.0	0.0	0.0
DPS (p)	0.0	0.0	5.0	10.0	Net Inc/Dec in Cash	-1.3	1.2	1.3	1.4
					Y/E Cash/(Debt)	0.2	1.4	2.6	4.0
					Enterprise Value	35.3	34.1	32.8	31.4

Ratios	2007(A)	2008(A)	2009(E)	2010(E)	Balance Sheet	2007(A)	2008(E)	2009(A)	2010(E)
Sales Growth (%)	76.7	37.5	35.8	30.0	Intangibles	3.5	7.2		
EBITDA Margin (%)	7.4	12.5	13.2	12.4	Tangibles	0.4	0.4		
Op Margin (%)	6.4	11.2	12.0	11.2	Net Current Assets	3.3	4.4		
Int Cover (x)	-40.9	120.8	n/a	n/a	LT Creditors	-0.1	-0.2		
EPS Growth (%)	107.6	199.5	47.3	20.8	& Provisions				
DPS Growth (%)	n/a	n/a	n/a	100.0	Shareholders funds	7.2	13.2	15.0	16.9
Div Cover (x)	n/a	n/a	8.4	5.1					

Valuation	2007(A)	2008(A)	2009(E)	2010(E)	Ratios	2007(A)	2008(E)	2009(A)	2010(E)
P/E (@current price)	57.6	19.2	13.1	10.8	NAV (p)	101.6	185.9	209.9	236.5
P/E (@target price) (x)	71.8	24.0	16.3	13.5	Gearing (%)	-2.5	-10.4	-17.5	-24.0
EV/EBITDA (x)	35.6	14.9	9.9	7.8	ROCE (%)	12.2	17.4	24.3	28.3
EV/Sales (x)	2.6	1.9	1.3	1.0	FCF/Share (p)	-15.4	15.7	15.8	17.4
FCF Yield (%)	-3.4	3.5	3.5	3.9	Cash Conversion (%)	-127.4	69.9	51.7	49.0
Dividend Yield (%)	0.0	0.0	1.0	2.0					

Source: Company/BD Estimates

Company Description

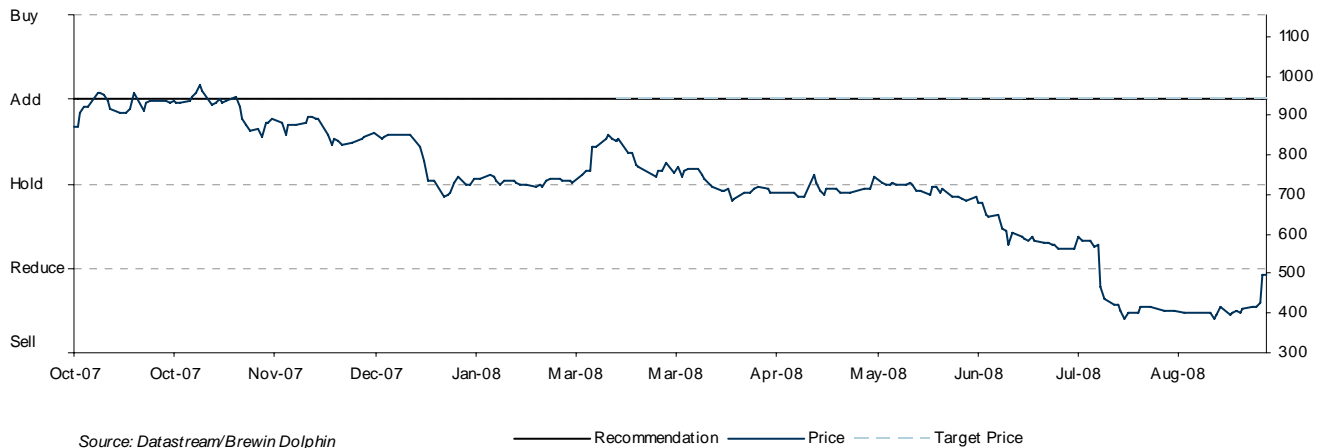
IndigoVision is a leading manufacturer of complete end-to-end IP video and alarm management solutions. IndigoVision is widely chosen for applications in airports, city centers, ports, mines, road and rail systems, education, banking, casinos, prisons, government and the military. These enterprise-class systems improve organisations' operational efficiency, enhance public safety and enable timely emergency response. IndigoVision is headquartered in Edinburgh UK, with local sales and support offices across the world. IndigoVision partners with over 200 authorised system integrators and installers in 40 countries to provide local system design, installation and service to end users.

Future Newsflow

06/11/2008 AGM



RECOMMENDATION HISTORY - INDIGOVISION (B)(A)



(B) Denotes Brewin Dolphin acts as broker to the company

(A) Denotes AIM listing

Brewin Dolphin Research - Recommendation Definition (expects absolute performance over next 12 months).

Buy - 20%+ upside to BD 12m Price Target

Add - 10% - 20% upside to BD 12m Price Target

Hold - minus 10% to +10% to BD 12m Price Target

Reduce – minus 10% to 20% downside to BD 12m Price Target

Sell - minus 20% or more downside to BD 12m Price Target

Fundamental View:

Positive - quality company, strong management, strong fundamentals, focussed strategy.

Neutral - ambivalent over the company's strategy, market place, management.

Negative - BD believes company has fundamental flaws and is not a long term investment.

Forecast Sensitivity:

1 = highly likely downgrade
upgrade

2 = likely downgrade

3 = neutral

4 = likely upgrade

5 = highly likely

Prices of other securities mentioned: None

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