

IndigoVision (B)(A)

Software & Computer Services

BUY

Trading Update

FY11 earnings will be significantly below market expectations owing to an H2 slowdown in sales growth and a 2% YoY reduction in gross margin. Sales should still improve YoY though we have reduced our forecast to £30.0m (£32.8m). An element of annual fixed cost growth is investment-driven therefore we expect savings here, though operational gearing will remain sufficiently high to ensure a leveraged impact on the bottom line. Despite this, Friday's share price reaction was, in our view, overdone since the investment case remains intact. We have reduced our PT to 387p (692p) but remain at BUY.

Core Investment Case Remains Intact

The core of IndigoVision's appeal is that it has strong brand identity in the rapidly-expanding IP CCTV market. The IP CCTV market is being driven by a move from analogue to digital equipment; by increasing focus on security and surveillance; and by the ability of advanced IP CCTV technologies to add value to both security/surveillance and operational systems.

We believe the disappointing trading update reflects a combination of an erratic global economy and a relatively short committed order book (a constant feature of the nature of IND's sales cycle, but one which should diminish in relevance as the company grows). IND sells to 20 vertical markets in 84 countries, and macro factors since 2008 have increased unpredictability (both downside and upside) amongst these individual end markets. This volatility is compounded by the fact that IND usually has a year end sales spike. Due to the short order cycle, the extent of this spike is often not apparent until Q4. At the interims, FY11 risks looked to be on the upside, but clearly circumstances have changed. We do not detect a fundamental reason for the shortfall; certain potential awards have not been converted as anticipated at this crucial period but in our view this does not reflect on long run growth potential. This issue is reflected in a recent (June 15th) statement from camera competitor Axis "[The] market is expected to have a growth potential of 25-30% in the coming years. At times, Axis' sales... will be irregular in the short term, but there is good long-term potential".

Forecast Changes

Forecast change table	2011(E) New	2011(E) Old	Δ%	2012(E) New	2012(E) Old	Δ%
Revenue £m	30.0	32.8	-8.5%	34.5	35.5	-2.8%
PBT £m	1.9	3.6	-46.4%	3.0	4.2	-29.2%
EPS fully diluted p^	18.3	34.5	-46.9%	28.6	40.0	-28.5%

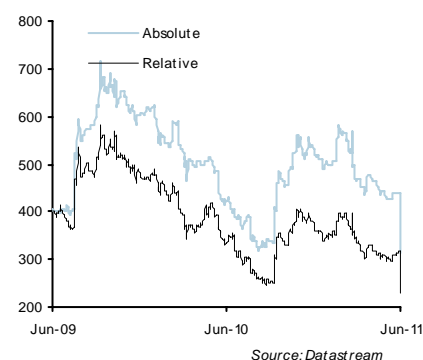
Source: BD Research

We have reduced revenue to £30.0m. This assumes H2 revenue was flat against H1 (1H11: £15.0m) and amounts to 7.1% YoY growth for the full year. We are now forecasting 15% sales growth into FY12 (from 8.2%). We have cautiously extended the margin weakness forward, though this may improve. We have reduced fixed cost expectations as an element of this is discretionary. As a result of our reduced earnings forecasts, we have also reduced our dividend forecasts to 8.0p (10.0p) and 10.0p (12.0p) in FY11/12.

Date

20th June 2011

Share Price:	315p**
12m Price Target:	387p
Upside:	23%
Fundamental View:	Positive
Forecast Sensitivity:	3
Shares in Issue:	7.7m
Market Cap:	£24.4m
Forecast Cash/(Debt):	£4.9m
Enterprise Value:	£19.4m



Reuters:

IND.L

Analyst:

Greig Aitken

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** Priced at close of business 17/06/11

Year End July	Sales £m	PBT* £m	Tax %	EPS† p	PE Ratio x	EV/EBITDA x	FCF/Share p	DPS p	Yield %
2009(A)	26.4	3.3	23.8	32.4	9.7	5.9	23.2	5.0	1.6
2010(A)	28.0	3.1	35.7	25.6	12.3	6.0	16.4	7.5	2.4
2011(E)	30.0	1.9	27.0	18.3	17.2	8.8	19.0	8.0	2.5
2012(E)	34.5	3.0	26.0	28.6	11.0	5.6	23.5	10.0	3.2

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



Revenue

Following the pattern of the last two years, sales have varied across regions and vertical markets. IND's website reveals success in the last year in markets as diverse as Las Vegas casinos, a Spanish port, and a Dutch power generation complex, along with the continuation of large scale projects such as multi-city surveillance in Chihuahua, Mexico and the end-to-end surveillance of Sakhalin Island.

Though IND will not achieve our market forecasts in the current year, we believe IND's outlook is positive. In 2010 the company changed its sales management in North America and we would expect to see this have an effect going forward. Also, IND has resolved the issues it had entering the camera market in 2010 and now has a camera range which meets the standards of its other premium products. IND has released a number of improved products in recent months – software, fixed dome cameras, NVRs – and continues to invest in R&D in order to keep up this schedule of product releases. All these factors should help IND monetise the growth in the IP CCTV market which is expected in coming periods.

Gross Margins

At the interim results, IND cited some pricing pressure and business mix as the reasons for gross margin falling to 57.7% in H1. We understood that pricing pressure contained some one-off elements – such as offering a late discount to gain a second reference site in a major new territory. We therefore expected that margins would improve in H2, but any improvement appears to have been marginal. There are hints of an improvement ahead: IND increased prices in Q4, and quality issues with IND's first ever range of cameras have been rectified with recent ranges, thus consigning returns work to being a legacy issue. This being the case, we may expect to see some improvement in FY12 GMs, however product mix will be an ongoing feature (cameras achieve lower margins than other parts of the system) therefore we have prudently reduced next year's gross margin to fall in line with FY11.

Valuation

We have reduced our price target to 387p, equivalent to 15.5x 2011 calendarised earnings (a 10% peer discount) plus 37p from a DCF valuation of the company's tax asset.

FINANCIALS

Income Statement	2009(A)	2010(A)	2011(E)	2012(E)
Year End July	£m	£m	£m	£m
Sales	26.4	28.0	30.0	34.5
EBITDA	3.5	3.3	2.2	3.3
Depreciation	0.3	0.3	0.3	0.3
Operating profit	3.3	3.1	1.9	3.0
Other Income	0.0	0.0	0.0	0.0
Interest	0.0	0.0	0.0	0.0
PBT (normalised)	3.3	3.1	1.9	3.0
Exceptionals				
Goodwill				
PBT (reported)	3.3	3.1	1.9	3.0
Tax Rate (%)	23.8	35.7	27.0	26.0
Minority Int				
Pref Dividends				
Av. No. Shares	7.3	7.4	7.4	7.4
F. Dil. No. Shares	7.7	7.7	7.7	7.7
EPS(nm - F.Dil.) (p)	32.4	25.6	18.3	28.6
DPS (p)	5.0	7.5	8.0	10.0

Ratios	2009(A)	2010(A)	2011(E)	2012(E)
Sales Growth (%)	43.3	6.2	7.1	15.0
EBITDA Margin (%)	13.4	11.9	7.4	9.5
Op Margin (%)	12.4	10.9	6.4	8.6
Int Cover (x)	-1,086.7	-277.6	-192.1	n/a
EPS Growth (%)	25.9	-21.0	-28.3	56.0
DPS Growth (%)	n/a	50.0	6.7	25.0
Div Cover (x)	6.8	3.6	2.4	3.0

Valuation	2009(A)	2010(A)	2011(E)	2012(E)
P/E (@current price)	9.7	12.3	17.2	11.0
P/E (@target price) (x)	12.0	15.1	21.1	13.5
EV/EBITDA (x)	5.9	6.0	8.8	5.6
EV/Sales (x)	0.8	0.7	0.6	0.5
FCF Yield (%)	7.3	5.2	6.0	7.4
Dividend Yield (%)	1.6	2.4	2.5	3.2

Cash Flow	2009(A)	2010(A)	2011(E)	2012(E)
Year End July	£m	£m	£m	£m
Operating profit	3.3	3.1	1.9	3.0
Depreciation/Amortisation	0.3	0.3	0.3	0.3
Working Capital	-1.6	-1.9	-0.6	-1.3
Interest	0.0	0.0	0.0	0.0
Tax	0.0	0.0	0.0	0.0
Exceptionals				
Other Operating Cashflows	0.1	0.1	0.2	0.1
Cash flow from Ops	2.1	1.5	1.8	2.1
Net Capex	-0.2	-0.4	-0.4	-0.5
Acqs/Disposals				
Other Investing Cashflows				
Cash Flow from Investing	-0.2	-0.4	-0.4	-0.5
Ord Div	0.0	-0.4	-0.8	-0.7
Share Issues	0.1	0.1	0.0	0.0
Other Financing Cashflows	0.0	-0.1	0.0	0.0
Cash Flow from Financing	0.1	-0.3	-0.8	-0.7
Net Inc/Dec in Cash	2.2	0.9	0.5	1.0
Y/E Cash/(Debt)	3.6	4.4	4.9	5.9
Enterprise Value	20.8	19.9	19.4	18.4

Balance Sheet	2009(A)	2010(A)	2011(E)	2012(E)
Intangibles	5.9	4.9	4.4	3.6
Tangibles	0.3	0.5	0.6	0.8
Net Current Assets	6.0	8.0	8.6	9.9
LT Creditors	-0.2	-0.3	-0.3	-0.4
& Provisions				
Shareholders funds	15.6	17.5	18.2	19.7

Ratios	2009(A)	2010(A)	2011(E)	2012(E)
NAV (p)	214.8	237.6	244.6	265.7
Gearing (%)	-22.7	-25.4	-27.2	-30.0
ROCE (%)	27.0	23.4	14.5	21.5
FCF/Share (p)	23.2	16.4	19.0	23.5
Cash Conversion (%)	63.2	50.0	91.2	70.8

Source: Company/BD Estimates

Company Description

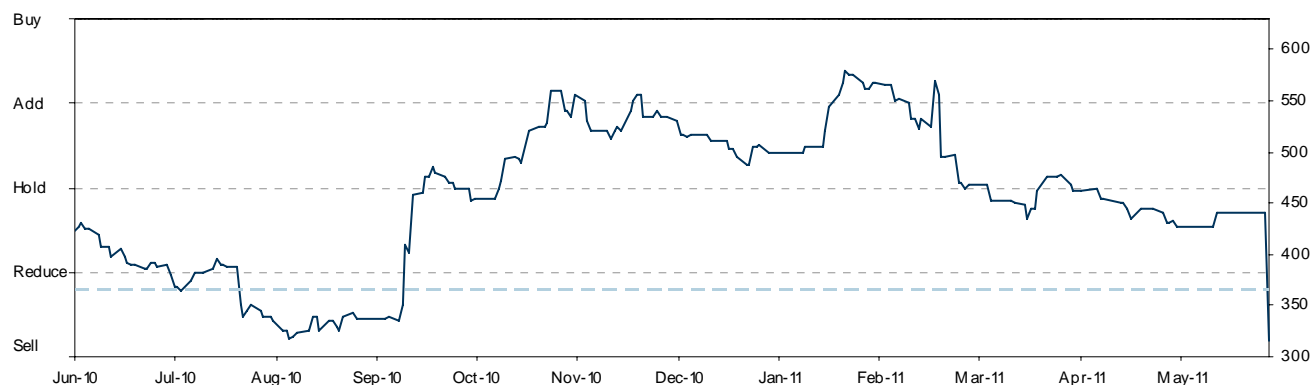
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Future Newsflow

August 11

Trading update

RECOMMENDATION HISTORY - INDIGOVISION (B)(A)



Source: Datastream/Brewin Dolphin

— Recommendation — Price - - - Target Price

(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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