

OCTOPUS DIGITAL LIMITED: Conforming to next digital era



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Recommendation – Subscribe till Cap of PKR 40.6

- Octopus Digital Limited (OCTOPUS), a wholly owned subsidiary of Avanceon Limited, provides B2B After Market Support (AMS) services to Industrial Automation clients both locally and internationally. The company plans to issue 27.35 mn ordinary shares at a floor price of PKR 29 per share through Book Building.
- Our blended P/E and P/BV based Fair Value for Octopus Digital comes at PKR 68 per share. Octopus Digital is thus an attractive investment opportunity, even at a cap price of PKR 40.6. We have used 2020 earnings, post IPO outstanding shares (136mn) and a trailing average sector P/E of 45.0x and P/BV of 7.0x to come up to the fair value.
- **Investment Thesis:** Our investment thesis on Octopus Digital is based on;
 - Sole Provider of AMS services in Pakistan along with a competing edge in cloud base services through procurement of Microsoft Azure services .
 - Strong potential owing to development of various digital dashboard platforms by building 29 Independent intellectual properties and two holistic digital platforms (Topware and OmniConnect).
 - Striving synergy through its parent company – Avanceon Ltd - helping in developing and retaining strong client base both in local market and internationally.
- **Risks:** Key risks to our investment thesis are;
 - Rising cost of developing Intellectual Properties, leading to acquiring less number of IPs then planned.
 - Delay in digital expansion plans.
 - High dependence on AMS services for revenue generation.
 - Rising international competition for AMS and cloud based services.
 - Retention of existing clients post contract expiry.

Key Highlights (Based on 2020 Financials)

	NETSOL	SYSTEMS	AVANCEON	OCTOPUS
Gross Margins	33%	33%	29%	92%
Operating Margins	7%	22%	20%	86%
Net Margins	5%	22%	16%	75%
Revenue Growth	-13%	31%	32%	14.0x
PAT Growth	-80%	59%	15%	84.2x
EPS (PKR)	2.73	15.68	4.07	1.53
ROE	4%	27%	19%	16%
ROA	3%	19%	12%	15%

Relative Valuation based Fair Value comes at PKR 68/ share

- OCTOPUS is going through high growth trajectory due to its unique business model and synergies coming from the parent company – Avanceon, which will result in the understated Price-to-Sales, hence we have valued the company on P/E and P/BV basis. Our blended Fair Value arrives at PKR 68/ share.
- **Price to Earnings based FV - PKR 69/ share**
 - Based on 2020 earnings IT sector is trading at an average price-to-earnings (P/E) of 45.1x. Using sector P/E and 2020 EPS of PKR 1.53, Octopus Digital’s Fair Value comes at PKR 69.
 - OCTOPUS’s P/E comes at 19.0x/26.6x at a floor/cap price of PKR 29/40.6 per share, a discount of 58%/41% relative to the sector. The stock looks an attractive investment opportunity considering it is the only AMS service provider in Pakistan and is already a preferred choice of many clients locally and abroad through its parent company.
- **Price to Book Value based FV - PKR 67/ share**
 - IT sector on trailing basis is trading at an average price-to-book (P/BV) of 7.0x. Incorporating 2020 BVS of PKR 9.5, Octopus Digital’s P/BV based Fair Value is PKR 67.
 - The company’s trailing P/B(x) stands at 3.0x/ 4.3x at a floor/cap price of PKR 29/40.6 per share, a 57%/39% discount relative to the sector. The lower P/B is justified as the company is yet to introduce digital dashboard platforms through building Independent Intellectual properties which would add considerable value.

Relative Valuation Matrix		
	P/E(x)*	P/B(x)*
Avanceon	31.2	5.8
Systems Ltd	49.1	13.3
NETSOL	55.1	2.0
Average	45.1	7.0
High	55.1	13.3
Low	31.2	2.0
Octopus Digital**	19.0	3.0
Octopus Digital***	26.6	4.3

*Prices as of 7th September, 2021

Based on Floor Price of PKR 29/ share * Based on Cap Price of PKR 40.6/ share

Fair Value Calculation	
Sector P/E (x)	45.1
2020 EPS (PKR)	1.5
P/E based Fair Value	68.9
Sector P/BV (x)	7.0
2020 BVS (PKR)	9.5
P/BV based Fair Value (PKR)	67.1
Blended P/E and P/BV based Fair Value (PKR)	68.0

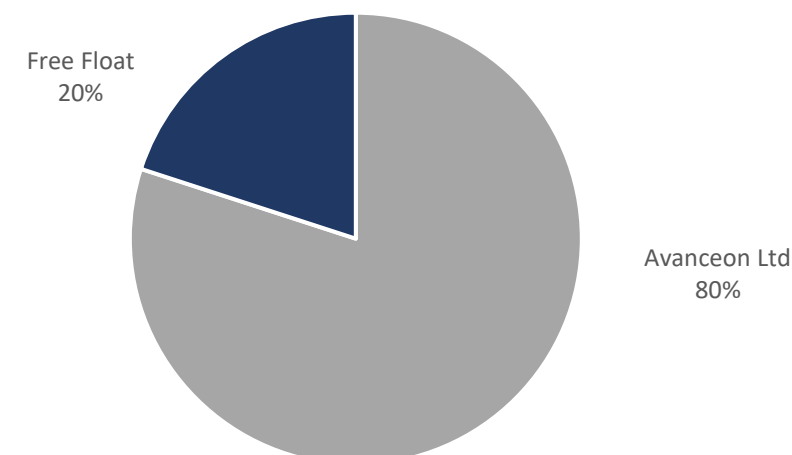
Company Overview

- Octopus Digital Limited (OCTOPUS) was incorporated in December 2017 as a wholly owned subsidiary of Avanceon Limited, providing B2B After Market Support (AMS) services to Industrial Automation clients locally and internationally.
- Avanceon limited, the parent company, has transferred its After Market Services (AMS) division to Octopus Digital in 2020 which constituted around 71% of the total group revenue.
- The company has an established clientele base in Pakistan ranging from Pepsi, Engro Polymer & Chemicals, Pakistan Petroleum, etc. Moreover, the company also offers (AMS) services to clients based in Dubai and Qatar among which some clients include Elegencia Hospitality & Facilities Management Services Co W.L.L and Serco limited.
- The company provides one of its kind (AMS) services in Pakistan with no direct competitor engaged in providing similar services. However, the company faces international competition from service providers such as Honeywell Automation, ABB, CISCO and Rockwell automation.
- AMS revenue has witnessed 5-year Revenue CAGR of 19% along with its gross margins achieving 5 year CAGR of 26%.

Key Company Stats	
Incorporation	December 2017
Parent Company	Avanceon Limited
Target Market	Industrial automation clients
Service type	After Market support (AMS)
AMS contribution to group revenue	71%

Source: Investment Prospectus

Post IPO shareholding pattern



Source: Investment Prospectus & Akseer Research

Octopus Digital: Conforming to next digital era

Initial Public Offering: 27.35 mn ordinary shares are being offered at a floor price of PKR 29 per share with a cap of PKR 40.6



- The company plans to issue 27.35 mn ordinary shares at a floor price of PKR 29 per share to the public. The price is capped at PKR 40.6 with a 40% premium to the floor price under IPO regulations. The company plans to raise PKR 793-1,099mn depending on the strike price decided through the book building.
- The issue is 100% Book Building based, in which 75% would be offered to the successful bidders consisting of institutional investors and high net worth individuals, while 25% will be offered to the retail investors.
- BMA Capital Management Limited is the Lead Manager and Book Runner to the issue and Meezan Bank is the banker to the Book Building.
- **Funding Utilization**
 - The company plans to launch various digital dashboard platforms by building 29 Independent intellectual properties followed with carrying their marketing and selling activities.

Key Data	
Issue Size	27.350 mn shares
Floor/Cap Price	PKR 29/40.6 per share
Capital to be Raised	PKR 793.15mn - 1,099mn
Book Building	75%
Retailer Investors	25%
Shariah Status	Compliant

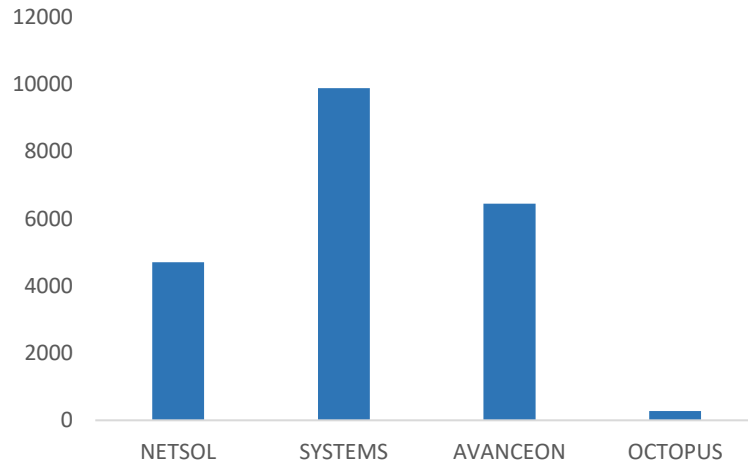
Source: Company Prospectus & Akseer Research

Funding Utilization (Figures in Million PKR)		
Categories	PKR	%
Intellectual Property	696	88%
Marketing	42	5%
Sales	55	7%
Total	793	100%

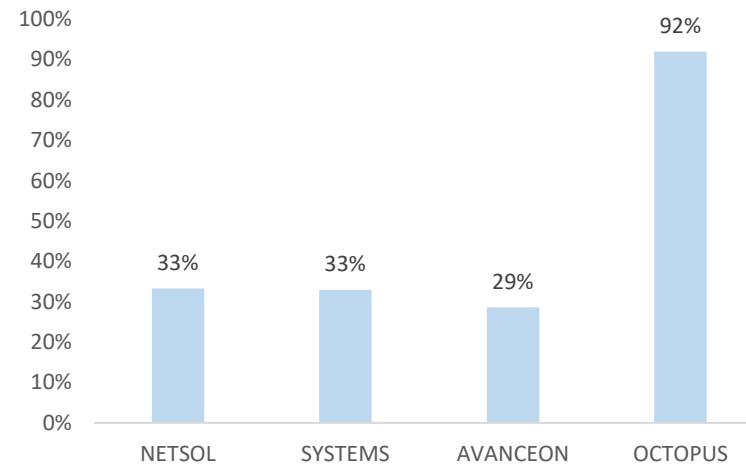
Source: Investment Prospectus & Akseer Research

Peers comparison – OCTOPUS is in limelight

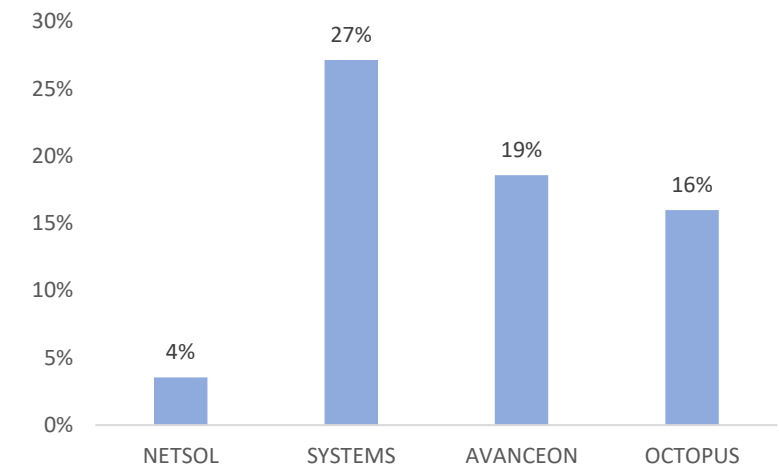
Sales (PKR mn)



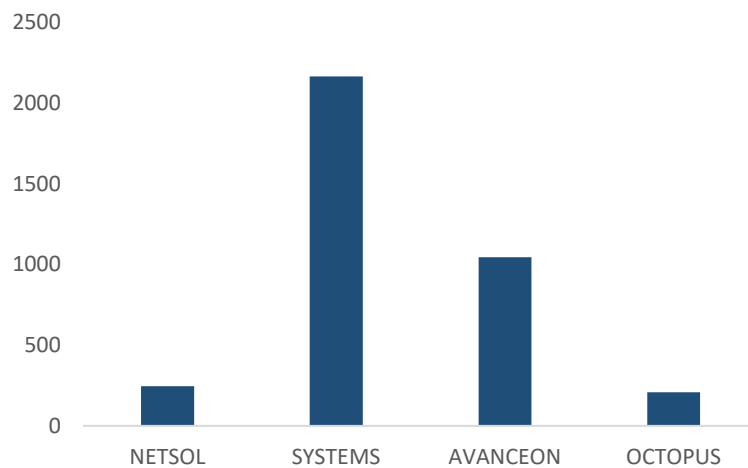
Gross Margins



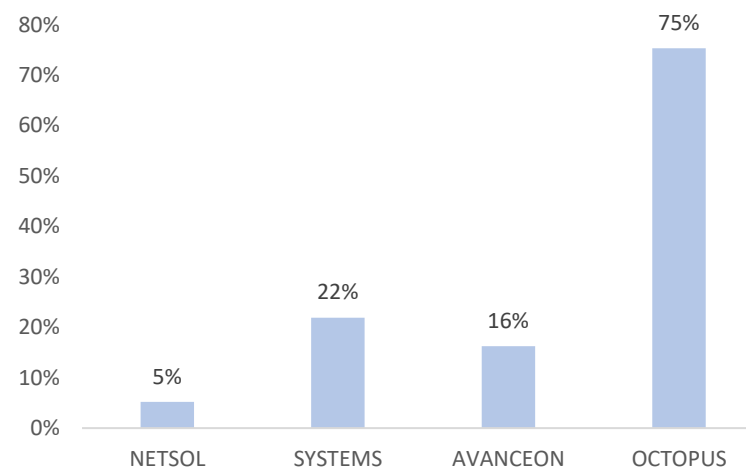
Return on Equity



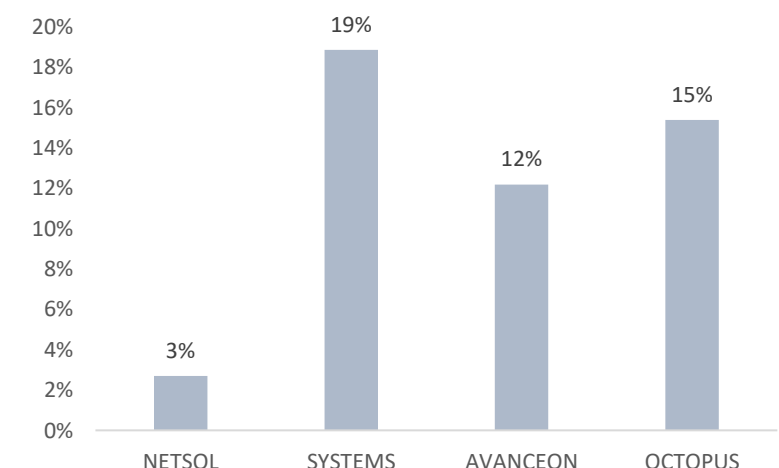
Profit After Tax (PKR mn)



Net Margins

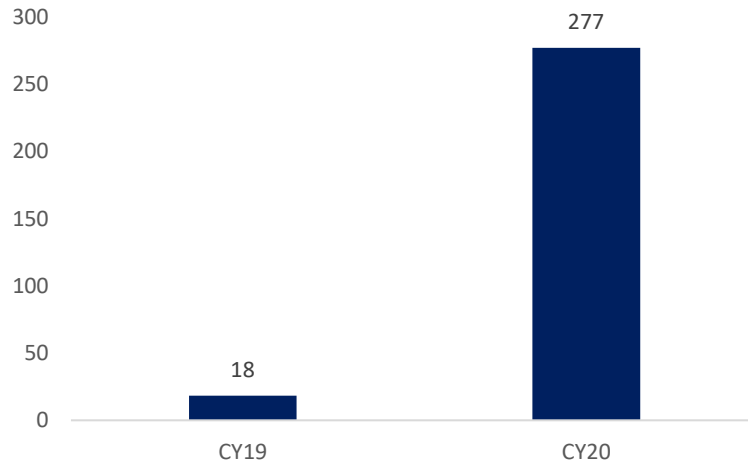


Return on Assets

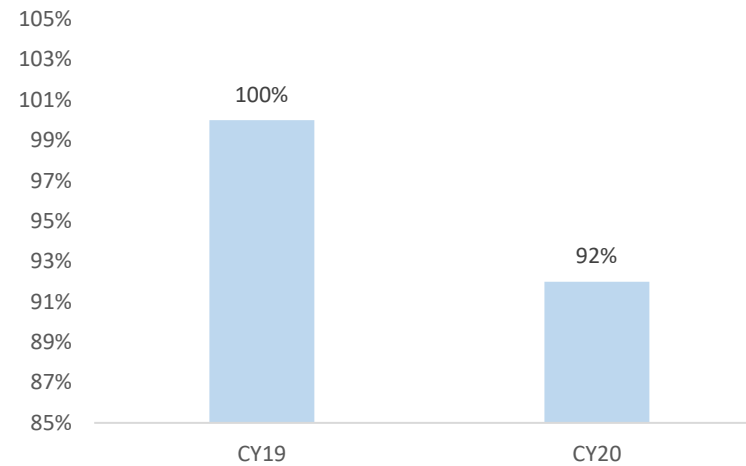


Key Ratios based on historical numbers

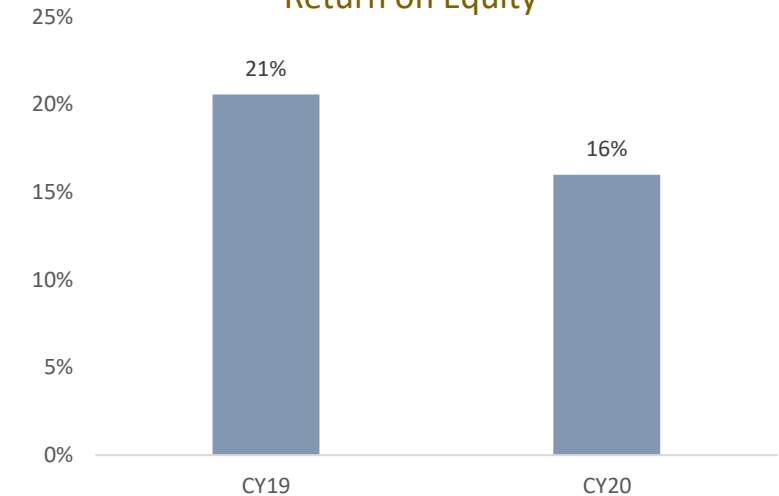
Sales (PKR mn)



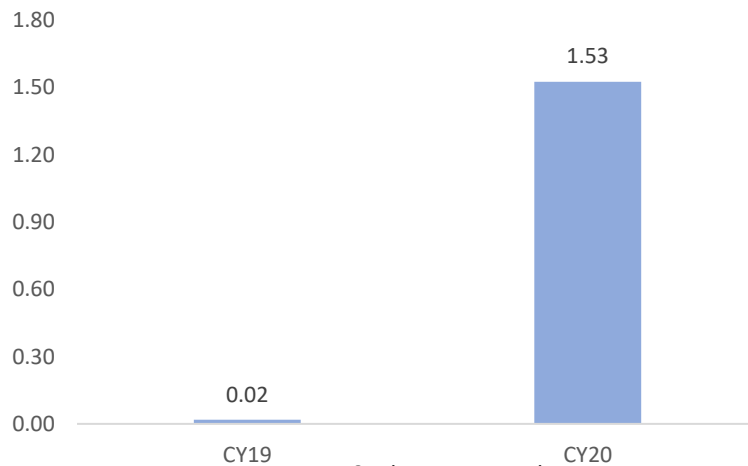
Gross Margins



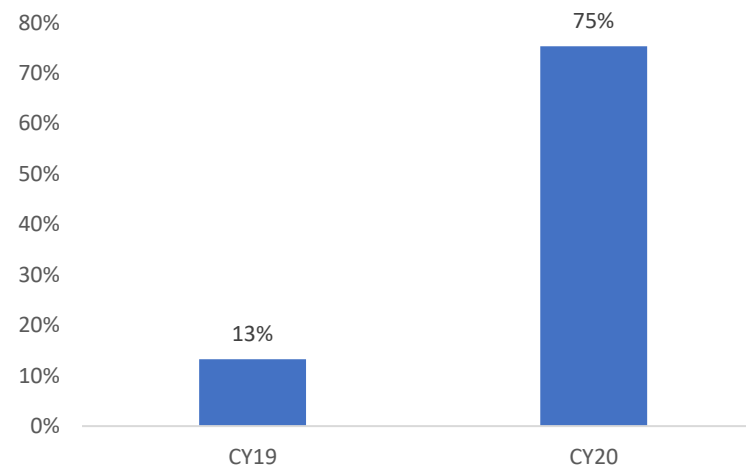
Return on Equity



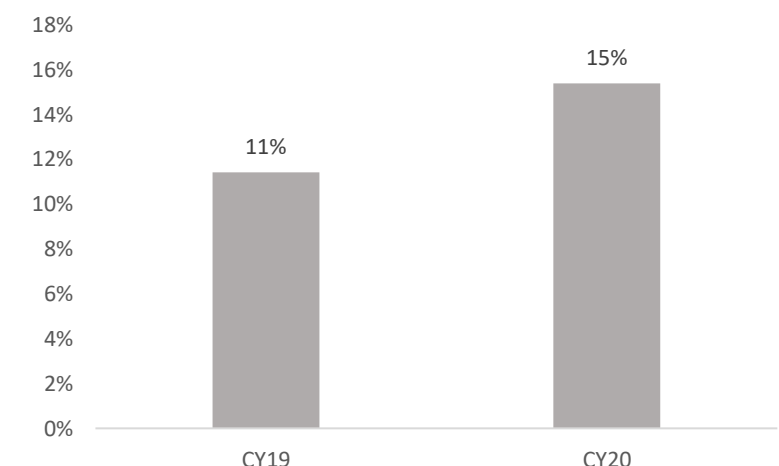
EPS (PKR)



Net Margins



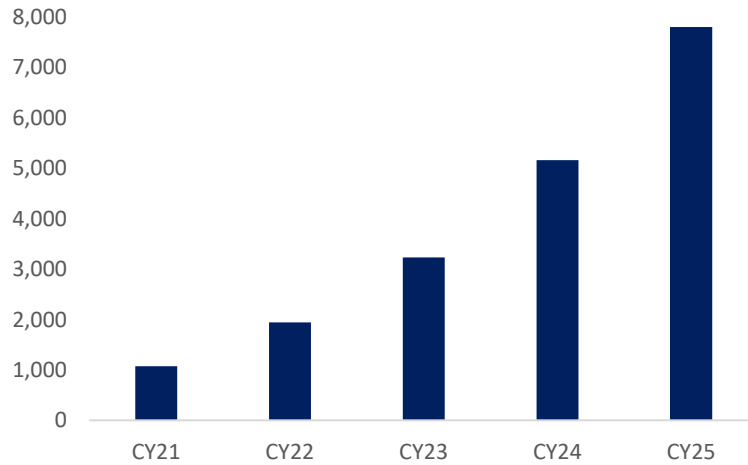
Return on Assets



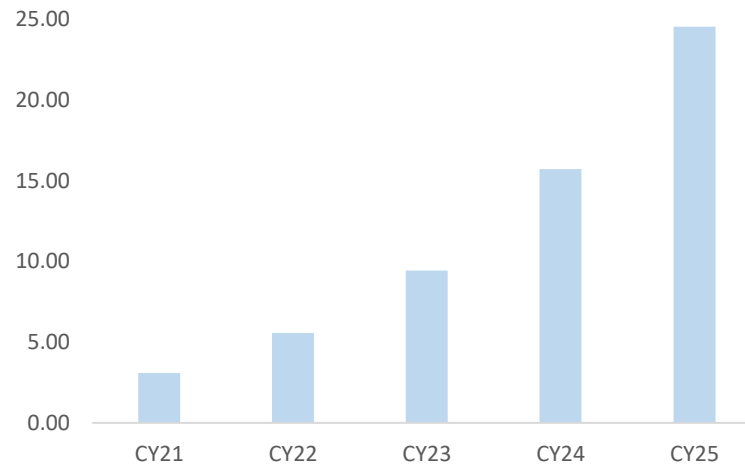
Source: Investment Prospectus & Akseer Research

Company guidance indicates robust expected future earnings performance

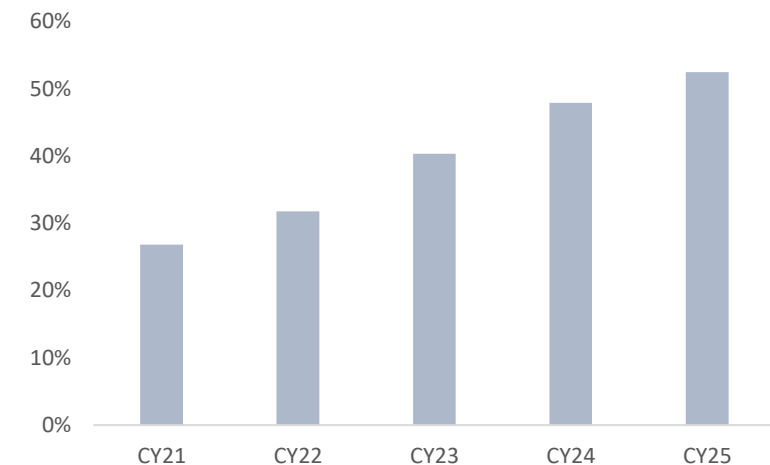
Sales (PKR mn)



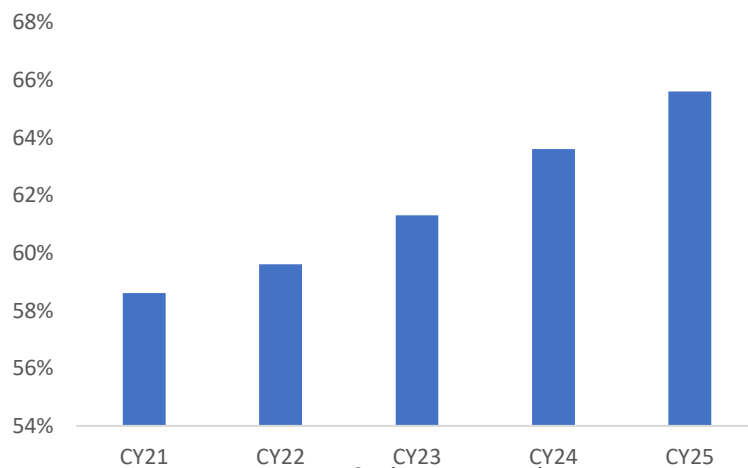
Earning Per Share (PKR/Share)



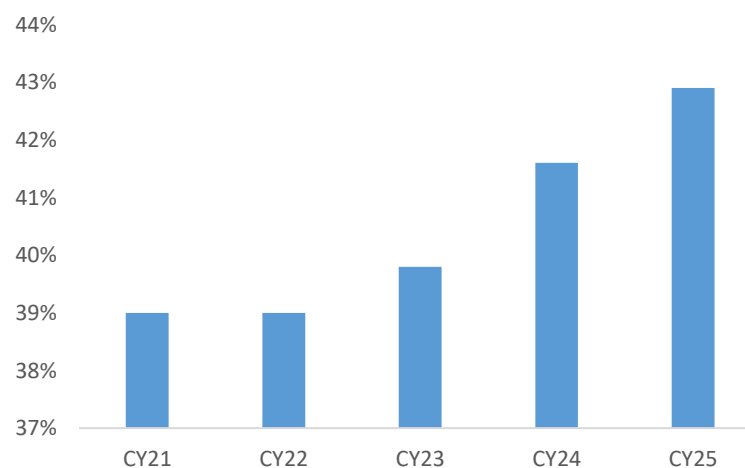
Return on Equity



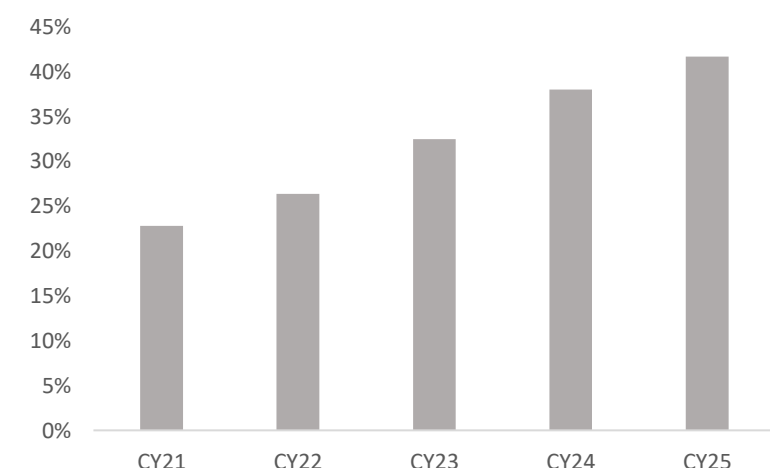
Gross Margins



Net Margins



Return on Assets



Source: Investment Prospectus & Akseer Research

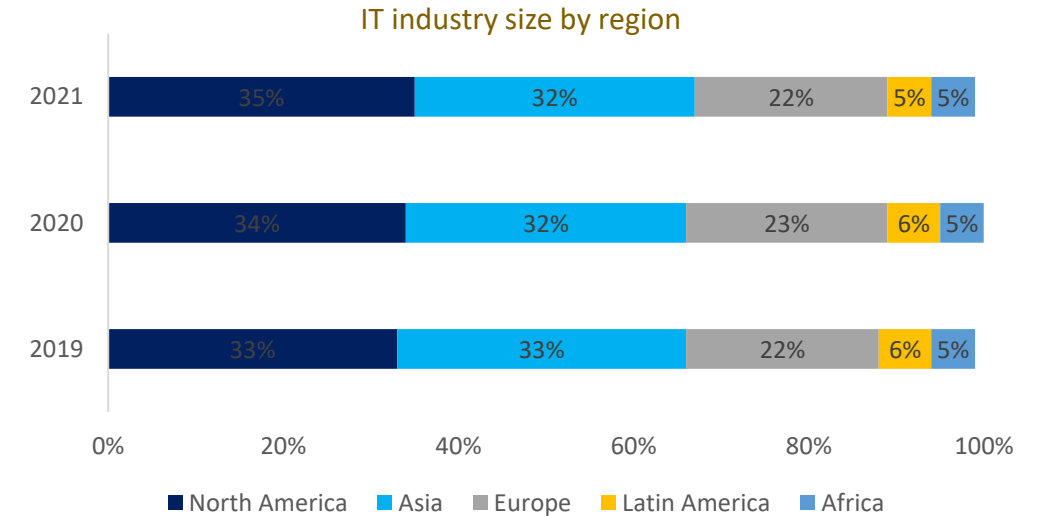
Industry Overview

Global Landscape

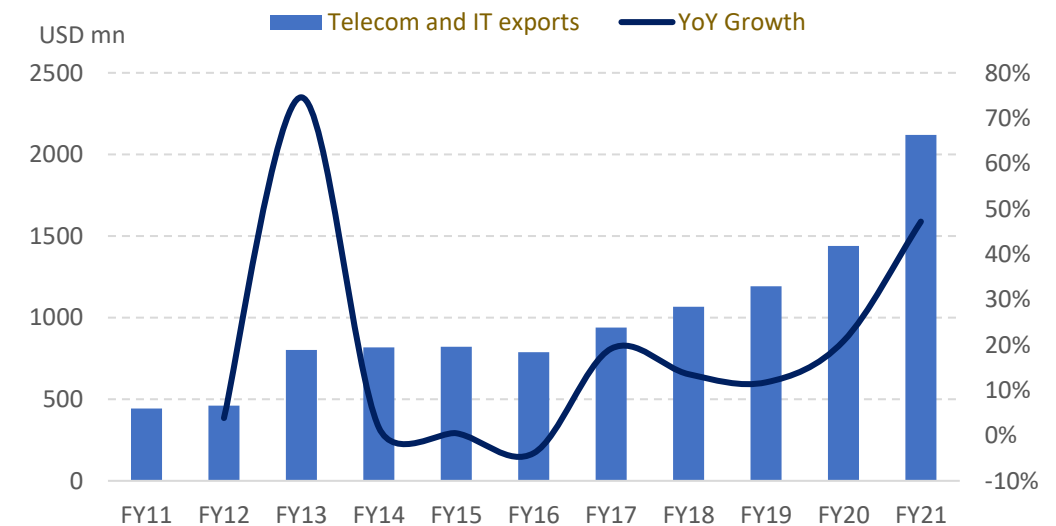
- The 4th Industrial Revolution also known as ‘Industry 4.0’ is penetrating around the globe at a rapid pace and is mostly digital. The digital economy size touched USD 11tn, comprising ~16% of the global GDP.
- Industry 4.0 is basically a hyper connectivity-based intelligent technology revolution triggered by the development of artificial intelligence, big data, and other digital technologies that is expected to give rise to innovative transformations in not only industries but also in the national system and society.

Pakistan - A promising market for the IT

- Pakistan is reflecting strong growth in the IT sector given the sector contributes only 1% to the GDP at USD 3.5bn versus global GDP contribution of ~16%.
- The country ICT exports crossed USD 2bn (+47% YoY) mark in FY21 for the first time in the history.
- In accordance with Pakistan Vision 2025 and the Digital policy of Pakistan 2018, the ICT industry size is targeted to reach USD 20bn by FY25.
- Currently, more than 2000 companies and call centers are operating in the country along with 12 software technology parks and the number is likely to grow further.



Source: Statista



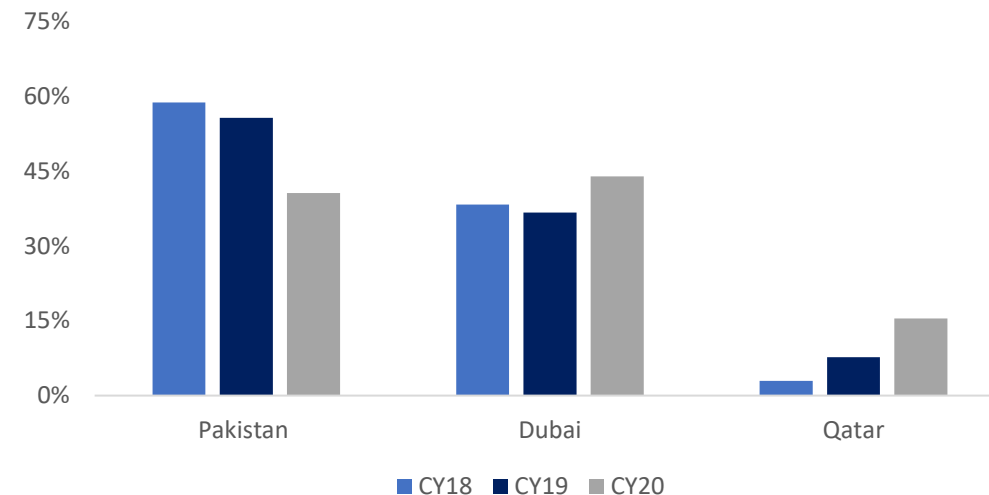
Source: SBP & Akseer Research

AMS leading the way with strong client base

AMS to drive the topline growth

- Octopus Digital Limited (OCTOPUS) is set to benefit from Industry 4.0 by having a strong hold in providing ‘After Market Support’ (AMS) services both locally and internationally. The management is looking to increase its service offerings by introducing independent vertical applications, intellectual properties and Independent category based IPs in the near future.
- As per CY20 numbers, Foreign clientele based AMS revenue accounted for 60% of the total (AMS) revenue, whereas the rest came from the local sales. UAE and Qatar are two major markets for company’s international operations.
- Moreover, the company is well positioned to enjoy monopolistic sales in the local market given it is the sole AMS services provider in Pakistan.
- The company is also an emerging player in provision of cloud-based solutions at a large scale in Pakistan after procuring Microsoft Azure’s services in 2019. It has also established its own data lake through Microsoft cloud facilities giving it a competitive advantage over its peers locally and internationally.
- Currently, OCTOPUS is providing cloud based services to prominent companies including Dewan sugar, Tapal, HUBCO, etc. through Azure cloud based data processing service.

Country wise Revenue Breakup



Source: Investment Prospectus & Akseer Research

Octopus Digital and Microsoft	
Service Type	Cloud Based
Cost	USD 12,000/year
Service Acquired	2019
Service Expiry	3 years Extendable post expiry

Source: Investment Prospectus & Akseer Research

Unwinding growth through Intellectual Properties

■ The Digital Expansion

- The company intends to launch various digital dashboard platforms by building 29 Independent intellectual properties (IPs) followed with carrying their marketing and selling activities. This will provide the company an exclusivity in AMS services as no other company will compete it in the same segments.
- The company plans to introduce objective specific dashboards under the following categories:
 - › **Industry Vertical based IP:** To display industry specific metrics such as capacity utilization.
 - › **Function based IP:** To display different benchmark or metrics of a specific function.
 - › **Utilities based IP:** To display performance of different utilities.
 - › **Maintenance based IP:** To display maintenance levels required for different assets.
 - › **Fuel retail specialty based IP:** To display transactional and inventory data of fuel in retail stations.

Funding Utilization (PKR mn)		
Categories	Amount (@Floor price of PKR 29)	%
Intellectual Property	696	88%
Marketing	42.15	5%
Sales	55	7%
Total	793.15	100%

Source: Investment Prospectus & Akseer Research

Funding Breakup- Intellectual Property (PKR mn)			
Particulars	No of IPs	Cost/IPs	Total
Intellectual Property	29	24	696

Source: Investment Prospectus & Akseer Research

Funding Breakup- (PKR mn)			
Particulars	No. of HR	Avg Annual Salary	Total Cost
Marketing	40	1.05	42.15
Sales	55	1	55

Source: Investment Prospectus & Akseer Research

Digital Platforms to further enhance its offering

■ The Digital Expansion Contd...

- The company also plans on providing data analytics services through two digital platforms named Topware and OmniConnect.
 - › **Topware:** An AI powered analytics platform providing end to end solution through Digital Dashboarding, Prediction & Prescription and Autonomous Command Center and in turn helping the clients infer data conveniently and to fit their needs for maintenance and personnel training.
 - › **OmniConnect:** This platform will serve under the brand name of several intellectual properties and would essentially allow clients to avoid potential losses through predictive analysis.
- The predictive analysis would incorporate the following functions:
 - › Data collection from source
 - › Data input into cloud
 - › Storage of data into data lake
 - › Configuration of KPI
 - › Performance of operations as required
 - › Data visualization



Digital dashboarding



Prediction and
Prescription



Autonomous
Command Center



Predictive Analysis

Source: Investment Prospectus & Akseer Research

OCTOPUS and Avanceon to cultivate thriving Synergy

- Avanceon Limited, the parent company, is a leading player in the machinery automation industry providing industrial automation, process control, and systems integration solutions.
- It had been providing AMS services to clients based in Pakistan and Middle East since 2008 which helped in culminating an established clientele along with a 100% customer retention and an average contract duration of 3 to 5 years.
- Avanceon established OCTOPUS to further enhance the delivery of AMS services by transferring the AMS business segment to the latter. Up till Dec-20 end OCTOPUS had provided services to Avanceon’s clients and further signed 26 new contracts, depicting strong brand value.
- OCTOPUS is likely to benefit from exponential growth trajectory of its parent company and as well as its own expertise.

Prominent Clients transferred from Avanceon			
Company	Location	Revenue Contribution	Tenure of Contract
Elegencia Hospitality and Facilities Management Services Co W.L.L	Qatar	15.35%	Up to 5 years
Engro Polymers and Chemicals Limited	Pakistan	6.52%	Up to 3 years
Pakistan Petroleum Limited	Pakistan	14.67%	Up to 3 years
Pepsi Cola International Private Limited	Pakistan	9.98%	Up to 3 years
Serco Limited	Dubai	10.96%	Up to 3 years
Others	Pakistan, Dubai and Qatar	35.99%	Up to 3 years

Source: Investment Prospectus & Akseer Research

Financial Highlights

Income Statement (PKR mn)

PKR Mn	CY18	CY19	CY20
Net Sales	-	18.45	277.14
Cost of Sales	-	-	22.2
Gross Profit	-	18.45	254.91
Operating Expenses	(0.51)	(13.78)	(15.56)
Profit from Operations	(0.51)	4.67	239.35
Finance Cost	-	0.01	0.04
Profit before Taxation	(0.51)	4.66	239.31
Tax	-	2.21	30.67
Profit After Tax	(0.51)	2.45	208.64

Source: Investment Prospectus & Akseer Research

Balance Sheet (PKR mn)

PKR Mn	CY18	CY19	CY20
Non-Current Assets	0.08	0.09	1,092.97
Current Assets	0.03	21.32	262.35
Total Assets	0.11	21.42	1,355.32
Equity and Reserves	(0.51)	11.94	1,304.58
Total Liabilities	0.62	9.59	50.74
Total Equity and Liabilities	0.11	21.42	1,355.32

Source: Investment Prospectus & Akseer Research

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To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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JV employs a three-tier ratings system to rate a stock, as mentioned below, which is based upon the level of expected return for a specific stock. The rating is based on the following with time horizon of 12-months.

Rating	Expected Total Return
Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

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