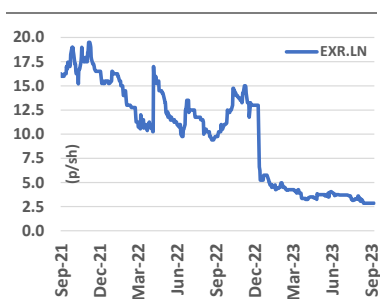


11th September 2023
Sector: Software

 Specialised Virtual Reality (VR)
communications platform company

Market data

Ticker	EXR
Price (p/sh)	2.85p
12m High (p/sh)	15.0p
12m Low (p/sh)	2.85p
Shares (m)	524.5m
Mkt Cap (£m)	14.9m
Markets	AIM



Source: Alpha

Description

ENGAGE XR is a leading virtual reality ('VR') technology company, focused on becoming the world's largest crossed reality ('XR') communications, training and virtual events platform provider, through commercialisation of ENGAGE, its proprietary online virtual platform www.engagexr.co

Board & key management

Chairman	Richard Cooper
CEO	David Whelan
COO	Sandra Whelan
CFO	Seamus Larrissey

Corporate Broking

Damon Heath
 damon.heath@shardcapital.com
 +44 207 186 9952

Analyst

David Jeary
 Consultant analyst

ENGAGE XR Holdings

FY23 interim results – on track for the full year

ENGAGE XR (formerly known as VR Education Holdings) has announced its FY23 interim results to 30 June 2023. These formally confirm the revenue, gross margin and net cash details of the August trading update. The principal new data points relate to measures of profitability with narrowing losses reported at both EBITDA and loss before tax levels. The interim results also clearly show the success of management's efforts to contain the operating cost base. Cash burn averaged around €0.5m per month in the period, with net cash resources of €9.4m on 30 June.

- ▶ **FY23 interim results:** ENGAGE XR's group H1 turnover increased by 18% over the equivalent period to €2.08m. The driver of this growth was the ENGAGE platform, whose revenues grew by 30% to around €1.9m, with a sales participation of 91% (vs 83% in H1 FY22). The higher ENGAGE participation was a key reason behind the expansion of gross margin percentage to 93.3% from 80.8% last year. Combined with the higher level of gross profit achieved, the company's focus on cost management has also borne fruit and contributed to the narrowing of EBITDA, operating and reported losses. The operating loss and loss before tax both narrowed by almost €0.6m to €2.19m. Period end cash stood at €9.4m following the oversubscribed net €9.9m fundraise in February 2023.
- ▶ **Operational highlights:** ENGAGE XR has continued to make client gains, with a net addition of more than 30 clients since 31 December 2022. The active customer base now numbers over 220 Enterprise and Education customers. Increasing the client base (and total licence numbers) is an important growth driver for the group. In March 2023, the potential of VR as a powerful and innovating entertainment medium was shown through the groundbreaking concert hosted in ENGAGE by Norman Cook, aka Fatboy Slim. Some 54% of group revenues came from North America in H1. While marginally down on the 58% delivered in Q1, this compares with 34% in H1 FY22 and 30% for the totality of FY23 following deployment of the US sales team last year. This points to growing traction in this important geographic market, which is home to many of the key global tech giants.
- ▶ **Key performance indicators (KPIs):** The company has continued to make solid progress with regard to the majority of the KPIs associated with its medium-term plan. The achieved gross margin percentage of 93% is well ahead of the target of being in excess of 80%. The revenue retention rate in the period was 201%, compared with 133% in H1 FY22 and with the targeted level of 80%. In terms of the average contract value (ACV), this has increased to €21K, compared with €18K last year. This partly reflects the trend to larger contract sizes, with 24% of contracts won in the period having a value of more than €50K. The total of licensed Enterprise and Education customers stood at over 12,000 at the period end, representing a 48% increase year-on-year. Subsequently, a K-12 education license deal for 5,400 users was signed with a US state for a pilot programme with a value of more than €300K.
- ▶ **Forecasts:** With H1 results being in line with management expectations and following a strong start to H2, with total revenues of €1m achieved across the months of July and August, we are leaving our forecasts unchanged, as cast in May at the FY22 full year results. The company may also start to accrue some revenue benefits arising from its partnership with Lenovo from Q4, but these will have a greater impact from FY24E onwards. *Full details of our forecasts can be found in the Summary financials section at the end of this note.*

ENGAGE XR has signed a rapidly growing number of strategic and commercial partnership agreements with companies invested in promoting the VR medium and the development of corporate metaverses. This reflects the significant changes in how people work, study and travel following the pandemic, favouring remote working with more immersive communication and conferencing platforms. This has underpinned ENGAGE XR's finances and ability to support the wider uptake of ENGAGE platforms in the enterprise, education, and events communities.

The future continues to evolve

Apple joins the XR party

The announcement on 5 June of Apple's first major new product launch for several years, the Apple Vision Pro headset, marked the arrival of one of the largest global tech giants into the arena of Extended Reality (XR). While long-rumoured to be on the drawing board at Apple, the formal announcement clearly signals Apple's belief in the commercial potential and prospects of this technology.

Slated for launch next year, Apple's headset will not be priced to appeal to the mass consumer market. Given its high specifications and price point, it is targeted initially at developers and "prosumers" who can build applications and be prepared for a more consumer friendly device and price point at some stage in the future. This follows the template for Apple hardware releases and ENGAGE XR fully anticipates its launch to mark a significant shift in acceptance and global adoption of immersive technologies.

The company states that it is undertaking development work to ensure ENGAGE can utilise the Apple Vision Pro to its maximum potential once released. However, with ENGAGE XR's products fully compatible with existing Apple devices and the iOS operating system, we do not anticipate any issues on this front.

As with the yet to launch Quest 3 model from Meta, with whom ENGAGE XR is working to ensure full operability of ENGAGE on the device, Apple's device will also focus on Augmented Reality (AR). AR gives the ability to see the real world and overlay it with digital objects, also known as AR passthrough.

Artificial Intelligence (AI)

Another development, which has been garnering considerable news coverage in recent months and gaining a significantly higher consumer profile, is that of Artificial intelligence (AI). The company announced earlier this year that it would be launching AI capabilities within the ENGAGE platform. This will take the form of Athena A.I, the company's artificial intelligence assistant.

Developed using open AI systems, Athena A.I not only interacts with users verbally but also interacts with core ENGAGE programmes. Athena A.I continues to be developed but can already do things such as create training scenarios from simple voice prompts. Athena A.I has been designed primarily as a solution and tool for enterprise clients, where it can be used in a variety of highly practical ways such as employee onboarding, sales and customer service training, education, and much more. Ahead of its launch later this year, Athena A.I will continue to be updated extensively, ready to provide another compelling service offer to ENGAGE customers and users.

The evolution of ENGAGE Link

The evolution and reach of ENGAGE Link is primarily visible to the outside world through access to public spaces. This does not however convey the full extent of the metaverse platform nor all the work the company is engaged in on behalf of customers. In other words, as highlighted in the interim results release, there is very strong demand for the creation of private virtual worlds for internal use and

demos by companies which are not accessible to the public. The public face of ENGAGE Link includes many substantial and well-known enterprises and education providers, which have created public spaces. These include names such as HTC, KPMG, Lenovo, Pearson, Victory XR and Stanford University. There are however company customers that have just created private virtual worlds and, in many instances, choose not to publicise their identity. These companies will however be included in the number of clients that ENGAGE XR is working with.

FY23 interim results

The following table provides a summary of the key financial metrics from ENGAGE XR's FY23 interim results, focussing on the P&L and net cash. These had mostly been highlighted earlier in the company's August H1 period end trading update, with the key new data pertaining to measures of profitability.

Summary of FY23 interim results – key interim financials for FY23 and FY22

€'000 unless otherwise stated	FY22	FY23	Change	% change
Turnover	1,757	2,075	318	18%
Gross profit	1420	1936	516	36%
<i>Gross margin (%)</i>	<i>80.8%</i>	<i>93.3%</i>		
EBITDA	(2,526)	(2,119)	407	16%
<i>EBITDA margin (%)</i>	<i>(144%)</i>	<i>(102%)</i>		
Operating loss	(2,781)	(2,187)	594	21%
<i>Operating margin (%)</i>	<i>(158%)</i>	<i>(105%)</i>		
Pre-exceptional pre-tax loss	(2,798)	(2,188)	611	22%
Pre-exceptional EPS (€)	(0.010)	(0.004)	0.006	60%
Net cash	4,901	9,447	4,546	93%

Source: Shard Capital: ENGAGE XR

ENGAGE revenues increased by 30% year-on-year to around €1.9m, accounting for some 91% (H1 FY22: 83%) of total group revenues, which increased by 18% to €2.08m. This implies that other revenues decreased by around 37% year-on-year.

The improved mix of very high margin ENGAGE revenues drove a 1250bps increase in gross margin to 93.3% from 80.8% in the prior year. This is substantially above the target of gross margin being in excess of 80%. This, in conjunction with overall revenue growth, translated into a gross profit increase of 36%, double the rate of group turnover growth.

Total active licenses as of 30 June 2023 stood at 12,048, an increase of 48% over the 8,148 licenses on 30 June 2022. The compound semi-annual growth in license numbers since H2 of FY18 equates to an impressive 84%. These figures exclude the 5,400 new licenses associated with the deal signed with a US state for an educational pilot programme.

At the EBITDA level, there was a 16% improvement ie reduction in the EBITDA loss to €2.12m from €2.53m in the prior year. The primary cost driver for the EBITDA loss is salary and associated costs, which the company states are currently running at around €0.5m per month.

At the operating loss and pre-tax loss levels, there were improvements of 21% and 22% respectively to €2.19m, which were in line with management expectations.

The pre-exceptional loss per share improved by 60%, reflecting the higher number of shares in issue following the equity raise in February 2023.

Management has maintained a tight control of operating costs across the period. While not highlighted in the table above, total operating costs, including depreciation and amortisation charges, were some 2% lower at €4.12m in the period. Excluding these charges, operating costs were just under 3% higher at €4.06m.

The balance sheet and cash position were strengthened considerably by the successful and oversubscribed equity placing in February 2023, which raised €10.5m gross and €9.9m net. By the end of the H1 period, cash reserves stood at just over €9.4m.

Forecasts

We leave our forecasts unchanged. With the interim results in line with management's expectations, a strong start to H2, with revenue of €1m generated in July and August, and the traditionally strongest fourth quarter to come, the company remains on track to deliver our revenue forecast. As outlined above, management is also keeping a tight control of operating expenses. This will help to protect the bottom-line outturn and cash resources, as does the higher gross margin percentage achieved compared with the shape of our forecasts. We shall review and recast the shape of our forecasts at a later date in light of the results and gross margin achieved across the totality of 2023E.

The following table summarises the key financial elements of our forecasts up to 2025.

<i>Summary of key ENGAGE XR forecasts – 2020 – 2025E</i>							
	2020	2021	2022	2023E	2024E	2025E	3-yr CAGR
Turnover	1.417	2.386	3.869	5.920	7.705	10.238	38.3%
Gross profit	1.013	1.894	3.160	4.972	6.472	8.682	40.1%
Gross margin (%)	71.5%	79.4%	81.7%	84.0%	84.0%	84.8%	
EBITDA	(2.067)	(2.478)	(5.507)	(3.951)	(2.703)	(0.826)	(46.9%)
EBITDA margin (%)	(145.9%)	(103.9%)	(142.3%)	(66.7%)	(35.1%)	(8.1%)	
Operating profit	(2.721)	(3.114)	(5.974)	(4.028)	(2.758)	(0.891)	(47.0%)
Operating margin (%)	(192.1%)	(130.5%)	(154.4%)	(68.0%)	(35.8%)	(8.7%)	
Pre-exceptional pre-tax loss	(2.728)	(3.130)	(6.005)	(4.058)	(2.793)	(0.921)	(46.5%)
Pre-exceptional EPS (€)	(0.011)	(0.010)	(0.019)	(0.008)	(0.005)	(0.002)	(55.0%)
Net cash/(debt)	2.033	7.790	2.209	7.845	5.107	4.362	25.5%

Source: Shard Capital, ENGAGE XR

For reference, we have included a more detailed summary of our P&L, cash flow and balance sheet forecasts, which are presented further below as the Summary Financials section of this note.

Investment case

ENGAGE XR has high ambitions, with a scalable platform utilising leading edge technology, soon to include the world's first integration of Artificial Intelligence (AI) into VR in the form of Athena A.I, further enhancing the technological offer to the company's clients. The Total Addressable Market (TAM) is estimated by management to range between \$10bn - \$44bn, with a substantial double-digit growth rate forecast over the medium-term. Client and revenue growth retains

momentum, with especially high interest and demand from North America, which accounted for 54% of revenue in H1 2023.

ENGAGE XR's collaborations with tech giants such as Meta and Lenovo serve as evidence both of the relevance of the group's proprietary platform and technology, and of the high regard in which it is held. Such collaborations are not only a valuable source of revenue generation but also of embedding ENGAGE within hardware and broader applications appealing to an ever-growing audience within its core Enterprise and Education customer base.

The release and planned release of new VR headsets from Meta, Lenovo, HTC and Apple underpins the growing interest in and future growth of immersive communications, spatial computing and metaverse services for a broad range of Enterprise and Education entities around the globe.

Summary financials

Profit and loss account and cash flow forecasts – 2019 – 2025E

Profit and loss account							
Year to December	2019	2020	2021	2022	2023E	2024E	2025E
Turnover	1.025	1.417	2.386	3.869	5.920	7.705	10.238
Cost of sales	(0.401)	(0.404)	(0.492)	(0.709)	(0.948)	(1.233)	(1.556)
Gross profit	0.623	1.013	1.894	3.160	4.972	6.472	8.682
Gross margin (GM) (%)	60.8%	71.51%	79.37%	81.7%	84.0%	84.0%	84.8%
Operating costs	(2.555)	(3.734)	(5.007)	(9.134)	(9.000)	(9.231)	(9.573)
Operating profit	(1.932)	(2.721)	(3.114)	(5.974)	(4.028)	(2.758)	(0.891)
Operating profit margin (%)	(188.6%)	(192.1%)	(130.5%)	(154.4%)	(68.0%)	(35.8%)	(8.7%)
Depreciation and amortisation	(0.494)	(0.655)	(0.635)	(0.467)	(0.077)	(0.055)	(0.065)
EBITDA	(1.438)	(2.067)	(2.478)	(5.507)	(3.951)	(2.703)	(0.826)
EBITDA margin (%)	(140.4%)	(145.9%)	(103.9%)	(142.3%)	(66.7%)	(35.1%)	(8.1%)
Interest charge	(0.007)	(0.007)	(0.017)	(0.031)	(0.030)	(0.035)	(0.030)
Pre-exceptional PBT	(1.939)	(2.728)	(3.130)	(6.005)	(4.058)	(2.793)	(0.921)
Exceptional charges	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Profit before tax	(1.939)	(2.728)	(3.130)	(6.005)	(4.058)	(2.793)	(0.921)
Adjusted diluted EPS (c)	(0.010)	(0.011)	(0.010)	(0.019)	(0.008)	(0.005)	(0.002)
Diluted EPS (c)	(0.010)	(0.011)	(0.010)	(0.019)	(0.008)	(0.005)	(0.002)
Dividend (c)	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Cash flow							
Year to December	2019	2020	2021	2022	2023E	2024E	2025E
Operating profit	(1.933)	(2.721)	(3.114)	(5.974)	(4.028)	(2.758)	(0.891)
Depreciation and amortisation	0.494	0.655	0.635	0.467	0.077	0.055	0.065
Inventory (increase)/decrease	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Debtors (increase)/decrease	0.189	(0.153)	(0.288)	(0.720)	0.087	0.030	0.133
Creditors increase/(decrease)	(0.002)	0.165	0.124	0.741	(0.337)	0.020	0.043
Other	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Operating cash flow	(1.252)	(2.055)	(2.642)	(5.486)	(4.202)	(2.653)	(0.650)
Interest	(0.007)	(0.007)	(0.017)	(0.031)	(0.030)	(0.025)	(0.010)
Tax	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Dividends	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Deferred tax	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Capital expenditure	(0.036)	(0.013)	(0.116)	(0.074)	(0.025)	(0.060)	(0.085)
Trading cash flow	(2.185)	(2.190)	(2.774)	(5.591)	(4.257)	(2.738)	(0.745)
Acquisition of businesses	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Disposal of businesses	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Share issues	0.000	2.938	8.466	0.000	9.900	0.000	0.000
Currency effects, other	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Net cash inflow/(outflow)	(2.192)	0.740	5.757	(5.581)	5.636	(2.738)	(0.745)
Net (debt)/cash	1.293	2.033	7.790	2.209	7.845	5.107	4.362

Source: Shard Capital, ENGAGE XR

Summary of balance sheet forecasts – 2019 – 2025E

Balance sheet							
Year to December	2019	2020	2021	2022	2023E	2024E	2025E
Tangible fixed assets	0.116	0.084	0.102	0.096	0.028	0.033	0.053
Intangible fixed assets	1.434	0.964	0.426	0.039	0.000	0.000	0.000
Investments and other	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Total fixed assets	1.550	1.048	0.529	0.136	0.029	0.034	0.054
Stock	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Trade and other debtors	0.205	0.358	0.646	1.366	1.279	1.449	1.316
Deferred tax	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Cash and short term deposits	1.293	2.033	7.790	2.209	7.845	5.107	4.362
Current assets	1.498	2.391	8.436	3.575	9.124	6.556	5.678
Total assets	3.047	3.439	8.964	3.711	9.153	6.589	5.732
Trade and other payables	(0.193)	(0.357)	(0.482)	(1.222)	(0.735)	(0.755)	(0.798)
Borrowings	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Other current liabilities	(0.033)	(0.039)	(0.013)	(0.008)	(0.028)	(0.033)	(0.053)
Current liabilities	(0.226)	(0.396)	(0.494)	(1.230)	(0.763)	(0.788)	(0.851)
Borrowings	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Other non-current liabilities	(0.034)	(0.020)	(0.008)	0.000	0.000	0.000	0.000
Non-current liabilities	(0.034)	(0.020)	(0.008)	0.000	0.000	0.000	0.000
Total liabilities	(0.260)	(0.417)	(0.502)	(1.230)	(0.763)	(0.788)	(0.851)
Net assets	2.788	3.022	8.463	2.480	8.390	5.801	4.881

Source: Shard Capital, ENGAGE XR

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