EDISON

TXT e-Solutions

H113 results

Promising North American pipeline

Software & comp services

TXT Perform continues to invest in winning new business in North America, with a focus on Tier 1 retailers. This investment should ultimately lead to large licence deals but did not contribute materially to H113 revenues. TXT Next showed growth in H113 despite the weak European environment and we continue to forecast modest growth in FY13 and FY14. We have reduced our revenue forecasts to reflect the timing of licence deals and a weaker European trading environment, resulting in a minimal cut to FY13 EPS and a 15.0% cut to FY14 EPS.

Year end	Revenue (€m)	PBT* (€m)	FD EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/11	40.1	0.9	0.06	2.00**	173.3	19.2
12/12	46.5	4.4	0.77	0.40	13.5	3.8
12/13e	51.9	4.9	0.72	0.22	14.4	2.1
12/14e	56.6	6.6	0.86	0.30	12.1	2.9

Note: *PBT is normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments; EPS is fully diluted. **Special dividend.

Cost control compensates for weaker H113 sales

H113 consolidated revenues grew 12% y-o-y (TXT Perform +20% due to addition of Maple Lake, TXT Next 2%). TXT Perform saw a slower rate of licence wins in H113 than we were expecting, partly due to the weak environment in Europe, but also to the nature of deals being sought in North America, which tend to be of a larger size and which had not been signed by the end of H1. Operating costs were well controlled, allowing TXT to report flat EBITDA vs H112 as expected.

Outlook: Pipeline points to new licence wins

Although in H113 reported licence revenues were lower than we expected, order intake in Q213 (+30% q-o-q) points to stronger licence revenues in H213. We have revised down our forecasts for both divisions, reflecting the lower level of revenues reported in H113. This is partially compensated by slower growth in operating expenses. A lower tax rate in FY13 reduces the impact on EPS to less than 1%, whereas our FY14 EPS forecast is reduced by 15%. We forecast growth in net cash to €8.2m by the end of FY13 (€5.5m net of contingent consideration) and to €12.0m by the end of FY14 (€10.2m net of contingent consideration).

Valuation: Discount to peers

After gaining 70% year to date, TXT trades on a P/E of 14.4x FY13e and 12.1x FY14e normalised EPS, which is still at a small discount to peers. In our view, this is not justified based on the company's growth, profitability and dividend yield prospects, and we see scope for upside to at least 13.5x FY14e EPS (€11.6). Triggers for share price appreciation include large licence wins in TXT Perform, evidence that operating profitability is improving and that the Maple Lake acquisition is leading to enhanced sales opportunities in both Europe and North America.

13 August 2013

Price	**€10.4**
Market cap	**€55m**
Net cash (€m) as at end-H113	6.8
Shares in issue	5.3m
Free float	80%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	8.6	16.1	108.4
Rel (local)	(2.4)	16.3	76.2
52-week high/low		€10.7	€4.9

Business description

TXT e-solutions has two divisions: TXT Perform provides software solutions for supply chain management in the international retail and consumer-driven industrial sectors; and TXT Next provides IT, consulting and R&D services to Italian aerospace, high-tech manufacturing, banking and finance customers.

Next event

Q313 results	6 November 2013

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Edison profile page

TXT e-Solutions is a research client of Edison Investment Research Limited

Investment summary

Company description: Specialist software solutions

TXT e-solutions is an Italian-headquartered software and services company. TXT operates through two divisions, TXT Perform (57% of FY12 revenues) and TXT Next (43% of FY12 revenues). TXT Perform develops, supplies and installs supply chain management software, specialising in fashion, luxury and retail. TXT Next is a software solutions and services business, focused on the aerospace and defence, high-tech manufacturing and banking and finance segments, primarily in Italy. The group plans to drive growth through greater internationalisation (currently c 50% of revenues are generated outside Italy), cross-selling and product development

Financials: Reflecting slower licence sales

Slower growth in new licence deals in H113 has prompted our downward revision to FY13 and FY14 revenue forecasts. As operating costs were well controlled and the effective tax rate of 12.1% was lower than our 25% forecast, we leave our FY13 EPS forecast substantially unchanged. For FY14, although we assume some reduction in operating costs, the overall impact is a 15% decline in our EPS forecast. We continue to expect strong cash generation in both years.

Exhibit 1: Changes to forecasts

	EPS (€)			PBT (€m)			EBITDA (€m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2013e	0.73	0.72	(0.7)	5.4	4.9	(10.4)	6.5	6.1	(6.3)
2014e	1.01	0.86	(15.0)	7.5	6.6	(12.8)	8.5	7.7	(9.5)

Source: Edison Investment Research

Valuation: Discount to peers despite recent performance

On our revised earnings forecasts, TXT trades at a premium to European IT services companies, but at a discount to specialist SCP software suppliers. Based on the growth and profitability profiles of both groups, we would expect TXT to trade somewhere in the middle of the two groups. Applying a small-cap company discount to the overall peer group, we view a multiple of 13.5x FY14e EPS as reasonable, equating to a share price of €11.6. We note a forecast dividend yield of at least 2%, supported by TXT's strong cash position. Triggers for share price appreciation include large licence wins in TXT Perform, evidence that operating profitability is improving and that the Maple Lake acquisition is leading to enhanced sales opportunities in both Europe and North America.

Sensitivities: Demand, competition, currency

- **General economic activity:** Sales in both divisions will be influenced by the health of the economy. The TXT Next business has more exposure to the Italian economy, although the international customer base of many of its customers reduces this exposure.
- **Competition:** TXT Perform competes against larger software companies with greater resources for R&D and sales. There is also the risk that TXT Perform could lose business to ERP vendors that include SCP software in their solutions, although the specialist nature of TXT's solutions should reduce this risk.
- **Acquisition risk:** TXT is in the process of integrating the Maple Lake acquisition and could make further acquisitions.
- **Currency:** The majority of TXT's revenues and costs are incurred in euros. There is some exposure to sterling, and US dollar exposure will increase with the acquisition of Maple Lake. In both cases, the impact will be mitigated by the costs of staffing local offices in the same currency as revenues.

Company description: Specialist software solutions

Company background

TXT e-solutions was formed in 1989 as a software and solutions vendor and listed on the STAR segment of the Borsa Italiana in 2000. The company operates through two divisions, TXT Perform (57% of FY12 revenues) and TXT Next (43% of FY12 revenues). TXT Perform develops, supplies and installs supply chain management software, specialising in fashion, luxury and retail. The business has grown organically and via acquisitions in Germany (2004), the UK (2008) and North America (Maple Lake acquisition in 2012). TXT Next is a software solutions and services business, focused on the aerospace and defence, high-tech manufacturing, and banking and finance segments, primarily in Italy. This business has grown organically.

Group strategy

Group strategy is to continue to drive revenue growth in the two businesses via greater internationalisation (currently c 50% of revenues are generated outside Italy), cross-selling and product development. The company continues to consider acquisitions, particularly in the TXT Perform business. We discuss the individual divisional strategies in more depth later in the report.

Management

TXT is run by a long-established team: the chairman is one of the original founders of the company and the CEO joined TXT in 1994. Divisional heads have many years' experience with the company. TXT Perform is headed by Andrea Cencini, who joined TXT in 1989 and has performed various roles in the business. TXT Next is headed by Paolo Colombo, who has been with TXT since it was founded and has built the division into its current structure.

TXT Perform: Supply chain solutions for retail

TXT Perform develops, sells and installs supply chain planning software. The division has more than 200 consultants operating out of 14 sales and delivery offices across Europe (in France, Germany, Italy, Spain and the UK), Canada and Australia.

Product offering

TXT's software solutions are based on its TXTPERFORM platform, developed to work with Microsoft SQL, Excel and Sharepoint. TXT Perform offers a suite of products across three main functional areas:

- Integrated retail planning solutions (c 75% of divisional revenues).
- Sales and operations planning (c 15% of divisional revenues).
- Product Lifecycle Management (PLM) for retail (c 10% of divisional revenues).

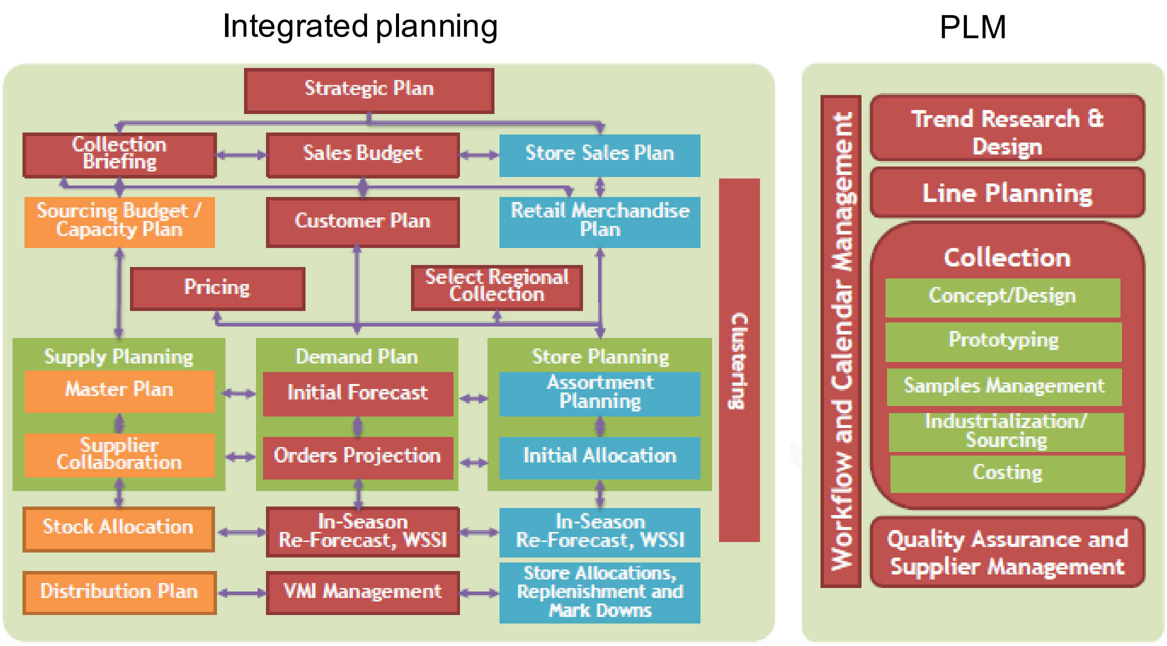
Integrated retail planning

TXT Perform's roots are in the retail sector, giving it many years' experience in this area and a product range that has been tailored to the industry's specific needs. Exhibit 2 shows TXT's comprehensive solution, although customers can choose to buy modules within it, such as Sales Planning or Merchandise & Assortment Planning. The software is designed to enable users to see the implications of each decision they make on both operational and financial KPIs, with 'what-if' analyses possible for a variety of factors such as channel, product, geography and brand.

Product lifecycle management

In the retail sector, PLM software is used to bring order to the collection-development process. The software is designed to align all stakeholders, eg merchandisers, designers, buyers, suppliers, product managers and developers, to reduce the time and cost involved in developing a new collection. TXT's solution (see Exhibit 2) operates in a single web environment, and is Sharepoint-based, enabling all stakeholders to participate in and/or review the process wherever they are. The software can be integrated with TXT's Integrated retail planning solution.

Exhibit 2: Integrated planning and PLM software solutions



Source: TXT e-Solutions

Sales and operations planning

TXT's market focus is CPG and consumer-facing industrials such as Kraft, Eckes Granini and elica (cooker hoods). Exhibit 3 shows the functionality of TXT's sales and operations planning solution.

Exhibit 3: Sales and operations planning functionality

Source: TXT e-Solutions

Blue chip customer base

Exhibit 4 demonstrates the strength of TXT''s customer base in its chosen markets. TXT Perform has more than 350 customers. The company targets Tier 1 customers, ie those with annual revenues of more than €250m, with the sweet spot being those over €500m. Overall, roughly two-thirds of annual revenues come from existing customers (one-third of licence sales and two-thirds of services revenues), highlighting the company's ability to cross- and up-sell. New customers won year to date include Delsey, Devenlay-Lacoste, Valeo and FatFace, and the company has won significant contracts this year with existing customers including Céline, Lavazza and Tesco.

Exhibit 4: Selected customers

Retail				S&OP		
Fashion	**Luxury**	**Hardlines**	**Mixed**	**Food & beverages**	**Other CPG**	**Industrial**
adidas	Burberry	Apollo Optik	Auchan	Amadori	B&B Italia	Agusta Westland
Aeropostale	Boss	Best Buy	Conad	Cadbury	Beghelli	Alenia Aeronautica
Arcadia Group	Céline	Carphone Warehouse	Groupe Casino	Delifrance	Chiesi	brembo
Desigual	Dior	dabs.com	Intersport	Eckes Granini	elica	Daimler Chrysler
Diesel	Dolce & Gabanna	EMI	La Redoute	Findus	Expanscience	Fiat
Ecco	dunhill	Game	Monoprix	Fox's	Galderma	Hutchinson
Geox	Gucci	Nicolas	Oriflame	Kraft	Husqvarna	Kwintet
Guess	Kenzo	Safilo	Redcats	Lavazza	Oriflame	Manuli Rubber
Levis	Loewe	ScanSource	Relay	Schweppes	Materis Paints	Messier-Dowty
The North Face	Louis Vuitton	Sony Music	Sperian	Weetabix	snaidero	
Tod's	Marc Jacobs	Swatch Group	Tesco	Young's	tesa	
United Colours of Benetton	Prada	Tag Heuer				

Source: TXT e-Solutions

Supply chain management software market

The supply chain management software market was worth \$8.3bn in 2012 (source: Gartner) and grew 7.1% y-o-y. Gartner expects the market (ex-procurement software) to continue to grow at a CAGR of 9.9% from 2012 to 2017. The top five vendors (SAP, Oracle, RedPrairie [incorporating JDA Software], Manhattan Associates and Epicor) made up more than 50% of the market. The remainder was made up of a large number of small and medium-sized vendors, including TXT. The market splits into two broad areas: supply chain planning and supply chain execution software. TXT specialises in supply chain planning (SCP) software. Gartner estimates that the SCP software market was worth more than \$3.0bn in 2012 (+8% y-o-y).

SAP and Oracle dominate this market and the other major player is JDA Software, acquired by RedPrairie at the end of 2012. TXT is focused on specific areas of the SCP market: fashion, luxury and retail integrated planning solutions, and sales and operations planning (S&OP) software for the CPG and industrial sectors. Based on the countries and niche segments in which TXT operates, the company estimates that it has an addressable software licence market of c €300m and therefore a market share of c 5%.

The retail market has a number of characteristics that drive the need for specialised SCP solutions:

- In fashion, the speed at which new collections are required is increasing. Customers of high-fashion stores expect multiple collections each year, with new lines expected on an ongoing basis.
- Outsourced manufacturing of apparel and footwear, particularly to China and Vietnam, makes it harder to have visibility and control over suppliers.
- The market is highly price competitive, so any advantage that can be gained at the cost-of-goods level is crucial.
- Retailers want to provide high levels of customer service and to do so need to be able to have the right product in the right place at the right price.
- The ability to sell products through different channels (multi-channel) is becoming a necessity.

Competitors include companies that develop standalone supply chain software that can be integrated with a customer's existing ERP software, or companies that develop supply chain modules as part of their ERP offering. TXT software is designed to integrate with the main ERP vendors' software, including SAP and Microsoft. For markets such as retail, often the supply chain functionality within an ERP system is not sufficiently deep to maximise the benefits of the software.

For retail integrated planning solutions, TXT competes against a number of specialist private companies, as well as the larger software companies. AMR Research (2011) ranked TXT in the top three software providers for this end market, alongside Oracle and JDA Software, and top in terms of core functionality. For S&OP, Gartner has given TXT a 'positive' rating, alongside Oracle, JDA Software and a small specialist provider, Steelwedge Software. For all products, TXT also competes with inertia, ie the customer continues to use their own spreadsheets and other manual processes.

Growth strategy

The division is seeking to grow through several routes:

- Internationalisation. Business is generated across the main geographies in which TXT Perform is based, with Italy making up only 15% of FY12 revenues (UK 23%, Germany 18%, France 15%, Spain 4% and other countries 25%). The division is keen to continue to grow the proportion of revenues from outside Italy, with North America, Eastern Europe and Scandinavia the main targets. The Maple Lake acquisition has increased the company's access to the US, Canada and Australia, as well as adding to the business in the UK (see below).
- Cross-selling/up-selling: TXT Perform seeks to sell PLM to its retail customers – around 30% of customers buying integrated planning software for fashion also buy the PLM solution. TXT Perform will also require licence extensions when the customer increases the number of users, processes, product categories or geographies. The products can be used for one or more channels (retail, wholesale, online) and increasingly customers are using across all channels.
- New product development: TXT Perform recently launched "TXT on Cloud", a hosted version of its software, and the TXTMobile platform, which makes PLM, buying, merchandising, assortment planning and in-store visibility capabilities available on Windows 8 mobile devices. The company continues to develop additional mobile functionality, and in the longer term is planning on developing in-memory processing capability and social media-related solutions.

Maple Lake acquisition increases addressable market

In September 2012, TXT acquired Maple Lake for €9.7m cash up front, the issue of 238,854 TXT shares and up to €2.8m based on the performance of the integrated TXT Perform business over FY13 and FY14 (payable in two parts). Maple Lake was a retail-focused SCP software provider, headquartered in Canada and with significant business across the US, as well as Canada, Europe and Australia. At the date of acquisition, the business had nearly 50 customers, many of them top-tier retailers such as adidas, Arcadia Group, Barneys New York, and Levi Strauss & Co.

Management has retained the Maple Lake teams in all locations. In H113, the company made the decision to market TXT Perform's planning solutions as the main platform going forward, and will add Maple Lake functionality for merchandising and assortment planning to new releases of the software by the end of this year. TXT will continue to support existing Maple Lake software for five years. The acquisition gives TXT local presence in North America, and from a product perspective, strengthens the TXT Perform platform. To accelerate North American sales, in Q113 TXT hired a new sales director for North America and a head of business development for the region.

TXT Next: Systems engineering specialist

TXT Next is the engineering division of TXT, which provides specialised software solutions and services to four end markets: aerospace and defence, automotive, high tech and banking and finance. The first three sectors are served through the Aerospace & High Tech Manufacturing (A&HT) division (69% of TXT Next FY12 revenues), with the Banking & Finance (B&F) division generating 25% of TXT Next FY12 revenues and the remaining 6% of FY12 revenues in the form of EU R&D grants. Exhibit 5 shows the key areas supported in each end market.

Exhibit 5: TXT Next business activities

	Aerospace & defence	Automotive	High tech	Banking & finance
Mission-critical systems software development	x	x	x	
Simulation and modelling	x			
Complex manufacturing	x	x		
Business intelligence & business process management	x	x	x	x
Independent verification & validation (IV&V)	x	x	x	x
IT governance and quality	x	x	x	x
Enterprise applications				x

Source: TXT e-Solutions

The division has a customer base of more than 30 companies. Although most of the work is project based and therefore not recurring in nature, TXT has a very loyal customer base that provides repeat work.

In FY12, the A&HT division's revenues were generated from systems engineering (57%), post-sales customer support systems (23%) and digital manufacturing (20%). Examples of the type of work undertaken by A&HT include:

- bespoke on-board software for Agusta Westland's EH101 helicopter since 1985;
- software for Agusta Westland helicopter flight simulator;
- digital manufacturing for aircraft manufacturers;
- in-car multi-media devices for Magneti Marelli;
- customised automation software for Siemens; and
- IT governance for bticino (door entry solutions).

In FY12, the B&F division generated 43% of revenue from IT governance, 42% from application maintenance and 15% from analysis and design. B&F's target market is the Italian banking market, which is made up of c 45 medium-to-large banks, of which five to six are top tier. Examples of the type of work undertaken include:

- IT governance for ING Direct, including software testing (new customer in 2011);
- intranet development and application maintenance for Banco Popolare (since 2006) and Credito Valtellinese (since 2010);
- software IV&V for Banca Mediolanum since 2004;
- analysis and design of front-end applications for Webank.it since 1999; and
- analysis and design for systems compliance for Banca Popolare di Milano since 1993.

Competitive environment

The division's competition is from customers' in-house R&D and IT departments, as well as from other local system integrators. The company estimates it has a 5-7% market share in system engineering in Italy. TXT Next has been a beneficiary of the trend to outsource, which gives the customer greater flexibility on cost and better access to specialist skills. Once a customer has outsourced a specialist area of R&D or IT, it is usually very difficult to bring it back in house, as the in-house knowledge and expertise will have diminished. TXT Next has worked closely with the majority of its customer base for many years, creating a strong partnership and demonstrating its specialist expertise.

Growth strategy

The business is based in Italy and only just over 10% of FY12 revenues were generated outside Italy, generally arising from a 'follow-my-customer' strategy. As part of the 2012-14 business plan, the division is not planning to expand internationally, apart from where customers demand it. The main focus is on developing new solutions and expertise and improving the profitability of the business.

Sensitivities

Our forecasts and TXT's share price will be sensitive to the following factors:

- **General economic activity**: Sales in both divisions will be influenced by the health of the economy. The TXT Next business has more exposure to the Italian economy, although the international customer base of many of its customers reduces this exposure.
- **Competition:** TXT Perform competes against larger software companies with greater resources for R&D and sales. There is also the risk that TXT Perform could lose business to ERP vendors that include SCP software in their solutions, although the specialist nature of TXT's solutions should reduce this risk.
- **Acquisition risk:** TXT is in the process of integrating the Maple Lake acquisition and could make further acquisitions.
- **Currency:** The majority of TXT's revenues and costs are incurred in euros. There is some exposure to sterling, and US dollar exposure will increase with the acquisition of Maple Lake – in both cases, the impact will be mitigated by the costs of staffing local offices in the same currency as revenues

Financials

Review of H113 results

Exhibit 6: H113 results highlights (€m)

	H113a	H112a	Change
Revenues	26.3	23.5	12.0%
TXT Perform	15.4	12.8	20.1%
TXT Next	10.9	10.6	2.2%
Gross margin	52.8%	52.3%	0.4%
EBITDA	3.1	3.1	0.8%
EBITDA margin	12.0%	13.3%	-1.3%
EBIT	2.4	2.6	-7.4%
EBIT margin	9.3%	11.3%	-2.0%
Net cash	6.8	14.9	-54.4%

Source: TXT e-Solutions

TXT grew H113 revenues 12% y-o-y. TXT Perform was the main driver of growth, up 20.1% y-o-y (we assume the majority of this growth was from the integration of Maple Lake) and TXT Next grew 2.2% y-o-y. Gross margin improved by 40bp as the mix of software was slightly higher than a year ago. Reflecting the addition of Maple Lake, operating costs (excluding depreciation and amortisation) were 17% higher than a year ago, resulting in flat EBITDA y-o-y. Net cash of €6.8m (before deferred consideration payable to Maple Lake of €2.7m) was 13% higher than at end-FY12.

TXT Perform

FY12 revenues were generated from licences (19%), maintenance and support (22%) and services (59%). Maintenance has a high retention rate of c 98%. Software is proprietary, so licence revenues generate GMs close to 100%. Taking into account maintenance and support revenues and services revenues, the division typically generates an overall GM of 60-65%. H113 revenues grew 20.1% y-o-y, reflecting the addition of Maple Lake. The company is now targeting larger licence deals, which increase the volatility of licence revenues, as the company is likely to win fewer deals but of a larger size than in previous years. To reflect a weaker-than-expected licensing performance in H113, we reduce TXT Perform revenues by 10% for FY13 and FY14.

Exhibit 7: TXT Perform financial performance and forecasts, FY09-14e (€m)

	FY09	FY10	FY11	FY12	FY13e	FY14e
Licences & maintenance	6.5	8.6	8.8	10.1	13.4	16.0
Projects & other income	11.1	12.5	13.3	16.2	18.0	19.6
Total revenue	17.5	21.1	22.1	26.4	31.4	35.6
Growth		20.6%	4.4%	19.5%	19.0%	13.4%
Organic growth		20.6%	4.4%	13.5%	-4.7%	7.6%
Gross margin	51.9%	58.0%	60.9%	62.6%	62.8%	65.1%

Source: TXT e-Solutions and Edison Investment Research

TXT Next

TXT Next revenues grew 2.2% y-o-y in H113, with revenues up 3.1% y-o-y in Q1 and 1.4% in Q2, but this should be viewed in the context of the 17% growth achieved in H112. We have reduced our FY13 revenues forecast by 2.2% which implies H213 revenues grow 2.1% y-o-y/-11.1% h-o-h, to achieve FY13 revenue growth of 2.2% (we note that the business tends to show seasonal weakness in Q3 due to the holiday period in Europe). We conservatively forecast 2% revenue growth for FY14 (1.5% reduction in previous revenue forecast). As a predominantly service-based business, TXT Next generates gross margins in the range 35-40%.

Exhibit 8: TXT Next financial performance and forecasts, FY09-14e (€m)

	FY09	FY10	FY11	FY12	FY13e	FY14e
Licences & maintenance	0.2	0.2	0.2	0.1	0.1	0.1
Projects & other income	13.4	16.1	17.9	20.0	20.4	20.9
Total revenue	13.6	16.3	18.1	20.1	20.5	21.0
Growth		20.2%	10.7%	11.4%	2.2%	2.3%
Gross margin	37.3%	39.4%	39.7%	38.0%	38.3%	38.7%

Source: TXT e-Solutions and Edison Investment Research

Changes to forecasts

We have revised our forecasts to reflect weaker licence sales in TXT Perform (which also feeds through into lower service revenues), slightly weaker performance in TXT Next and lower ongoing operating expenses. We have reduced our forecast tax rate for FY13 from 25% to 15%, reflecting the use of previous losses to offset profits in the period.

Exhibit 9: Changes to estimates

	FY13 old	FY13 new	Change	FY14 old	FY14 new	Change
Revenues (€m)	56.0	51.9	-7.3%	60.9	56.6	-7.1%
Gross margin	54.2%	53.1%		55.7%	55.3%	
Normalised EBIT (€m)	5.5	5.1	-8.3%	7.5	6.7	-11.3%
Normalised EBIT margin	9.9%	9.7%		12.3%	11.8%	
Normalised net income (€m)	4.1	4.1	1.7%	5.6	4.9	-12.7%
Normalised FD EPS (€)	0.73	0.72	-0.7%	1.01	0.86	-15.0%
Net cash (€m)*	8.2	8.2	-0.2%	11.4	12.0	5.1%
Dividend (€)	0.22	0.22	0.0%	0.30	0.30	0.0%

Source: Edison Investment Research. Note: *Before contingent consideration of up to €2.7m for Maple Lake.

Valuation

On our revised earnings forecasts, TXT trades at a premium to European IT services companies, but at a discount to specialist SCP software suppliers. Based on the growth and profitability profiles of both groups, we would expect TXT to trade somewhere in the middle of the two groups. Applying a small-cap company discount to the overall peer group, we view a multiple of 13.5x FY14e EPS as reasonable, equating to a share price of €11.6. We note a forecast dividend yield of at least 2%, supported by TXT's strong cash position. Triggers for share price appreciation include large licence wins in TXT Perform, evidence that operating profitability is improving and that the Maple Lake acquisition is leading to enhanced sales opportunities in both Europe and North America.

Multiples-based valuation

As the business is a combination of software and IT services, we include the valuation multiples for international SCP software companies, as well as European IT services providers.

Exhibit 10: Peer group valuation table

Company	Share price	Market cap	Rev growth		EBIT margin		EBITDA margin		EV/ Sales (x)		P/E (x)	
		m	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	€ 10.40	€ 55	11.7%	9.0%	9.7%	11.8%	11.8%	13.6%	1.0	0.9	14.4	12.1
Software companies with SCM software offerings												
American Software	$9.01	$247	4.4%	11.0%	14.4%	16.8%	20.1%	22.0%	1.7	1.5	22.5	18.8
Descartes	$11.90	$747	19.0%	11.8%	13.9%	15.8%	25.3%	26.0%	4.6	3.9	62.6	39.7
Manhattan Associates	$89.00	$1,719	9.2%	9.9%	24.8%	25.4%	26.4%	26.9%	3.9	3.6	26.0	24.0
MICROS Systems	$48.70	$3,831	3.4%	3.6%	21.6%	21.5%	23.2%	23.9%	2.5	2.4	19.7	18.5
Oracle	$32.57	$150,825	4.8%	5.2%	47.4%	48.6%	49.8%	51.0%	3.5	3.1	11.3	10.3
SAP	€ 56.26	€ 67,085	6.9%	8.6%	31.0%	32.3%	34.5%	35.5%	3.8	3.4	16.8	15.0
Totvs	R 37.08	R 6,013	10.2%	10.5%	22.8%	23.7%	26.8%	27.5%	3.7	3.3	21.4	18.3
Average			**8.3%**	**8.7%**	**25.1%**	**26.3%**	**29.4%**	**30.4%**	**3.4**	**3.0**	**25.8**	**20.7**
European IT services companies												
AtoS	€ 58.19	€ 4,979	-0.3%	2.2%	7.0%	7.6%	10.9%	11.5%	0.5	0.5	13.1	11.9
Cap Gemini	€ 42.98	€ 6,909	0.0%	2.8%	7.8%	8.1%	10.1%	10.4%	0.6	0.5	14.6	13.3
Computacenter	£4.93	£684	2.3%	2.8%	2.4%	2.7%	3.5%	3.7%	0.2	0.2	12.7	11.3
Devoteam	€ 9.92	€ 93	-10.6%	-2.4%	3.5%	4.5%	4.5%	5.7%	0.2	0.1	11.5	10.9
Engineering II	€ 29.69	€ 362	7.2%	4.5%	9.7%	9.8%	12.5%	12.6%	0.4	0.4	8.5	7.9
Groupe Steria	€ 10.66	€ 325	-1.7%	2.8%	5.9%	6.7%	8.4%	9.3%	0.3	0.3	6.0	4.8
Sopra Group	€ 56.00	€ 666	9.2%	6.2%	7.7%	8.2%	8.7%	9.5%	0.6	0.5	10.1	8.9
SQS	£0.04	£106	8.5%	10.1%	5.7%	6.4%	8.6%	9.3%	0.5	0.4	12.7	9.8
Average			**1.8%**	**3.6%**	**6.2%**	**6.7%**	**8.4%**	**9.0%**	**0.4**	**0.4**	**11.1**	**9.8**

Source: Thomson and Edison Investment Research

Reverse DCF

We have performed a reverse 10-year DCF to calculate what we believe the market is factoring into the current share price. Using a WACC of 10%, long-term growth of 1%, working capital/sales of 1.0% and capex/sales of 1.5%, a revenue CAGR of 3.6% for 2015-22 and average EBITDA margins of 12.5% from FY15-22 are required to reach the current share price. Based on forecast market growth for SCP software and IT services, this appears overly harsh in terms of revenue growth and implies no margin expansion post-2014.

Exhibit 11: Financial summary

€'000s	2010	2011	2012	2013e	2014e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	37,458	40,138	46,499	51,945	56,618
Cost of sales	(18,757)	(19,522)	(22,366)	(24,375)	(25,311)
Gross profit	18,701	20,616	24,133	27,570	31,307
EBITDA	2,769	4,397	5,320	6,113	7,707
Operating Profit (before amort and except)	(776)	843	4,258	5,063	6,657
Amortisation of acquired intangibles	0	0	0	(450)	(450)
Exceptionals and other income	13	(4,581)	924	0	0
Other income	0	0	0	0	0
Operating Profit	(763)	(3,738)	5,182	4,613	6,207
Net Interest	(198)	72	130	(200)	(100)
Profit Before Tax (norm)	(974)	915	4,388	4,863	6,557
Profit Before Tax (FRS 3)	(961)	(3,666)	5,312	4,413	6,107
Tax	255	(591)	(176)	(662)	(1,527)
Profit After Tax (norm)	(719)	324	4,243	4,133	4,918
Profit After Tax (FRS 3)	(706)	(4,257)	5,136	3,751	4,580
Average Number of Shares Outstanding (m)	5.1	5.1	5.0	5.3	5.3
EPS - normalised (c)	(14)	6	85	79	94
EPS - normalised fully diluted (c)	(13)	6	77	72	86
EPS - (IFRS) (c)	4	281	103	71	87
Dividend per share (c)	0.00	200.00	40.00	22.00	30.00
Gross margin (%)	49.9%	51.4%	51.9%	53.1%	55.3%
EBITDA Margin (%)	7.4	11.0	11.4	11.8	13.6
Operating Margin (before GW and except) (%)	-2.1	2.1	9.2	9.7	11.8
BALANCE SHEET					
Fixed Assets	14,328	7,735	21,815	20,816	19,816
Intangible Assets	11,526	6,561	19,866	18,767	17,667
Tangible Assets	1,528	819	1,154	1,254	1,354
Other	1,274	355	795	795	795
Current Assets	28,876	32,145	36,769	36,969	42,680
Stocks	793	661	1,388	1,200	1,200
Debtors	21,453	15,083	19,562	21,347	23,268
Cash	6,630	14,181	15,819	14,422	18,213
Other	0	2,220	0	0	0
Current Liabilities	(17,719)	(14,049)	(20,631)	(19,599)	(21,931)
Creditors	(15,615)	(12,292)	(15,135)	(17,703)	(20,035)
Short term borrowings	(2,104)	(1,757)	(5,496)	(1,896)	(1,896)
Long Term Liabilities	(8,398)	(5,567)	(11,770)	(10,870)	(9,070)
Long term borrowings	(3,870)	(2,155)	(4,301)	(4,301)	(4,301)
Other long term liabilities	(4,528)	(3,412)	(7,469)	(6,569)	(4,769)
Net Assets	17,087	20,264	26,183	27,316	31,495
CASH FLOW					
Operating Cash Flow	9,967	19,265	3,734	5,684	8,118
Net Interest	(198)	166	188	(200)	(100)
Tax	255	390	(176)	(662)	(1,527)
Capex	(2,340)	(2,159)	(822)	(500)	(500)
Acquisitions/disposals	(137)	2,403	(8,700)	0	(900)
Financing	324	(106)	1,501	0	0
Dividends	0	(10,292)	0	(2,120)	(1,301)
Net Cash Flow	7,871	9,667	(4,275)	2,202	3,791
Opening net debt/(cash)	7,248	(723)	(10,266)	(6,023)	(8,225)
HP finance leases initiated	0	0	0	0	0
Other	100	(124)	32	0	0
Closing net debt/(cash)	(723)	(10,266)	(6,023)	(8,225)	(12,016)

Source: TXT e-Solutions and Edison Investment Research

Contact details	Revenue by geography
Via Frigia, 27 20126 Milano Italy +39 02 257711 www.txtgroup.com	N/A

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 11-14e	141.3%	ROCE 13e	12.6%	Gearing 13e	(30.1%)	Litigation/regulatory	○
EPS 12-14e	5.3%	Avg ROCE 10-14e	6.6%	Interest cover 13e	25.3	Pensions	○
EBITDA 10-14e	20.6%	ROE 13e	15.1%	CA/CL 13e	1.9	Currency	◖
EBITDA 12-14e	7.2%	Gross margin 13e	53.1%	Stock days 13e	8.4	Stock overhang	◖
Sales 10-14e	12.2%	Operating margin 13e	9.7%	Debtor days 13e	150	Interest rates	○
Sales 12-14e	10.3%	Gr mgn / Op mgn 13e	5.4x	Creditor days 13e	118	Oil/commodity prices	○

Management team

CEO: Marco Guida

Mr Guida joined TXT e-solutions from Pirelli Group in 1994. As director of international operations, he successfully led the transformation of TXT e-solutions from an Italian organisation to an international one. In 2006, he became the general manager of TXT e-solutions and was appointed CEO of TXT Group in 2009.

CFO: Paolo Matarazzo

Before joining TXT in 2007, Mr Matarazzo spent seven years as head of finance, administration and control in Europe for Eurand, a company listed on NASDAQ in 2007. Before that, he worked for the Recordati Group for seven years, with responsibility for treasury management. He spent three years as an analyst in London.

Chairman: Alvise Braga Illa

Mr Braga Illa led the optical communications group and the network systems at the Massachusetts Institute of Technology. He directed the R&D Labs at Italtel, founded Zeltron and managed the restructuring of Ducati Energia. He founded TXT Automation Systems, sold to ABB in 1997, and TXT e-solutions in 1989.

Principal shareholders	(%)
E-business Consulting	29.7
Alvise Braga Illa (Chairman)	14.9
Neil Coulton	3.2
Marco Guida	2.1
Lazard Frères Gestions SAS	2.0

Companies named in this report

American Software (AMSWA), JDA Software, Manhattan Associates (MANH), Oracle (ORCL), Retalix (RTLX), SAP (SAP), Totvs (TOTS3).