TXT e-solutions

Q3 results

Steady growth in Q3

Software & comp services

TXT reported a strong set of results for Q316: organic growth in both businesses was boosted by the contribution from April's acquisition of Pace, resulting in 49% growth in EBITDA y-o-y. We have revised our forecasts to reflect a lower cost base in FY16 and slightly higher tax rates in both years; we raise FY16 EPS by 6.4% and trim FY17 EPS by 2.4%. The company is making good progress in its efforts to internationalise the business and we believe it may make further bolt-on acquisitions.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/14	54.4	4.0	0.28	0.23	27.7	3.0
12/15	61.5	5.7	0.40	0.25	19.0	3.3
12/16e	69.3	7.7	0.50	0.26	15.2	3.4
12/17e	74.7	7.6	0.50	0.27	15.4	3.5

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Growth for both businesses in Q3

TXT reported Q316 y-o-y revenue growth of 18.5% (7.2% organic); TXT Retail grew 5.1% and TXT Next grew 37.9% (10.3% organic growth plus a €1.6m contribution from Pace). Lower than expected operating expenses resulted in EBITDA of €2.4m (margin 14.3% vs 11.4% in Q315 and 11.7% in Q216). The company ended Q316 with a net cash position of €2.7m. International revenues made up 62% of the total, helped by the inclusion of Pace and customer wins by the original TXT Next business across Europe.

Outlook and changes to forecasts

Management expects a positive business development in Q416, although it highlighted the difficulty in forecasting the timing of contract wins for TXT Retail in particular. We have revised our FY16 forecasts to reflect Q3 performance – this results in a 1.3% reduction in revenues but a 6.4% boost to normalised EPS. In FY17, a slightly higher tax rate results in a 2.4% cut to EPS.

Valuation: International expansion to drive upside

On our revised earnings forecasts, TXT trades at an EV/Sales and P/E premium to European IT services companies, but at a discount to specialist supply chain planning (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. With the addition of Pace, the mix of revenues is shifting in favour of higher-margin licence sales, which should drive up valuation multiples over time. We also note a forecast dividend yield of more than 3%. Triggers for share price appreciation include large licence wins in TXT Retail, evidence of growing North American and Asia Pacific market share and further international wins in TXT Next.

11 November 2016

Price	**€7.66**
Market cap	**€90m**
	$1.09:€1
Net cash (€m) at end Q316	2.7
Shares in issue	11.7m
Free float	45.5%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	5.8	3.2	(9.2)
Rel (local)	5.0	3.4	19.2
52-week high/low		€8.30	€6.96

Business description

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

Next events

FY16 trading update	January 2017

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Review of Q316 results

Exhibit 1: Quarterly results highlights

	Q316a	Q315a	Change
Revenues	16.9	14.3	18.5%
TXT Retail	8.9	8.4	5.1%
TXT Next	8.0	5.8	37.9%
Gross margin	54.2%	52.5%	1.7%
EBITDA	2.4	1.6	49.0%
EBITDA margin	14.3%	11.4%	2.9%
Normalised EBIT	2.2	1.4	61.4%
Normalised EBIT margin	13.3%	9.7%	3.5%
Reported EBIT	2.1	1.3	58.1%
Reported EBIT margin	12.3%	9.3%	3.1%
Net cash	2.7	9.4	-71.7%

Source: TXT e-solutions, Edison Investment Research

For Q316, TXT reported y-o-y revenue growth of 18.5%, with 5.1% growth from TXT Retail and 37.9% growth from TXT Next. Stripping out the €1.6m revenue contribution from the Pace acquisition, underlying TXT Next revenues grew 10.3% y-o-y (vs 9.5% organic growth in Q216 and 7.4% in Q116). As Pace contributes software revenues to TXT Next, which was previously mainly a services business, the group gross margin increased by 1.7 percentage points y-o-y. Operating expenses in Q3 were €1.3m lower than in Q2 (excluding acquisition-related costs incurred in Q2). This resulted from a combination of currency effects (UK-related costs became slightly cheaper) and a slower ramp in headcount in TXT Retail. This resulted in a 49% increase in EBITDA and a 2.9 percentage point increase in EBITDA margin y-o-y.

The company reported a tax rate of 26% for Q316 and 24% for 9M16. Net cash at the end of Q316 stood at €2.7m compared to €0.5m at the end of H116.

Business update

TXT Retail – raising the profile

In Q3, TXT Retail signed new contracts with customers including GiFi (French multi-channel retailer with 400 home and family stores), WE Fashion (Dutch fashion retailer with 240 shops across the Netherlands, Germany and France), Brunello Cucinelli (Italian cashmere clothing and accessory retailer selling across all continents), Christian Dior (France), and Cotton-on (Australian fashion retailer with 1,200 stores across Australia, Asia, South Africa and the US).

In September Gartner released an update of the Gartner Magic Quadrant for Merchandise Assortment Management Applications. Last year TXT was placed in the Leader category (high ability to execute, high completeness of vision). In Gartner's own words, TXT moved significantly up the 'Ability to Execute' category over the last year. We believe this should help raise the company's profile, particularly in the US, and should increase the likelihood of the company being asked to quote.

TXT Next – strong growth

The Pace integration is on track and Pace continues to win new business. It recently signed a contract with Icelandair to equip its entire fleet with Pace's Flight Profile Optimizer fuel efficiency software. The original TXT Next business also continues to generate strong growth, with customer wins in the UK, the Netherlands, Germany and Switzerland.

Outlook and changes to estimates

Management anticipates a positive business development in Q416 for both divisions, but highlighted that forecasting for TXT Retail in particular is difficult.

For FY16, we have revised our forecasts to reflect the revenues achieved in Q3 and reduced our TXT Retail Q4 estimate, while slightly increasing our TXT Next estimate. We have also reflected the lower level of operating costs.

For FY17, our revenue forecasts are substantially unchanged, hence our EBITDA forecast is unchanged.

In both years, we have increased our tax rate assumption from 20% to 22%. For the nine months to September 2016, TXT reported a 24% tax rate. The effective rate will depend on the geographies in which profits are generated, as well as the availability of tax losses in certain regions.

Overall, our FY16 normalised EPS forecast increases by 6.4%, as the reduction in operating costs more than offsets the higher tax rate. In FY17, with EBITDA unchanged, the tax rate increase reduces our normalised EPS forecast by 2.4%.

Exhibit 2: Changes to forecasts

	FY16e old	FY16e new	change	y-o-y	FY17e old	FY17e new	change	y-o-y
Revenues (€m)	**70.2**	**69.3**	**-1.3%**	**12.7%**	**74.5**	**74.7**	**0.2%**	**7.7%**
TXT Retail	37.5	36.3	-3.0%	-0.9%	39.0	39.0	0.0%	7.3%
TXT Next	32.8	33.0	0.7%	32.7%	35.5	35.7	0.5%	8.1%
Gross margin	53.1%	53.3%	0.2%		53.6%	53.3%	-0.2%	
Gross profit	37.3	37.0	-1.0%	14.3%	39.9	39.8	-0.2%	7.8%
EBITDA (€m)	**7.9**	**8.5**	**7.1%**	**27.0%**	**8.5**	**8.5**	**0.0%**	**0.6%**
EBITDA margin	11.2%	12.2%	1.0%		11.4%	11.4%	0.0%	
Normalised EBIT (€m)	**7.1**	**7.8**	**8.8%**	**33.6%**	**7.7**	**7.7**	**0.0%**	**-0.9%**
Normalised EBIT margin	10.2%	11.2%	1.0%		10.3%	10.3%	0.0%	
Normalised net income (€m)	5.5	5.9	6.3%	24.2%	6.0	5.8	-2.6%	-1.2%
Normalised EPS (€)	**0.47**	**0.50**	**6.4%**	**24.9%**	**0.51**	**0.50**	**-2.4%**	**-1.2%**
Reported basic EPS (€)	0.39	0.45	15.2%	34.3%	0.43	0.42	-2.4%	-5.7%
Net cash (€m)	2.3	2.7	18.2%	-67.7%	4.2	4.0	-3.7%	50.5%
Dividend (€)	0.26	0.26	0.0%	4.0%	0.27	0.27	0.0%	3.8%

Source: Edison Investment Research

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Exhibit 3: Financial summary

	€'000s	2012	2013	2014	2015	2016e	2017e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		46,499	52,560	54,410	61,540	69,341	74,673
Cost of sales		(22,351)	(24,854)	(26,455)	(29,189)	(32,380)	(34,837)
Gross profit		24,148	27,706	27,955	32,351	36,962	39,836
EBITDA		5,322	6,263	5,324	6,659	8,455	8,506
Operating Profit (before amort and except)		4,283	5,241	4,284	5,820	7,775	7,706
Amortisation of acquired intangibles		0	(285)	(285)	(285)	(549)	(637)
Exceptionals and other income		939	0	1,468	0	(300)	0
Other income		0	0	0	(740)	0	(500)
Operating Profit		5,222	4,956	5,467	4,795	6,926	6,569
Net Interest		(37)	(435)	(249)	(151)	(100)	(100)
Profit Before Tax (norm)		4,246	4,806	4,035	5,669	7,675	7,606
Profit Before Tax (FRS 3)		5,185	4,521	5,218	4,644	6,826	6,469
Tax		(188)	121	(1,046)	(762)	(1,502)	(1,423)
Profit After Tax (norm)		4,092	4,927	3,226	4,739	5,986	5,933
Profit After Tax (FRS 3)		4,997	4,642	4,172	3,882	5,324	5,046
Average Number of Shares Outstanding (m)		11.0	11.5	11.5	11.7	11.7	11.7
EPS - normalised (c)		37	43	28	41	50	50
EPS - normalised fully diluted (c)		34	41	28	40	50	50
EPS - (IFRS) (c)		45	40	36	33	45	42
Dividend per share (c)		18.2	22.7	22.7	25.0	26.0	27.0
Gross margin (%)		51.9	52.7	51.4	52.6	53.3	53.3
EBITDA Margin (%)		11.4	11.9	9.8	10.8	12.2	11.4
Operating Margin (before GW and except) (%)		9.2	10.0	7.9	9.5	11.2	10.3
BALANCE SHEET							
Fixed Assets		18,570	17,850	18,019	18,132	23,473	22,856
Intangible Assets		16,621	15,370	15,078	14,692	19,913	19,246
Tangible Assets		1,154	1,118	1,249	1,361	1,481	1,531
Other		795	1,362	1,692	2,079	2,079	2,079
Current Assets		36,769	34,914	34,892	38,946	38,741	42,381
Stocks		1,388	1,451	1,820	2,075	2,175	2,275
Debtors		19,562	18,642	20,768	27,791	28,496	30,688
Cash		15,819	14,821	12,304	9,080	8,070	9,418
Other		0	0	0	0	0	0
Current Liabilities		(20,651)	(17,864)	(17,451)	(18,349)	(21,778)	(22,294)
Creditors		(15,155)	(14,512)	(15,297)	(17,528)	(17,778)	(18,294)
Short term borrowings		(5,496)	(3,352)	(2,154)	(821)	(4,000)	(4,000)
Long Term Liabilities		(8,666)	(6,965)	(6,491)	(5,105)	(6,505)	(6,505)
Long term borrowings		(4,301)	(2,896)	(1,685)	0	(1,400)	(1,400)
Other long term liabilities		(4,365)	(4,069)	(4,806)	(5,105)	(5,105)	(5,105)
Net Assets		26,022	27,935	28,969	33,624	33,932	36,438
CASH FLOW							
Operating Cash Flow		2,760	7,630	5,404	2,412	7,299	7,331
Net Interest		(37)	(435)	(249)	(151)	(100)	(100)
Tax		64	(1,615)	(1,344)	(1,461)	(1,502)	(1,423)
Capex		(405)	(483)	(615)	(763)	(770)	(820)
Acquisitions/disposals		(8,450)	19	0	0	(5,430)	(600)
Financing		1,690	(755)	(597)	2,215	(530)	0
Dividends		0	(2,107)	(2,615)	(2,678)	(2,931)	(3,040)
Net Cash Flow		(4,378)	2,254	(16)	(426)	(3,964)	1,348
Opening net debt/(cash)		(10,266)	(6,023)	(8,575)	(8,465)	(8,259)	(2,670)
HP finance leases initiated		0	0	0	0	0	0
Other		135	298	(94)	220	(1,625)	(0)
Closing net debt/(cash)		(6,023)	(8,575)	(8,465)	(8,259)	(2,670)	(4,018)

Source: TXT e-solutions, Edison Investment Research

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