EDISON

TXT e-solutions

Q218 results

Cheleo acquisition drives upgrades

Software & comp services

TXT reported H118 revenue growth of 6% y-o-y; investments in R&D and sales and marketing ahead of this growth rate resulted in margin pressure in H118. TXT has completed the acquisition of a majority stake in Cheleo and we have factored this into our forecasts from 1 August. The combination of slightly lower growth forecasts for TXT Next, a one-off tax credit and the higher margin growth of Cheleo results in normalised EPS upgrades of 16% in FY18e and 24% in FY19e. After paying for Cheleo, we estimate the company has funds of more than €70m to invest in accretive acquisitions in the transportation and fintech markets.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/16	33.1	4.0	0.27	0.30	35.6	3.1
12/17	35.9	3.0	0.19	1.00	51.9	10.4
12/18e	39.9	3.2	0.21	0.16	44.9	1.7
12/19e	44.9	4.4	0.27	0.17	36.1	1.8

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

H118 results show steady growth and investment

TXT reported 6.1% y-o-y revenue growth in H118 (+4.3% in Q118, +7.2% in Q218). Gross margins have improved on a year-on-year basis, resulting in gross profit growth of 8.2%. Growth in the operating cost base of 17% over the period resulted in a 2.5pp decline in the normalised operating margin to 7.5%. As well as investing in R&D and sales and marketing, TXT is now incurring the full cost of central functions that were previously split across TXT Next and TXT Retail (sold in Q417). Net cash at the end of H118 stood at €74.0m.

Earnings upgraded after incorporating Cheleo

The Cheleo acquisition completed on 31 July. We have factored in revenue growth for Cheleo of 25% for FY18 and 10% for FY19 with 34% EBITDA margins in both years. We estimate Cheleo will make up 8.5% of FY19 revenues. We trim our underlying TXT Next forecasts to reflect slower than expected growth in Q218. Overall, this results in revenue upgrades of 2.2% in FY18 and 7.4% in FY19. We upgrade normalised EPS by 16% in FY18 (also taking into account a one-off tax credit in H118), and 24% in FY19. We forecast net cash of €71.9m at the end of FY18, providing ample funds to make further earnings enhancing acquisitions.

Valuation: Factoring in accretive acquisitions

On price-based valuation metrics, TXT continues to trade at a premium to peers as even post the deal c 60% of its market cap is made up of the net cash balance. Until the bulk of TXT's cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a significant premium to peers on a P/E basis. On an EV basis, TXT trades more in line with peers, with forecast EBITDA and EBIT margins moving up to the peer group average by FY19. The company continues to evaluate targets in the transportation and fintech markets.

6 August 2018

Price	**€9.64**
Market cap	**€115m**

Net cash (€m) at end H118	74.0
Shares in issue* *Includes 0.3m issued for Cheleo acquisition	12.0m
Free float	45.5
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(8.8)	(28.1)	(20.1)
Rel (local)	(8.9)	(19.3)	(19.6)
52-week high/low		€13.52	€9.20

Business description

TXT e-solutions operates through TXT Next, which provides IT, consulting and R&D services to aerospace, aviation, banking and finance customers.

Next events

Q318 results	6 November

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Review of H118 results

Exhibit 1: TXT half-year results highlights

€m	H118	H117	% y-o-y
Revenues	19.0	17.9	6.1%
Licenses & maintenance	2.4	1.5	57.8%
Services	16.7	16.4	1.4%
Gross margin	*44.4%*	*43.6%*	*0.9%*
EBITDA	2.1	1.9	6.3%
EBITDA margin	*10.9%*	*10.9%*	*0.0%*
Normalised EBIT	1.4	1.8	-20.4%
Normalised EBIT margin	*7.5%*	*9.9%*	*-2.5%*
Net income from continuing operations	0.9	1.0	-10.6%
Discontinued operations	0.0	0.6	-100.0%
Reported net income	0.9	1.6	-44.5%
Net cash	74.0	5.5	1245.5%

Source: TXT e-solutions, Edison Investment Research

TXT reported H118 revenue growth of 6.1% y-o-y, which splits out as revenues of €9.4m in Q118 (+4.9% y-o-y) and €9.6m in Q218 (+7.2% y-o-y, lower than our 11% expectation). H1 software sales saw 57.8% y-o-y growth whereas services only grew 1.4%. Gross margin improved 90bp to 44.4%, partially offsetting lower revenue growth. H118 operating costs including depreciation totalled €7.0m, 2% ahead of our forecast. The company has been investing in R&D and sales and marketing ahead of the revenue growth rate, in part due to the end of social contribution grants that TXT was earning as a result of hiring in Italy and also reflecting investment in international expansion. G&A costs now incorporate the full charge for central costs, which previously were shared with TXT Retail (sold in Q417).

The company incurred an effective tax rate of 4% in H118, benefiting from a €0.2m one-off credit relating to the patent box regime.

After paying €11.7m for dividends in Q218, the company closed H118 with net cash of €74.0m, down from €87.3m at the end of FY17. During Q2, the company invested €70m of its cash in short-term investments. A portion of these investments is marked to market, resulting in a net finance charge of €0.3m for H118.

Acquisition of Cheleo

TXT has acquired a controlling stake in Cheleo, an Italian developer of lifecycle management software for financing. Cheleo's portfolio includes software to manage the entire process (initial application, credit management and collection, disposal of loan books) for leasing, mortgages, personal loans, salary-based loans, factoring and non-performing loans. Customers are Italian specialist financial companies.

Terms of the deal

On 31 July, TXT acquired 51% of Cheleo; it has a put/call option in place to acquire the remaining 49% over the period 1 January to 31 January 2019. Cheleo was majority-owned by Laserline, the business owned by Enrico Magni, TXT's largest shareholder and a TXT board director.

The price of the deal was set at a total consideration of €10m, based on an enterprise value of €7.6m plus c €2.5m of net cash. TXT is paying 60% in cash and 40% in treasury shares. It has issued 354,202 shares at an implied price of €11.293/share to the founders of the business (value €4.0m) and paid €1.1m in cash to Laserline. TXT will pay the remaining €4.9m in cash when it exercises its option to acquire the remaining 49% of the business. We understand that Cheleo will be fully consolidated with the amount due for the 49% stake treated as debt.

Highly profitable business

Cheleo reported 2017 revenues of €2.8m and EBITDA of €0.95m (34% margin). The acquisition price implies a trailing EV/EBITDA multiple of 8x versus TXT's trailing multiple of 7.9x FY17.

While Cheleo will continue to operate on a standalone basis within the banking and finance division, we expect a focus on cross-selling opportunities across the combined Italian client base. The two founders, Bruno Roma and Flavio Minari, will remain on the Cheleo board and will be entitled to a future cash payment based on the 2019 performance of Cheleo.

We have included Cheleo from 1 August 2018. TXT expects Cheleo to grow revenues and EBITDA by 25% compared to 2017 ie revenues €3.5m and EBITDA €1.19m (34% margin) spread equally across the year. We assume that c 50% of revenues are licence-based and c 50% services-based. We note that the software is sold on a subscription basis. We assume the business continues to achieve EBITDA margins in the region of 34%. We have factored in a 10% revenue growth rate for FY19.

Outlook and changes to forecasts

Management expects organic revenue growth in Q318 and organic profitability in line with last year. We have reduced our underlying revenue forecasts for TXT Next by 1.5% in FY18 and 1.8% in FY19. We have reduced the effective tax rate in FY18 from 28% to 20% to reflect the one-off €0.2m tax credit received for R&D spending. Our net cash forecasts take into account the full cash cost of the Cheleo acquisition (€1.1m paid in Q318 and €4.9m due in Q119).

Exhibit 2: Changes to forecasts

	FY18e old	FY18e new	% change	% y-o-y	FY19e old	FY19e new	% change	% y-o-y
Revenues (€m)	39.1	39.9	2.2%	11.4%	41.9	44.9	7.4%	12.6%
Gross margin	43.5%	44.3%	0.9%	0.8%	43.1%	44.4%	1.4%	0.1%
Gross profit	17.0	17.7	4.3%	13.3%	18.0	20.0	10.8%	12.8%
EBITDA (€m)	4.1	4.3	5.2%	22.7%	4.6	5.6	22.1%	29.9%
EBITDA margin	10.6%	10.9%	0.3%	1.0%	11.0%	12.5%	1.5%	1.7%
Normalised EBIT (€m)	2.9	3.0	5.4%	(5.2%)	3.4	4.3	28.0%	42.4%
Normalised EBIT margin	7.3%	7.6%	0.2%	(1.3%)	8.0%	9.6%	1.5%	2.0%
Normalised net income (€m)	2.2	2.5	16.8%	16.7%	2.5	3.2	26.8%	26.4%
Normalised EPS (€)	0.19	0.21	16.0%	15.5%	0.22	0.27	24.0%	24.5%
Reported basic EPS (€)	0.16	0.18	17.0%	(96.9%)	0.19	0.24	27.7%	30.3%
Net cash (€m)	76.8	71.9	(6.5%)	(17.7%)	78.0	73.3	(6.0%)	2.0%
Dividend per share (€)	0.16	0.16	0.0%	(84.0%)	0.17	0.17	0.0%	6.3%

Source: Edison Investment Research

Valuation

Taking into account the recent payment of the dividend and the full cost of the Cheleo acquisition, TXT is now trading at a small discount to peers on most EV multiples. We note that with the inclusion of Cheleo, by FY19 TXT's margins are in line with peers.

TXT continues to trade at a premium to peers on a P/E basis, although with the upgrade in earnings arising from the Cheleo acquisition, this has reduced since we wrote in May, from 66.9x to 44.9x for FY18e and from 57.6x to 36.1x for FY19e. With net cash of €71.9m (after paying for 100% of Cheleo), the company still has ample funds to make further earnings enhancing acquisitions.

Exhibit 3: Peer valuation

Company	Share price	Market cap (m)	Rev growth		EBIT margin		EBITDA margin		EV/Sales		EV/EBITDA		P/E	
			CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	**€9.64**	**€115**	**11.4%**	**12.6%**	**7.6%**	**9.6%**	**10.9%**	**12.5%**	**1.2**	**1.1**	**10.9**	**8.4**	**44.9**	**36.1**
European engineering & IT services companies														
AKKA Technologies	€62.00	€1,258	9.8%	11.0%	7.1%	7.9%	9.1%	9.5%	1.0	0.9	11.2	9.6	21.7	16.6
Alten	€85.15	€2,880	11.2%	7.5%	9.9%	10.1%	10.6%	10.8%	1.3	1.2	12.2	11.2	18.7	16.9
Altran*	€8.19	€2,105	25.9%	10.6%	10.8%	12.1%	13.6%	14.6%	0.8	0.8	6.2	5.2	10.5	8.4
AtoS	€112.45	€12,019	-2.5%	4.8%	9.7%	10.4%	13.5%	14.2%	1.0	0.9	7.3	6.6	13.0	11.7
Cap Gemini	€108.80	€18,359	2.4%	6.0%	11.0%	11.7%	14.2%	14.4%	1.6	1.5	11.0	10.2	18.3	16.3
Devoteam	€105.20	€877	16.5%	9.6%	10.3%	10.6%	10.8%	11.0%	1.3	1.2	12.4	11.1	26.2	22.9
ESI Group	€42.20	€254	9.4%	7.3%	8.2%	10.0%	11.2%	12.9%	1.9	1.8	17.2	14.0	37.2	28.4
Exprivia	€1.21	€63	278.4%	2.3%	3.5%	4.4%	6.9%	7.7%	0.5	0.5	7.8	6.9	30.2	9.3
Reply	€58.00	€2,170	15.7%	10.3%	12.8%	13.1%	14.2%	14.5%	2.1	1.9	14.5	13.0	23.7	20.7
SciSys	£1.83	£54	-7.3%	5.2%	9.2%	9.9%	11.5%	11.8%	1.1	1.1	9.8	9.1	17.0	15.3
Sopra Steria	€150.10	€3,086	6.2%	4.9%	7.6%	8.5%	9.6%	10.1%	0.9	0.8	9.2	8.4	14.1	12.1
Average			**33.2%**	**7.2%**	**9.1%**	**9.9%**	**11.4%**	**12.0%**	**1.2**	**1.2**	**10.8**	**9.6**	**21.0**	**16.2**
Discount to peers									(4%)	(8%)	1%	(12%)		

Source: Edison Investment Research, Bloomberg (as at 1 August). Note: *Trading on depressed multiples after notifying the market that it had discovered a fraud in a business it recently acquired. Prior to that, Altran was trading nearer to 8.4x FY18e EBITDA and 7.1x FY19e.

Exhibit 4: Financial summary

€'000s	2014	2015	2016	2017	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	54,410	61,540	33,060	35,852	39,927	44,942
Cost of sales	(26,455)	(29,189)	(18,954)	(20,224)	(22,221)	(24,973)
Gross profit	27,955	32,351	14,106	15,628	17,707	19,969
EBITDA	5,324	6,659	4,260	3,536	4,340	5,639
Operating Profit (before amort and except)	4,284	5,820	3,954	3,180	3,016	4,295
Amortisation of acquired intangibles	(285)	(285)	(264)	(439)	(439)	(439)
Exceptionals and other income	1,468	0	(557)	0	0	0
Other income	0	(740)	0	(69)	0	0
Operating Profit	5,467	4,795	3,133	2,672	2,577	3,856
Net Interest	(249)	(151)	48	(208)	150	150
Profit Before Tax (norm)	4,035	5,669	4,002	2,972	3,166	4,445
Profit Before Tax (FRS 3)	5,218	4,644	3,181	2,464	2,727	4,006
Tax	(1,046)	(762)	(661)	(710)	(545)	(1,122)
Profit After Tax (norm)	3,226	4,739	3,170	2,170	2,532	3,200
Profit After Tax (FRS 3)	4,172	3,882	2,520	1,754	2,181	2,884
Average Number of Shares Outstanding (m)	11.5	11.7	11.7	11.7	11.8	12.0
EPS - normalised (€)	0.281	0.406	0.271	0.186	0.215	0.267
EPS - normalised fully diluted (€)	0.276	0.403	0.271	0.186	0.215	0.267
EPS - (IFRS) (€)	0.364	0.333	0.475	5.874	0.185	0.241
Dividend per share (c)	0.23	0.25	0.30	1.00	0.16	0.17
Gross margin (%)	51.4	52.6	42.7	43.6	44.3	44.4
EBITDA Margin (%)	9.8	10.8	12.9	9.9	10.9	12.5
Operating Margin (before GW and except) (%)	7.9	9.5	12.0	8.9	7.6	9.6
BALANCE SHEET						
Fixed Assets	18,019	18,132	25,428	8,860	18,426	17,083
Intangible Assets	15,078	14,692	21,296	7,332	14,388	13,945
Tangible Assets	1,249	1,361	1,598	793	3,303	2,403
Other	1,692	2,079	2,534	735	735	735
Current Assets	34,892	38,946	37,085	109,426	102,850	102,036
Stocks	1,820	2,075	3,146	2,528	2,828	3,128
Debtors	20,768	27,791	26,369	17,215	18,596	20,932
Cash	12,304	9,080	7,570	89,683	81,426	77,976
Other	0	0	0	0	0	0
Current Liabilities	(17,451)	(18,349)	(21,051)	(13,612)	(19,920)	(16,753)
Creditors	(15,297)	(17,528)	(20,243)	(12,937)	(14,345)	(16,078)
Short term borrowings	(2,154)	(821)	(808)	(675)	(5,575)	(675)
Long Term Liabilities	(6,491)	(5,105)	(7,180)	(4,781)	(7,093)	(7,093)
Long term borrowings	(1,685)	0	(1,391)	(1,688)	(4,000)	(4,000)
Other long term liabilities	(4,806)	(5,105)	(5,789)	(3,093)	(3,093)	(3,093)
Net Assets	28,969	33,624	34,282	99,893	94,263	95,273
CASH FLOW						
Operating Cash Flow	5,404	2,412	10,676	119	4,066	4,736
Net Interest	(249)	(151)	105	(208)	150	150
Tax	(1,344)	(1,461)	(2,022)	379	(545)	(1,122)
Capex	(615)	(763)	(738)	(661)	(430)	(440)
Acquisitions/disposals	0	0	(5,403)	82,250	1,400	(4,900)
Financing	(597)	2,215	(828)	(6)	(1,200)	0
Dividends	(2,615)	(2,678)	(2,931)	(3,496)	(11,710)	(1,874)
Net Cash Flow	(16)	(426)	(1,141)	78,377	(8,269)	(3,449)
Opening net debt/(cash)	(8,575)	(8,465)	(8,259)	(5,371)	(87,320)	(71,851)
HP finance leases initiated	0	0	0	0	0	0
Other	(94)	220	(1,747)	3,572	(7,200)	4,900
Closing net debt/(cash)	(8,465)	(8,259)	(5,371)	(87,320)	(71,851)	(73,301)

Source: TXT e-solutions, Edison Investment Research

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