

TXT e-solutions

FY18 results

Accelerating growth with M&A

Group organic revenue growth in FY18 was driven by double-digit growth of the aerospace business. TXT started to invest some of its substantial cash pile in H218, acquiring two Italian businesses in the fintech space. This investment should provide growth opportunities for the Banking & Finance business. Increased investment in sales and R&D in FY19 reduces our normalised EPS forecast by 15.5%; we introduce a forecast for 21% EPS growth in FY20. The company continues to assess targets in both business lines and has net cash of €60m available to fund acquisitions.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/17	35.9	3.0	0.19	1.00	48.5	11.1
12/18	40.0	1.5	0.10	0.50	87.6	5.5
12/19e	46.0	3.8	0.23	0.13	38.6	1.4
12/20e	49.5	4.6	0.28	0.15	31.9	1.7

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

FY18 results: Organic revenue growth of 7.5%

TXT reported revenue growth of 11.4% year-on-year in FY18, of which 7.5% was organic. The Aerospace, Aviation and Automotive (AAA) business grew 12% (all organic), while the underlying Banking & Finance business declined 8.6% before the contribution of €1.4m of revenues from the Cheleo acquisition. While gross profit was marginally better than expected, higher commercial and R&D costs resulted in lower than expected EBITDA. Net finance costs were affected by fair value losses on the funds in which the company invested its cash in H218, resulting in normalised EPS 46% below our forecast. The company announced a €0.5 annual dividend, well ahead of our €0.16 forecast.

Outlook: Organic plus acquisitive growth

Management expects to report revenue growth in Q119 (organic plus Cheleo) and EBITDA broadly in line with Q118. We have revised our forecasts to reflect slightly higher revenues that are outweighed by higher sales and R&D costs, resulting in a 15.5% decline in our normalised EPS forecast. TXT continues to assess potential targets in both business lines. In AAA, we believe that the focus is on adding niche software and internationalising the business. In Banking & Finance, we believe the business is seeking to add technology to widen its product offering with a focus on European customers.

Valuation: Factors in accretive acquisitions

TXT is trading on EV multiples that are at a small discount to peers – EBITDA margins are broadly in line with peers, although EBIT margins are lower. As the company has not yet deployed most of the cash from the sale of TXT Retail, its P/E multiples are inflated versus peers. We expect this premium to reduce as the company makes earnings-enhancing acquisitions.

Software & comp services

15 March 2019

Price €9.01

Market cap €105m

Net cash (€m) at end FY18 60.4

Shares in issue 11.6m

Free float 45%

Code TXT

Primary exchange Borsa Italiana (STAR)

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (5.6) 12.0 (15.6)

Rel (local) (10.1) 1.3 (9.0)

52-week high/low €13.5 €7.7

Business description

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

Next events

Q119 results 10 May 2019

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Review of FY18 results

Exhibit 1: FY18 results highlights

	FY17a	FY18e	FY18a	diff	y-o-y
Revenues (€m)	35.9	39.8	40.0	0.4%	11.4%
Gross margin	43.6%	44.3%	44.2%	(0.1%)	0.6%
Gross profit	15.6	17.6	17.7	0.2%	13.1%
EBITDA (€m)	3.5	4.3	4.1	(4.1%)	15.9%
EBITDA margin	9.9%	10.7%	10.3%	(0.5%)	0.4%
Normalised EBIT* (€m)	3.2	2.8	2.8	(0.8%)	(13.4%)
Normalised EBIT* margin	8.9%	7.0%	6.9%	(0.1%)	(2.0%)
Normalised net income (€m)	2.2	2.2	1.2	(46.1%)	(44.5%)
Normalised EPS (€)	0.19	0.19	0.10	(46.0%)	(44.7%)
Reported basic EPS (€)	5.87	0.15	0.05	(67.8%)	(99.2%)
Net cash (€m)	87.3	69.6	60.4	(13.3%)	(30.9%)
Dividend (€)	1.00	0.16	0.50	212.5%	(50.0%)

Source: TXT e-solutions. Note: *Excludes amortisation of acquired intangibles (€0.6m) and exceptional costs relating to acquisitions (€0.3m).

TXT reported FY18 revenues and gross profit substantially in line with our forecast. Excluding €100k of transaction-related costs in Q4 (which we treat as exceptional), underlying opex was €220k higher than forecast, with each cost line ahead of our forecasts in Q4. The company increased investment in software development within the Aerospace, Aviation and Automotive (AAA) business and added sales headcount to commercialise the recently acquired fintech solutions in the Banking & Finance (B&F) business.

In H218, the company invested the majority of its cash balance (from a combination of the TXT Retail disposal and the €40m long-term debt taken out in Q3) in multi-segment insurance funds, some of which are marked to market. In FY18, market volatility resulted in a €0.97m reduction in value of these investments (most of the decline occurred in Q4), contributing the majority of the €1.28m net finance cost. The company noted that it has regained nearly all of this loss in the year to date.

As noted at the half year, the company saw a €0.2m R&D tax credit – this completely offset the reported full-year tax charge.

The combination of higher opex and the loss on the cash investments resulted in net income and EPS (both reported and normalised) below our forecasts.

The company closed the year with a net cash balance of €60.4m (end FY17 €87.3m). The majority of the reduction over the year was from the combination of the following items:

- Special dividend of €1 per share – €11.7m.
- Share buybacks – €4.6m.
- Recognition of lease debt (IFRS 16) – €2.8m.
- Acquisition of Cheleo – €5.1m. Net investing cash flow from this acquisition in FY18 was positive as initial consideration of €1.1m was offset by the €2.5m cash acquired with the business. The company also recognised the €4.9m liability to acquire the remainder of the business – Laserline exercised its put option in January 2019 and TXT bought out the remaining 49% stake. In addition, TXT recognised a €1.4m liability for contingent consideration based on FY19 results.
- Acquisition of TXT Risk Solutions – €1.6m.
- General working capital requirements - €1.1m.

The company announced a €0.5 dividend per share for the year. This comes after a special dividend of €1.0 per share was paid out for FY17. The dividend is not covered by earnings in FY18, but at a total cost of €5.8m, is easily funded out of the company's large net cash balance.

Business update

Divisional performance

The table below shows divisional performance in FY18. Clearly the AAA division saw strong growth. The original B&F software testing business saw a decline in activity, mainly due to the merger of Banco Popolare and BPM. Cheleo contributed €1.4m in revenues since it was acquired at the beginning of August, split €0.4m in License & Maintenance revenues and €1.0m in Service revenues.

Exhibit 2: Divisional revenue split			
Revenues (€m)	FY17	FY18	y-o-y
Aerospace, Aviation & Automotive (AAA)	27.8	31.1	12.0%
Banking & Finance (B&F)	8.1	8.8	8.7%
- Original business	8.1	7.4	(8.6%)
- Cheleo	0	1.4	N/A

Source: TXT e-solutions

Management changes

Triggered by Laserline acquiring a 25% stake in TXT last year, the management structure of the group has changed. The owner of Laserline, Enrico Magni, was elected to the board last year and towards the end of 2018 took on the role of TXT group CEO. The previous CEO, Marco Guida, is now CEO of the AAA division. We understand that Mr Guida will continue to build the AAA business, including seeking out suitable acquisition targets, while Mr Magni will focus on the B&F business, where he is also seeking to acquire.

Outlook and changes to forecasts

Management expects revenues to accelerate in Q119 from the combination of organic growth and the inclusion of Cheleo. EBITDA is expected to be roughly flat versus Q118 (which was €1.18m).

We have revised our forecasts to reflect slightly stronger revenues and better gross margins in the services element of the Cheleo business. On the cost side, we have factored in higher commercial costs as the business adds sales headcount to grow the new fintech businesses, and higher R&D costs reflecting the development of new software in the AAA business. Overall, the higher cost base outweighs the higher gross profit, resulting in a reduction in normalised EPS of 15.5% in FY19. We have introduced a forecast for FY20 factoring in 7.7% revenue growth, 22.6% growth in normalised EBIT and 20.8% growth in normalised EPS. We have reduced our dividend forecast based on the lower EPS, assuming a payout ratio of 67–75%.

Exhibit 3: Changes to forecasts

	FY19e old	FY19e new	change	y-o-y	FY20e new	y-o-y
Revenues (€m)	44.9	46.0	2.3%	15.1%	49.5	7.7%
Gross margin	44.4%	45.2%	0.8%	1.0%	45.2%	(0.0%)
Gross profit	20.0	20.8	4.2%	17.7%	22.4	7.7%
EBITDA (€m)	5.8	5.1	(13.1%)	24.0%	5.9	15.5%
EBITDA margin	13.0%	11.1%	(2.0%)	0.8%	11.8%	0.8%
Normalised EBIT (€m)	4.2	3.5	(17.9%)	26.3%	4.3	22.6%
Normalised EBIT margin	9.4%	7.6%	(1.9%)	0.7%	8.6%	1.0%
Normalised net income (€m)	3.3	2.7	(16.7%)	126.0%	3.3	20.8%
Normalised EPS (€)	0.28	0.23	(15.5%)	127.3%	0.28	20.8%
Reported basic EPS (€)	0.25	0.17	(31.6%)	261.3%	0.22	27.9%
Net cash (€m)	71.3	57.7	(19.1%)	(4.4%)	60.2	4.3%
Dividend (€)	0.17	0.13	(23.5%)	(74.0%)	0.15	15.4%

Source: Edison Investment Research

Valuation

TXT is trading on EV multiples that are at a small discount to peers – EBITDA margins are broadly in line with peers, although EBIT margins are lower. As the company has not yet deployed the cash from the sale of TXT Retail, its P/E multiples are inflated versus peers. We expect this premium to reduce as the company makes earnings-enhancing acquisitions.

Exhibit 4: Peer group financial performance and valuation metrics

Company	Share price	Market cap	Rev growth		EBIT margin		EBITDA margin		EV/Sales (x)		EV/EBITDA (x)		P/E* (x)		Div yield (%)	
			m	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY
TXT	€9.01	€ 105	15.1%	7.7%	7.6%	8.6%	11.1%	11.8%	1.0	0.9	8.8	7.6	38.6	31.9	1.4	1.7
European Engineering and IT services companies																
AKKA Technologies	€60.90	€ 1,232	20.5%	5.3%	7.3%	8.1%	9.5%	10.2%	0.8	0.8	8.8	7.8	14.6	12.4	1.7	2.0
Alten	€94.95	€ 3,201	11.4%	6.2%	9.9%	9.9%	10.6%	10.7%	1.3	1.2	12.2	11.4	17.2	15.9	1.2	1.2
Altran	€10.03	€ 2,569	9.9%	5.5%	11.4%	12.1%	14.6%	15.1%	1.2	1.1	8.2	7.5	12.2	10.4	2.3	2.7
AtoS	€83.90	€ 8,937	9.0%	3.2%	10.4%	10.6%	14.1%	14.5%	1.0	1.0	7.3	6.9	9.1	8.4	2.2	2.4
Cap Gemini	€106.9	€ 17,822	7.1%	5.4%	12.3%	12.6%	14.4%	14.6%	1.4	1.3	9.8	9.2	16.5	15.0	1.8	1.9
Devoteam	€105.8	€ 879	17.6%	12.1%	11.1%	11.1%	12.1%	12.2%	1.1	1.0	9.2	8.2	18.9	16.8	1.6	1.8
ESI Group	€23.40	€ 139	6.3%	4.3%	8.2%	9.3%	9.9%	10.9%	1.1	1.1	11.6	10.0	19.9	16.0	0.0	0.0
Exprivia	€1.24	€ 64	2.8%	3.4%	4.5%	5.0%	7.7%	8.0%	0.5	0.5	6.3	5.8	10.3	6.9	0.0	0.0
Reply	€56.60	€ 2,110	12.5%	8.8%	12.6%	12.9%	14.0%	14.2%	1.8	1.6	12.8	11.6	20.5	18.5	0.8	0.8
SciSys	£158.5	£47	5.4%	4.0%	9.2%	9.3%	11.1%	11.3%	0.8	0.8	7.6	7.2	11.9	11.8	1.6	1.8
Sopra Steria	€104.0	€ 2,128	5.3%	3.9%	7.5%	8.2%	9.3%	9.8%	0.6	0.6	6.6	6.0	10.2	8.7	2.3	2.7
Average			9.8%	5.6%	9.5%	9.9%	11.6%	12.0%	1.1	1.0	9.1	8.3	14.7	12.8	1.4	1.6
<i>(Discount)/premium to peers</i>									<i>(9%)</i>	<i>(11%)</i>	<i>(4%)</i>	<i>(9%)</i>	<i>163%</i>	<i>149%</i>	<i>3%</i>	<i>5%</i>

Source: Edison Investment Research, Refinitiv (as at 14 March). Note: *Uses normalised EPS.

Exhibit 5: Financial summary

	€'000s	2014	2015	2016	2017	2018	2019e	2020e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue		54,410	61,540	33,060	35,852	39,957	45,971	49,521
Cost of sales		(26,455)	(29,189)	(18,954)	(20,224)	(22,289)	(25,181)	(27,131)
Gross profit		27,955	32,351	14,106	15,628	17,668	20,790	22,390
EBITDA		5,324	6,659	4,260	3,536	4,098	5,080	5,867
Operating Profit (before amort and except)		4,284	5,820	3,954	3,180	2,755	3,480	4,267
Amortisation of acquired intangibles		(285)	(285)	(264)	(439)	(610)	(960)	(960)
Exceptionals and other income		1,468	0	(557)	0	(300)	0	0
Other income		0	(740)	0	(69)	0	0	0
Operating Profit		5,467	4,795	3,133	2,672	1,845	2,520	3,307
Net Interest		(249)	(151)	48	(208)	(1,284)	300	300
Profit Before Tax (norm)		4,035	5,669	4,002	2,972	1,471	3,780	4,567
Profit Before Tax (FRS 3)		5,218	4,644	3,181	2,464	561	2,820	3,607
Tax		(1,046)	(762)	(661)	(710)	4	(790)	(1,010)
Profit After Tax (norm)		3,226	4,739	3,170	2,170	1,204	2,722	3,288
Profit After Tax (FRS 3)		4,172	3,882	2,520	1,754	565	2,031	2,597
Average Number of Shares Outstanding (m)		11.5	11.7	11.7	11.7	11.7	11.6	11.6
EPS - normalised (€)		0.281	0.406	0.271	0.186	0.103	0.234	0.282
EPS - normalised fully diluted (€)		0.276	0.403	0.271	0.186	0.103	0.234	0.282
EPS - (IFRS) (€)		0.364	0.333	0.475	5.874	0.048	0.174	0.223
Dividend per share (c)		0.23	0.25	0.30	1.00	0.50	0.13	0.15
Gross margin (%)		51.4	52.6	42.7	43.6	44.2	45.2	45.2
EBITDA Margin (%)		9.8	10.8	12.9	9.9	10.3	11.1	11.8
Operating Margin (before GW and except) (%)		7.9	9.5	12.0	8.9	6.9	7.6	8.6
BALANCE SHEET								
Fixed Assets		18,019	18,132	25,428	8,860	22,942	21,072	18,952
Intangible Assets		15,078	14,692	21,296	7,332	17,751	16,763	15,775
Tangible Assets		1,249	1,361	1,598	793	3,680	2,798	1,666
Other		1,692	2,079	2,534	735	1,511	1,511	1,511
Current Assets		34,892	38,946	37,085	109,426	134,674	121,449	117,259
Stocks		1,820	2,075	3,146	2,528	3,141	3,441	3,741
Debtors		20,768	27,791	26,369	17,215	16,992	19,549	21,059
Cash		12,304	9,080	7,570	89,683	114,541	98,458	92,459
Other		0	0	0	0	0	0	0
Current Liabilities		(17,451)	(18,349)	(21,051)	(13,612)	(30,086)	(27,062)	(28,170)
Creditors		(15,297)	(17,528)	(20,243)	(12,937)	(12,782)	(14,658)	(15,766)
Short term borrowings		(2,154)	(821)	(808)	(675)	(17,304)	(12,404)	(12,404)
Long Term Liabilities		(6,491)	(5,105)	(7,180)	(4,781)	(41,184)	(32,684)	(24,184)
Long term borrowings		(1,685)	0	(1,391)	(1,688)	(36,882)	(28,382)	(19,882)
Other long term liabilities		(4,806)	(5,105)	(5,789)	(3,093)	(4,302)	(4,302)	(4,302)
Net Assets		28,969	33,624	34,282	99,893	86,346	82,774	83,858
CASH FLOW								
Operating Cash Flow		5,404	2,412	10,676	119	2,039	4,099	5,165
Net Interest		(249)	(151)	105	(208)	(69)	300	300
Tax		(1,344)	(1,461)	(2,022)	379	(624)	(790)	(1,010)
Capex		(615)	(763)	(738)	(661)	(526)	(440)	(440)
Acquisitions/disposals		0	0	(5,403)	82,250	1,314	(4,900)	0
Financing		(597)	2,215	(828)	(6)	(7,227)	0	0
Dividends		(2,615)	(2,678)	(2,931)	(3,496)	(11,710)	(5,855)	(1,514)
Net Cash Flow		(16)	(426)	(1,141)	78,377	(16,803)	(7,586)	2,501
Opening net debt/(cash)		(8,575)	(8,465)	(8,259)	(5,371)	(87,320)	(60,358)	(57,672)
HP finance leases initiated		0	0	0	0	(2,788)	0	0
Other		(94)	220	(1,747)	3,572	(7,371)	4,900	0
Closing net debt/(cash)		(8,465)	(8,259)	(5,371)	(87,320)	(60,358)	(57,672)	(60,173)

Source: Edison Investment Research, TXT e-solutions

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