TXT e-solutions

H120 results

Entering the Swiss fintech market

Software & comp services

TXT reported flat organic revenues in Q220 and 6% organic growth for H120, despite the disruption caused by COVID-19. Normalised EBIT was 44% higher y-o-y in Q220 and 51% higher for H120. The company took its first step to internationalise its fintech business with the €5m acquisition of a Swiss IT services business in July. We have revised our forecasts to reflect the acquisition and lower underlying operating costs, resulting in upgrades to our normalised EPS forecasts (+29% FY20, +6% FY21).

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/18	40.0	1.5	0.10	0.50	79.5	6.1
12/19	59.1	7.6	0.46	0.00	17.9	0.0
12/20e	66.8	5.9	0.34	0.10	24.1	1.2
12/21e	73.0	6.8	0.39	0.12	20.8	1.5

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

Respectable Q2 performance despite COVID-19

COVID-19 has not yet had a material impact on TXT's results: H120 revenues saw 19% growth (5.9% organic) and normalised EBIT increased 51% over the same period, increasing the margin by 2pp to 9.7%. Meanwhile, the company continues to expand its fintech division and has made the first step to internationalise this business with the €5m acquisition of a Swiss IT services business focused on the banking sector. Net cash of €38.3m at the end of H120 provides ample funds for additional acquisitions.

Upgrading estimates

While in the medium term demand from civil aviation and automotive customers is likely to be weaker, other segments such as defence and digital industry could compensate, and TXT is focusing on developing expertise in areas such as artificial intelligence, remote training and support, and cybersecurity. For Q320, management expects to report organic revenue growth and EBITDA growth on a year-on-year basis. We have revised our forecasts to reflect a lower cost base for the rest of FY20 and for FY21, and we have included MAC Solutions from 14 July. This results in a revenue upgrade of 3.6% in FY20 and 7.3% in FY21, and a normalised EPS upgrade of 28.8% in FY20 and 5.5% in FY21.

Valuation: Discount to peers

TXT continues to trade at a large discount to its peer group on an EV/sales and EV/EBIT basis, with revenue growth at the top end of the group and margins in line with peer group averages. P/E multiples continue to be inflated versus peers due to the €38m of net cash on the balance sheet. We expect the company will continue to seek earnings-enhancing acquisitions.

11 August 2020

Price	**€8.15**
Market cap	**€96m**

Net cash (€m) at end-H120	38.3
Shares in issue	11.7m
Free float	45%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	8.2	5.8	(1.2)
Rel (local)	8.5	(6.1)	2.0
52-week high/low		€10.66	€4.63

Business description

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

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Review of H120 results

Exhibit 1: Financial highlights, Q220 and H120

€m							y-o-y		
	Q120	Q220	H120	Q119	Q219	H119	Q120	Q220	H120
Revenues	**16.3**	**15.9**	**32.1**	**11.9**	**15.1**	**27.0**	**36.8%**	**4.9%**	**18.9%**
Licences & maintenance	2.3	2.1	4.4	1.5	1.4	2.9	50.2%	47.5%	48.8%
Services	14.0	13.7	27.7	10.4	13.7	24.1	34.8%	0.4%	15.3%
Gross profit	7.3	6.7	14.0	5.2	6.5	11.7	39.5%	3.5%	19.5%
Gross margin	44.7%	42.6%	43.7%	43.9%	43.1%	43.5%	0.9%	(0.6%)	0.2%
EBITDA	**2.0**	**2.1**	**4.0**	**1.3**	**1.5**	**2.8**	**52.1%**	**38.8%**	**45.0%**
EBITDA margin	12.1%	13.1%	12.6%	10.9%	9.9%	10.3%	1.2%	3.2%	2.3%
Normalised EBIT	**1.5**	**1.6**	**3.1**	**1.0**	**1.1**	**2.1**	**58.5%**	**43.9%**	**50.7%**
Normalised EBIT margin	9.4%	10.0%	9.7%	8.1%	7.3%	7.6%	1.3%	2.7%	2.0%
Reported EBIT	1.2	0.9	2.1	0.7	0.5	1.2	61.0%	79.7%	68.8%
Reported EBIT margin	7.2%	5.9%	6.5%	6.1%	3.4%	4.6%	1.1%	2.4%	1.9%
Reported net income	**0.3**	**2.5**	**2.7**	**1.4**	**0.7**	**2.2**	**(82.3%)**	**232.2%**	**25.7%**
Net cash	42.1	38.3	38.3	61.1	44.2	44.2	(31.1%)	(13.3%)	(13.3%)

Source: TXT e-solutions

TXT reported 4.9% revenue growth in Q220, which, after the very strong growth in Q120, resulted in H120 revenue growth of 18.9%. Q2 revenues on a like-for-like basis were flat. Gross profit increased by a similar amount to revenue in H120. Lower operating costs such as significantly reduced travel costs, lower admin costs, and lower sales and marketing costs, resulted in a 38.8% y-o-y increase in EBITDA in Q220 and a 45.0% increase in H120. Of the €1.3m increase in H120, €0.6m was from the Assioma acquisition and the remainder organic growth. TXT noted that investment in TXT Risk Solutions and TXT Working Capital Solutions had a €0.5m negative impact on EBITDA in Q2.

The normalised EBIT margin increased by 2.7pp y-o-y in Q220 and 2.1pp y-o-y in H120 as a result of the lower cost base. The company took a €0.35m one-off charge for restructuring in Q220. Net financial income of €0.9m in H120 was the combination of two things: as we have previously written, the company holds a large proportion of its cash balance in multi-segment insurance funds (€78m at the end of Q1), which are marked to market. Due to the market turmoil prompted by COVID-19, these funds reduced in value by €0.7m in Q120 but had regained their value in Q220. The company also reported a €0.8m one-off credit in Q220 for the reduction in an earn-out payment (see below for more detail).

The tax rate for H120 was 8.8%, affected by the one-off credit relating to the PACE earn-out, although we have maintained our 28% forecast for FY20 and FY21.

Exhibit 2: Net cash reconciliation

€m	FY19	H120
Cash and cash equivalents	11.4	17.0
Trading securities at fair value	87.3	77.6
Short-term bank debt	(17.4)	(20.7)
Short-term leases	(1.3)	(1.3)
Short-term earn-outs	(6.6)	(1.6)
Long-term bank debt	(23.5)	(23.5)
Long-term lease debt	(4.5)	(4.0)
Long-term earn-outs	(4.0)	(5.1)
Net cash	41.4	38.3

Source: TXT e-solutions

In H1, the company generated €0.8m cash from operations, after paying €1.2m to the retiring chairman, which was accrued in H219. €1.8m was spent buying back shares during H1 and €0.5m on capex. Net cash declined by €3.1m over the period. A new €2.7m earn-out was recorded for the acquisition of TXT Working Capital Solutions. The PACE and Cheleo earn-outs were paid during H1, totalling €5.9m. Although this would ordinarily have no impact on the net cash position, the final payout for PACE was €0.8m lower than originally accrued.

Exhibit 3: Divisional revenues

€m							y-o-y		
	Q120	Q220	H120	Q119	Q219	H119	Q120	Q220	H120
Aerospace & Aviation	10.5	10.3	**20.9**	8.9	9.8	**18.6**	18.8%	5.8%	12.0%
Software licences & maintenance	2.0	1.8	**3.8**	1.3	1.2	**2.5**	52.5%	48.6%	50.6%
Services	8.6	8.5	**17.1**	7.6	8.5	**16.1**	13.1%	-0.2%	6.0%
Fintech	5.7	5.5	**11.2**	3.0	5.4	**8.4**	89.5%	3.2%	34.3%
Software licences & maintenance	0.3	0.3	**0.6**	0.2	0.2	**0.4**	36.9%	41.3%	39.1%
Services	5.4	5.2	**10.7**	2.8	5.1	**7.9**	93.7%	1.6%	34.0%
Software licences & maintenance	**2.3**	**2.1**	**4.4**	**1.5**	**1.4**	**2.9**	**50.2%**	**47.5%**	**48.8%**
Services	**14.0**	**13.7**	**27.7**	**10.4**	**13.7**	**24.1**	**34.8%**	**0.4%**	**15.3%**

Source: TXT e-solutions

Aerospace & Aviation (A&A) – still reporting organic growth

In Q220, the A&A division saw 5.8% organic revenue growth, with a 48.6% increase in software revenues (this reflects licence deals signed in H219) and effectively flat revenues from services. Based on the stronger performance in Q120, this results in 12.0% growth for H120, with 50.6% growth in software revenues and 6.0% growth in services revenues. The company noted that it had recently signed a multi-year contract within the defence sector for its virtual pilot training platform.

PACE call option exercised for remaining 21%

In June, TXT acquired the remaining 21% of PACE for €5.1m. The company had previously 100%-consolidated the acquisition and treated the option to acquire the remaining 21% as debt. At the end of FY19, the liability (included in short-term debt) was revalued from €1.7m to €5.9m to reflect client wins in 2019. The difference of €0.82m was reported in the income statement in Q220 as a one-off credit.

Fintech – growing beyond Italy

As TXT acquired Assioma on 30 April 2019, Q2 revenue growth of 3.2% was a combination of one extra month of Assioma and the underlying business showing a slight decline. For H120, revenue growth of 34.3% came from 39.1% growth in software revenues and 34.0% growth from services. On a like-for-like basis, revenue growth declined 3.8% in H120.

Expanding into the Swiss market with MAC acquisition

In June, the company announced that it had agreed to acquire MAC Solutions, a Swiss IT services company with a focus on the banking market, for CHF5.4m/€5.0m in cash. The agreement includes a clawback clause of up to CHF2.2m, depending on EBITDA achieved over 2020–22 and this amount will sit in escrow for three years. The deal completed on 13 July and MAC Solutions has been consolidated from 14 July. In late July, TXT sold 224,604 treasury shares at €9/share for €2.0m, so that the sole shareholder of MAC Solutions, Alberto Franceschini, could exchange the part of the sales proceeds sitting in escrow for TXT shares. This makes him a 1.7% shareholder of TXT.

MAC Solutions has been in operation for more than 20 years, specialising in the supply and integration of financial software, and developing custom software and apps for local banking customers. In 2019, MAC generated revenue of CHF4.8m and EBITDA of CHF1.08m (22.5% margin) – this excludes consulting activities that TXT is not acquiring. This implies a trailing EV/sales multiple of 1.1x and EV/EBITDA of 5.0x (compared to 1.0x and 8.1x, respectively, for TXT).

MAC Solutions is based in Chiasso, Switzerland, close to the Italian border. TXT already has a Swiss subsidiary based in Chiasso focused on the aerospace market and this acquisition is a move to expand the fintech division outside of Italy. TXT noted that during lockdown, MAC Solutions' business has remained at normal levels.

Outlook and changes to forecasts

The company noted that, despite the inevitable impact that COVID-19 has had on the civil aviation, automotive and manufacturing sectors, the immediate transition to remote working ensured continuity for its customers, and its specialised skills in digital transformation have enabled it to grow volumes and margins compared to H119. Management will continue to invest in R&D and acquisitions to increase the range of expertise it can offer and is continuing its share buyback plan. For Q320, management expects organic revenue growth and EBITDA growth y-o-y.

We have revised our forecasts to reflect:

- consolidation of MAC Solutions from 14 July;
- lower operating costs based on lower expenses incurred in Q220; and
- share count adjusted for the treasury shares sold to the MAC Solutions vendor.

Overall, this results in a 30% increase in FY20 normalised EPS and a 6% increase in FY21.

Exhibit 4: Changes to forecasts

	FY20e old	FY20e new	change	y-o-y	FY21e old	FY21e new	change	y-o-y
Revenues (€m)	64.4	66.8	3.6%	13.0%	68.0	73.0	7.4%	9.3%
Gross margin	44.7%	43.2%	(1.5%)	(2.9%)	46.6%	44.4%	(2.2%)	1.1%
Gross profit	28.8	28.9	0.2%	5.9%	31.7	32.4	2.3%	12.2%
EBITDA (€m)	6.5	7.8	21.0%	11.4%	8.0	8.5	6.7%	9.0%
EBITDA margin	10.0%	11.7%	1.7%	(0.2%)	11.7%	11.7%	(0.1%)	(0.0%)
Normalised EBIT (€m)	4.7	5.9	25.9%	9.1%	6.2	6.6	5.6%	11.1%
Normalised EBIT margin	7.3%	8.8%	1.6%	(0.3%)	9.1%	9.0%	(0.1%)	0.1%
Normalised net income (€m)	3.1	3.9	28.5%	(26.1%)	4.3	4.6	5.8%	16.5%
Normalised EPS (€)	0.26	0.34	28.8%	(25.9%)	0.37	0.39	5.5%	15.9%
Reported basic EPS (€)	0.19	0.28	51.2%	954.7%	0.30	0.31	4.1%	8.9%
Net cash (€m)	42.5	37.6	(11.4%)	(9.1%)	46.0	41.2	(10.5%)	9.5%
Dividend (€)	0.10	0.10	0.0%	N/A	0.12	0.12	0.0%	20.0%

Source: Edison Investment Research

Valuation

TXT continues to trade at a discount to peers on EV multiples. Due to the high net-cash balance, the stock trades at a premium on a P/E basis, although this is reducing as the company makes acquisitions.

Exhibit 5: Peer financial and valuation metrics

Company	Share price	Market cap	Rev growth		EBIT margin		EBITDA margin		EV/sales		EV/EBIT		P/E		Div yield	
	€	€m	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	**8.15**	**96**	**13.2%**	**9.2%**	**8.9%**	**9.0%**	**11.7%**	**11.7%**	**0.9**	**0.8**	**10.0**	**9.0**	**24.1**	**20.8**	**1.2%**	**1.5%**
European IT services companies																
AKKA Technologies	16.46	370	-5.8%	5.7%	0.5%	4.6%	5.7%	9.0%	0.4	0.3	65.9	7.1	N/A	8.9	0.0%	1.1%
Alten	67.95	2,327	-8.0%	6.1%	5.8%	8.1%	8.1%	9.8%	1.0	0.9	17.3	11.6	22.0	14.7	1.3%	1.3%
AtoS	73.66	8,163	-2.5%	0.8%	7.8%	8.6%	13.5%	14.2%	0.9	0.9	11.5	10.5	10.5	9.8	1.9%	2.1%
Cap Gemini	111.30	19,002	12.0%	8.0%	10.5%	11.2%	14.3%	14.7%	1.3	1.2	12.1	10.6	17.6	15.1	1.5%	1.8%
Devoteam	98.10	824	-0.3%	4.3%	8.8%	9.8%	11.2%	11.5%	1.1	1.0	12.4	10.7	23.5	18.5	0.9%	1.1%
ESI Group	38.30	228	42.5%	5.1%	5.1%	6.8%	11.7%	11.3%	1.9	1.8	36.8	26.3	46.7	37.6	0.0%	0.0%
Reply	88.50	3,336	5.2%	9.4%	12.2%	12.9%	15.3%	15.7%	2.6	2.4	21.1	18.4	30.6	26.6	0.6%	0.7%
Sopra Steria	133.40	2,740	-1.8%	4.1%	5.8%	7.0%	9.9%	10.8%	0.8	0.8	14.4	11.4	16.9	13.3	1.4%	1.6%
Average			**5.2%**	**5.4%**	**7.1%**	**8.6%**	**11.2%**	**12.1%**	**1.2**	**1.2**	**24.0**	**13.3**	**19.7**	**18.1**	**0.9%**	**1.2%**
(Discount)/premium to peers									***(29%)***	***(31%)***	***(58%)***	***(32%)***	***22%***	***15%***	***30%***	***21%***

Source: Edison Investment Research, Refinitiv (as at 10 August 2020)

Exhibit 6: Financial summary

€'000s	2016	2017	2018	2019	2020e	2021e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	33,060	35,852	39,957	59,091	66,769	72,968
Cost of sales	(18,954)	(20,224)	(22,289)	(31,825)	(37,898)	(40,582)
Gross profit	14,106	15,628	17,668	27,266	28,871	32,386
EBITDA	4,260	3,536	4,098	7,004	7,803	8,504
Operating Profit (before amort and except)	3,954	3,180	2,755	5,408	5,897	6,552
Amortisation of acquired intangibles	(264)	(439)	(610)	(1,142)	(1,365)	(1,365)
Exceptionals and other income	(557)	0	(300)	(4,145)	470	0
Other income	0	(69)	0	0	0	0
Operating Profit	3,133	2,672	1,845	121	5,002	5,187
Net Interest	48	(208)	(1,284)	2,194	0	250
Profit Before Tax (norm)	4,002	2,972	1,471	7,602	5,897	6,802
Profit Before Tax (FRS 3)	3,181	2,464	561	2,315	5,002	5,437
Tax	(661)	(710)	4	(1,867)	(1,401)	(1,522)
Profit After Tax (norm)	3,170	2,170	1,204	5,473	4,246	4,898
Profit After Tax (FRS 3)	2,520	1,754	565	448	3,602	3,915
Average Number of Shares Outstanding m)	11.7	11.7	11.7	11.7	11.7	11.7
EPS - normalised (€)	0.271	0.186	0.102	0.456	0.338	0.391
EPS - normalised fully diluted (€)	0.271	0.186	0.102	0.456	0.338	0.391
EPS - (IFRS) (€)	0.475	5.874	0.048	0.027	0.283	0.308
Dividend per share (€)	0.30	1.00	0.50	0.00	0.10	0.12
Gross margin (%)	42.7	43.6	44.2	46.1	43.2	44.4
EBITDA Margin (%)	12.9	9.9	10.3	11.9	11.7	11.7
Operating Margin (before GW and except) (%)	12.0	8.9	6.9	9.2	8.8	9.0
BALANCE SHEET						
Fixed Assets	25,428	8,860	22,942	34,635	40,165	37,948
Intangible Assets	21,296	7,332	17,751	24,380	30,716	29,351
Tangible Assets	1,598	793	3,680	7,929	7,123	6,271
Other	2,534	735	1,511	2,326	2,326	2,326
Current Assets	37,085	109,426	134,674	127,052	115,362	113,373
Stocks	3,146	2,528	3,141	4,156	4,456	4,756
Debtors	26,369	17,215	16,992	24,150	28,394	31,030
Cash	7,570	89,683	114,541	98,746	82,512	77,587
Current Liabilities	(21,051)	(13,612)	(29,366)	(43,129)	(40,030)	(41,584)
Creditors	(20,243)	(12,937)	(12,062)	(17,823)	(19,747)	(21,301)
Short term borrowings	(808)	(675)	(17,304)	(25,306)	(20,283)	(20,283)
Long Term Liabilities	(7,180)	(4,781)	(41,903)	(36,538)	(29,113)	(20,613)
Long term borrowings	(1,391)	(1,688)	(36,882)	(32,029)	(24,604)	(16,104)
Other long term liabilities	(5,789)	(3,093)	(5,021)	(4,509)	(4,509)	(4,509)
Net Assets	34,282	99,893	86,347	82,020	86,383	89,124
CASH FLOW						
Operating Cash Flow	10,676	119	2,039	(354)	5,184	7,122
Net Interest	105	(208)	(69)	3,102	0	250
Tax	(2,022)	379	(624)	(229)	(1,401)	(1,522)
Capex	(738)	(661)	(548)	(916)	(1,100)	(1,100)
Acquisitions/disposals	(5,403)	82,250	1,314	(2,178)	(4,800)	0
Financing	(828)	(6)	(7,208)	(4,287)	210	0
Dividends	(2,931)	(3,496)	(11,710)	(5,781)	0	(1,174)
Net Cash Flow	(1,141)	78,377	(16,806)	(10,643)	(1,907)	3,575
Opening net debt/(cash)	(8,259)	(5,371)	(87,320)	(60,355)	(41,412)	(37,625)
HP finance leases initiated	0	0	(2,788)	(2,500)	(2,700)	0
Other	(1,747)	3,572	(7,371)	(5,800)	820	(0)
Closing net debt/(cash)	(5,371)	(87,320)	(60,355)	(41,412)	(37,625)	(41,200)

Source: Company accounts/Edison Investment Research

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