TXT e-Solutions

Full year results

Edison investment research

Growth in a tough market

Technology

TXT reported strong growth in both divisions, despite a difficult economic environment in Italy and the retail industry, and management expects growth to continue into Q113. Integration of Maple Lake is underway, but there is still more to be done in TXT Perform to create a unified business. We trim our FY13 forecasts to reflect slightly slower growth from Maple Lake and forecast 38% EPS growth in FY14. In our view, the share price does not reflect the company's growth prospects.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/11	40.1	0.9	0.06	2.00**	129.2	25.3
12/12	46.5	4.4	0.77	0.40	10.2	5.1
12/13e	56.0	5.4	0.73	0.22	10.9	2.8
12/14e	60.9	7.5	1.01	0.30	7.8	3.8

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

FY12 results: organic and acquisition growth

While Q412 revenues were slightly weaker than we forecast, and the higher proportion of services drove weaker gross margins, this was partially compensated for by good operating expense control, resulting in a normalised operating margin of 9.2% versus 2.1% in FY11. Tax credits relating to IRAP refunds and deferred tax assets resulted in an effective tax rate of 3% and normalised EPS of €0.77 versus our €0.66 forecast. The company announced a €0.4 per share dividend, based on underlying profits and returning the remaining proceeds from selling KIT Digital shares.

Outlook and changes to forecasts

Despite the weak economic environment in Italy and difficult conditions in the retail market, the current order book leads the company to expect growth in Q113. We have slightly reduced our FY13 revenue forecast to reflect the weaker economy and delays in North American licensing, but with the mix more in favour of software, we forecast slightly higher gross margins (54.2% versus 54.0%) and normalised operating margins of 9.9% versus our previous 10.0% forecast. We have revised down our FY13 EPS forecast by 5% and introduce a FY14 forecast of 38% EPS growth. We expect the company will continue to increase its net cash position.

Valuation: Undervalued versus peers

On our revised forecasts, TXT trades on a P/E of 10.9x FY13e and 7.8x FY14e normalised EPS, which is at a 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 10x FY14e EPS (€10.1). Triggers for share price appreciation include continued strong contract wins in TXT Perform and TXT Next, evidence that operating profitability is improving, smooth integration of Maple Lake and evidence that the Maple Lake acquisition is leading to enhanced sales opportunities in both Europe and North America.

14 March 2013

Price	€7.9
Market cap	€41m

Shares in issue	5.2m
Free float	72%
Code	TXT
Net cash at end FY12 (€m)	6.0
Primary exchange	Borsa Italiana (STAR)
Other exchanges	N/A

Share price performance

%	1m	3m	12m
Abs	11.1	23.5	72.9
Rel (local)	13.4	18.9	76.7
52-week high/low		€9.2	€4.5

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 events

Shareholders Meeting	23 April 2013

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Review of FY12 results

TXT reported FY12 revenues below our forecast, with the shortfall in TXT Perform (all from Maple Lake licensing). This moved the revenue mix in favour of services and therefore reduced gross margins below our forecast. Operating expenses came in lower than expected, resulting in EBIT much closer to our forecast. The company received one-off tax refunds relating to IRAP and recognised a deferred tax asset relating to previous losses, resulting in an effective tax rate of 3% versus our 25% forecast.

Exhibit 1: Results highlights

€m	FY12e	FY12a	FY11a	Change
Revenues	47.1	46.5	40.1	15.8%
TXT Perform	27.0	26.4	22.1	19.5%
TXT Next	20.1	20.1	18.1	11.4%
Gross margin	52.9%	51.9%	51.4%	
EBIT	4.44	4.28	0.8	407.3%
EBIT margin	9.4%	9.2%	2.1%	
Normalised net income	3.40	4.26	0.32	1214.9%
Normalised EPS (€)	0.66	0.78	0.06	1172.7%
Net cash	5.33	6.02	10.27	-41.4%

Source: TXT e-Solutions and Edison Investment Research

The company sold down the remaining shares in KIT Digital (part of the consideration received for selling the Polymedia business in 2011) resulting in an exceptional gain of €0.94m in FY12. A dividend of €0.4 per share was announced, equating to a payout ratio of approximately 30% on underlying earnings plus the payout of the KIT Digital share sale proceeds. The company expects to maintain the payout ratio at around the 30% level.

TXT Perform

The original TXT Perform business generated Q4 revenues of €6.0m, in line with our forecast, equating to FY12 revenue growth for the original business of 13.5%. The new Maple Lake business generated revenues of €1.3m (€0.4m licenses and €0.9m services), lower than our €2.0m forecast, with the shortfall in licenses. We understand that this was partly an issue of revenue recognition and partly due to the time taken to integrate the business and hire new heads.

Integration of Maple Lake

The Maple Lake acquisition completed on 28 September 2012, with €8.7 net cash paid (€9.7m initial consideration less working capital adjustments and net cash acquired) and 238,854 shares issued in December. The company also recorded contingent consideration of €2.8m at the end of FY12, payable in two tranches based on results at the end of FY13 and FY14. The Maple Lake operations have been integrated into the existing TXT Perform business and TXT Perform and Maple Lake continue to sell each other's products.

TXT Next

This division reported revenues and profitability in line with our expectations. Revenues grew 7.1% y-o-y in Q412 and 11.4% in FY12.

Outlook and changes to forecasts

The company will work on further integrating the Maple Lake business, including expanding the sales team; current discussions regarding TXT Perform business are positive. The current order book points to growth in Q113, despite the difficult retail environment and economic situation in Italy.

We have reduced our revenue forecast for FY13 by 1%, reflecting slightly slower growth from the North American business. This equates to y-o-y growth of 20.5% and includes Maple Lake for a full year. We introduce an 8.7% group revenue growth rate for FY14. Based on the mix of software and services, we forecast growth in the gross margin from 51.9% in FY12 to 55.7% in FY14. We forecast growth in commercial and G&A costs in FY14, with flat R&D as Maple Lake R&D is integrated with the existing TXT Perform R&D. This results in growth in our normalised EBIT margin forecast from 9.2% in FY12 to 12.3% in FY14. We continue to factor in a 25% tax rate for FY13-14.

With a higher diluted share count than previously forecast, we reduce our FY13 EPS forecast by 5% and reduce our dividend forecast to reflect the target 30% payout ratio.

Our FY13 lower net cash forecast reflects higher working capital. We note that this does not include the payment of contingent consideration for Maple Lake of €2.8m. We assume €1.4m of this is paid in FY14 and the remaining €1.4m in FY15.

Exhibit 2: Changes to forecasts

	FY13 old	FY13 new	change	FY14 new
Revenues (€m)	56.5	56.0	-0.9%	60.9
Gross margin	54.0%	54.2%		55.7%
Normalised EBIT (€m)	5.6	5.5	-2.0%	7.5
Normalised EBIT margin	10.0%	9.9%		12.3%
Normalised net income (€m)	4.1	4.1	-2.0%	5.6
Normalised EPS (€)	0.77	0.73	-5.4%	1.01
Net cash (€m)	9.3	8.2	-11.0%	11.4
Dividend (€)	0.24	0.22	-8.3%	0.30

Source: Edison Investment Research

Valuation

On our revised forecasts, TXT trades on a P/E of 10.9x FY13e and 7.8x FY14e normalised EPS (see Exhibit 3). With a business split 50/50 between software and services, we would expect TXT to trade somewhere between the two groups. Applying a small-cap company discount to the overall peer group, we view a multiple of 10x FY13e EPS as reasonable, equating to a share price of €10.1. Triggers for share price appreciation include continued strong licensing in TXT Perform, continued contract wins in TXT Next, evidence that operating profitability is improving, smooth integration of Maple Lake and evidence that the Maple Lake acquisition is leading to enhanced sales opportunities in both Europe and North America.

Recent acquisitions – supply chain software in demand

Two recent acquisitions, which although are of larger, more established companies than TXT, highlight the value of supply chain software to enterprise software vendors. In December 2012, JDA Software was acquired by RedPrairie (itself privately owned) for an enterprise value of $1.9bn, combining to create a company with annual revenues of more than $1bn. This valued JDA on an EV/Sales basis of 2.8x FY12e and a P/E of 21.2x FY12e. In February, NCR completed its acquisition of Retalix for $650m, valuing the business at an EV/Sales multiple of 2.4x FY12e and 2.2x FY13e and a P/E of

35.7x FY12e and 26.8x FY13e. Retalix was forecast to grow at 10%+ for FY12 and FY13 with EBIT margins of c 10%.

Exhibit 3: Peer group valuation

Company	Share price	Market cap	Rev growth		EBIT margin		EBITDA margin		EV/Sales		P/E	
		m	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	*€ 7.90*	*€ 41*	*20.5%*	*8.7%*	*9.9%*	*12.3%*	*11.6%*	*14.0%*	*0.7*	*0.6*	*10.9*	*7.8*
Software companies with SCM software offerings												
American Software	$8.50	$231									18.1	15.2
Descartes	$9.87	$618	11.8%	13.5%	16.3%	22.1%	30.1%	31.5%	3.9	3.4	17.6	17.3
Manhattan Associates	$72.09	$1,415	9.7%	9.5%	24.1%	25.2%	25.8%	26.8%	3.2	2.9	22.7	20.1
MICROS Systems	$42.74	$3,391	8.9%	4.7%	21.5%	21.6%	23.7%	24.1%	2.0	1.9	15.6	14.6
Oracle	$35.96	$170,222	6.5%	6.1%	47.5%	48.1%	50.0%	51.1%	3.5	3.1	12.1	11.1
SAP	€ 64.00	€ 88,022	11.6%	9.8%	30.9%	32.5%	34.3%	36.1%	4.8	4.3	18.5	16.2
Totvs	R 43.12	R 6,969	13.0%	11.1%	24.5%	25.2%	27.4%	28.1%	4.2	3.7	22.6	19.5
Average			**10.3%**	**9.1%**	**27.4%**	**29.1%**	**31.9%**	**33.0%**	**3.6**	**3.2**	**18.2**	**16.3**
European IT services companies												
AtoS	€ 57.25	€ 4,834	0.9%	2.4%	7.1%	7.6%	11.2%	11.6%	0.5	0.4	12.2	11.6
Cap Gemini	€ 38.28	€ 5,878	1.2%	3.1%	7.7%	8.1%	10.0%	10.4%	0.5	0.4	13.0	11.9
Computacenter	£5.02	£773	4.1%	3.0%	2.6%	2.8%	3.8%	3.9%	0.2	0.2	12.1	11.1
Devoteam	€ 10.30	€ 100	-2.2%	2.3%	4.7%	5.9%	5.9%	7.1%	0.1	0.1	8.0	6.5
Engineering II	€ 30.60	€ 373	2.5%	2.6%	9.7%	9.8%	12.4%	12.4%	0.5	0.4	8.9	8.5
Groupe Steria	€ 12.41	€ 365	0.9%	3.1%	6.0%	6.8%	8.3%	9.0%	0.3	0.3	5.7	4.9
Sopra Group	€ 57.00	€ 677	3.5%	3.9%	8.7%	8.9%	9.9%	10.3%	0.7	0.6	9.6	8.9
SQS	£2.76	£72	7.8%	11.3%	5.9%	6.5%	9.0%	9.1%	0.4	0.3	8.9	7.1
Average			**2.3%**	**4.0%**	**6.6%**	**7.0%**	**8.8%**	**9.2%**	**0.4**	**0.4**	**9.8**	**8.8**

Source: Thomson and Edison Investment Research

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Exhibit 4: 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	56,016	60,916
Cost of sales	(18,757)	(19,522)	(22,366)	(25,647)	(27,007)
Gross profit	18,701	20,616	24,133	30,369	33,909
EBITDA	2,769	4,397	5,320	6,519	8,509
Operating Profit (before amort and except)	(776)	843	4,258	5,519	7,509
Amortisation of acquired intangibles	0	0	0	(500)	(500)
Exceptionals and other income	13	(4,581)	924	0	0
Other income	0	0	0	0	0
Operating Profit	(763)	(3,738)	5,182	5,019	7,009
Net Interest	(198)	72	130	(100)	0
Profit Before Tax (norm)	(974)	915	4,388	5,419	7,509
Profit Before Tax (FRS 3)	(961)	(3,666)	5,312	4,919	7,009
Tax	255	(591)	(176)	(1,230)	(1,752)
Profit After Tax (norm)	(719)	324	4,243	4,065	5,632
Profit After Tax (FRS 3)	(706)	(4,257)	5,136	3,690	5,257
Average Number of Shares Outstanding (m)	5.1	5.1	5.0	5.1	5.1
EPS - normalised (c)	(14)	6	85	79	110
EPS - normalised fully diluted (c)	(13)	6	77	73	101
EPS - (IFRS) (c)	4	281	103	72	103
Dividend per share (c)	0.00	200.00	40.00	22.00	30.00
Gross margin (%)	49.9%	51.4%	51.9%	54.2%	55.7%
EBITDA Margin (%)	7.4	11.0	11.4	11.6	14.0
Operating Margin (before GW and except) (%)	-2.1	2.1	9.2	9.9	12.3
BALANCE SHEET					
Fixed Assets	14,328	7,735	21,815	20,895	19,895
Intangible Assets	11,526	6,561	19,866	18,654	17,554
Tangible Assets	1,528	819	1,154	1,446	1,546
Other	1,274	355	795	795	795
Current Assets	28,876	32,145	36,769	42,255	47,468
Stocks	793	661	1,388	1,200	1,200
Debtors	21,453	15,083	19,562	23,020	25,034
Cash	6,630	14,181	15,819	18,035	21,234
Other	0	2,220	0	0	0
Current Liabilities	(17,719)	(14,049)	(20,631)	(24,947)	(26,570)
Creditors	(15,615)	(12,292)	(15,135)	(19,451)	(21,074)
Short term borrowings	(2,104)	(1,757)	(5,496)	(5,496)	(5,496)
Long Term Liabilities	(8,398)	(5,567)	(11,770)	(10,370)	(8,970)
Long term borrowings	(3,870)	(2,155)	(4,301)	(4,301)	(4,301)
Other long term liabilities	(4,528)	(3,412)	(7,469)	(6,069)	(4,669)
Net Assets	17,087	20,264	26,183	27,833	31,823
CASH FLOW					
Operating Cash Flow	9,967	19,265	3,734	6,165	8,119
Net Interest	(198)	166	188	(100)	0
Tax	255	390	(176)	(1,230)	(1,752)
Capex	(2,340)	(2,159)	(822)	(500)	(500)
Acquisitions/disposals	(137)	2,403	(8,700)	0	(1,400)
Financing	324	(106)	1,501	0	0
Dividends	0	(10,292)	0	(2,120)	(1,268)
Net Cash Flow	7,871	9,667	(4,275)	2,215	3,199
Opening net debt/(cash)	7,248	(723)	(10,266)	(6,023)	(8,238)
HP finance leases initiated	0	0	0	0	0
Other	100	(124)	32	(0)	(0)
Closing net debt/(cash)	(723)	(10,266)	(6,023)	(8,238)	(11,437)

Source: TXT e-Solutions and Edison Investment Research

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