TXT e-solutions

FY15 results

TXT Next is next for international expansion

Software & comp services

TXT reported strong FY15 revenue growth of 13%, with double-digit growth from both divisions, and normalised EPS ahead of our forecast. The planned acquisition of PACE adds higher-margin aerospace software capability and accelerates TXT Next's quest to expand its addressable market outside of Italy. We have incorporated PACE into our estimates, forecasting normalised EPS growth of 16% in FY16 and 9% in FY17.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/14	54.4	4.0	0.28	0.23	29.8	3.5
12/15	61.5	5.7	0.40	0.25	20.9	2.4
12/16e	70.3	7.1	0.47	0.26	17.8	2.0
12/17e	74.5	7.7	0.51	0.27	16.4	1.9

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

FY15 results ahead of expectations

TXT reported revenues 1.5% ahead of our forecast for FY15, with EBITDA 2.6% ahead (EBITDA margin 10.8%) and normalised EPS 7.9% ahead. Revenue growth was 12.4% for TXT Perform and 14.2% for TXT Next. Late payments post year-end by several large customers took year-end net cash below our forecast.

TXT Next acquisition enhances software capabilities

TXT is on track to acquire PACE on 1 April for consideration of up to €7.5m in cash. The addition of PACE brings specialist aerospace software to TXT Next's existing (predominantly Italian) aerospace business, as well as a larger international customer base. We have incorporated the company into our forecasts from the beginning of Q216, forecasting a revenue contribution of €5.4m in FY16 and €7.6m in FY17 at a similar EBITDA margin to the existing TXT group margin.

Forecasts and valuation: Growing software contribution to boost profitability

As a result of incorporating PACE and slightly increasing our growth assumptions for TXT Perform, we raise our FY16 revenue forecast by 11% (14% y-o-y growth) and our normalised EPS forecast by 3%, and introduce a FY17 revenue growth forecast of 6% with EPS growth of 9%. The stock trades on a P/E of 17.1x FY16e and 15.7x FY17e based on normalised EPS. This is a discount to global supply chain software vendors and a premium to European IT services companies, which is reasonable considering the current split of the business. Even after acquiring PACE, we forecast a strong net cash position and a dividend yield above 3% for FY16/17. If TXT is able to successfully integrate and grow the PACE business as well as sell TXT Next's existing services to PACE's international customer, we see scope for stronger growth in TXT Next and margin enhancement. For TXT Perform, key growth drivers include the North American business and the recently established Asia Pacific operations.

11 March 2016

Price	**€7.59**
Market cap	**€99m**
	$1.10:€
Net cash (€m) at end FY15	8.3
Shares in issue	11.7m
Free float	43%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	2.6	(4.3)	(13.1)
Rel (local)	(5.2)	12.4	5.1
52-week high/low		€9.36	€7.11

Business description

TXT e-solutions has two divisions: TXT Perform, 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 event

Q116 results	13 May 2016

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Review of FY15 results

Exhibit 1: FY15 results highlights

€m	FY15e	FY15a	Diff.	y-o-y
Revenues	**60.6**	**61.5**	**1.5%**	**13.1%**
TXT Perform	36.2	36.7	1.2%	12.4%
TXT Next	24.4	24.9	2.0%	14.2%
Gross margin	*52.0%*	*52.6%*	*0.5pp*	
Gross profit	31.5	32.4	2.6%	15.7%
EBITDA	**6.5**	**6.7**	**2.5%**	**25.1%**
EBITDA margin	*10.7%*	*10.8%*	*0.1pp*	
Normalised EBIT	**5.7**	**5.8**	**2.3%**	**35.9%**
Normalised EBIT margin	*9.4%*	*9.5%*	*0.1%*	
Normalised net income	4.4	4.7	7.0%	46.9%
Normalised EPS (€)	**0.37**	**0.40**	**7.9%**	**45.5%**
Reported basic EPS (€)	0.34	0.33	-2.0%	-8.6%
Net cash (€m)	12.2	8.3	-32.3%	-2.4%
Dividend (€)	0.24	0.25	5.8%	10.0%

Source: TXT e-solutions, Edison Investment Research

TXT reported revenue growth of 13.1% for FY15, with both TXT Perform and TXT Next achieving double-digit growth rates. With a higher proportion of software licensing in FY15 than in FY14, gross margin expanded by 1.2pp to 52.6%. Despite higher investment over the year in R&D and sales & marketing and legal costs incurred in Q415 for the PACE acquisition, EBITDA grew 25% y-o-y, achieving an EBITDA margin of 10.8% (FY14: 9.8%). Year-end net cash was affected by delays in payment by several large customers, leading to a higher than expected year-end debtor position. These invoices were paid in January. The company announced a dividend of €0.25 for FY15, marginally above our €0.24 estimate.

Business update

TXT Next expands with the acquisition of PACE

TXT recently announced that it had agreed to acquire 79% of PACE, a German software vendor focused on the aerospace market.

Terms of the deal

TXT is paying initial cash consideration of €5.6m for 79% of the company held by private equity investors (eCAPITAL, Strategic European Technologies and IBB Beteiligungsgesellschaft). There is also a put/call option for the remaining 21% stake (owned by the three founders) exercisable from 1 January 2020 to 31 December 2021. Contingent consideration of c €1.9m is payable in 2016 and 2017 subject to meeting targets for FY15 and FY16. Taking into account estimated closing net cash of €1.7m, the consideration values PACE on a historic EV/sales multiple of 0.7x initial and 1.1x maximum consideration and EV/EBITDA of 6.7x and 9.7x respectively. In our view, this valuation is attractive considering the cross-selling potential offered by the business. The acquisition is scheduled to complete on 1 April 2016.

Background

PACE was founded in Michael Kokorniak, Dr Oliver Kranz and Alexander Schneegans and now has 70 employees, with the majority based at its Berlin headquarters. The business specialises in developing and selling software to the aerospace industry. The table below summarises the company's product range:

Exhibit 2: PACE product suite

Solution	Functionality
Preliminary aircraft design	
Pacelab Suite	Platform that supplies functional & procedural infrastructure for early-stage product design.
Pacelab APD	Supports development of conventional and unconventional aircraft in the conceptual and preliminary design phases.
Pacelab SysArc	Built on Pacelab APD, adds a functional layer for building, analysing and optimizing system and sub-system architectures.
Aircraft marketing & acquisition	
Pacelab Cabin	Aircraft and cabin configurator that supports aircraft manufacturers, seat & component suppliers, airlines and consultants with detailed cabin investigations and feasibility studies.
Pacelab Mission Suite	Integrated software solution for route analysis, aircraft performance and economic investigations.
Pacelab Route Network Analyser	Windows app which brings the route analysis capabilities of Pacelab Mission Suite to tablet computers and mobile phones.
Flight operations	
Pacelab CI Ops	Enables flight crews to flexibly determine the most cost-efficient trajectory whenever flight conditions have changed.
Pacelab Flight Profile Optimiser	Complements the functional scope of flight management systems with advanced flight profile optimization capabilities.
Pacelab EFB Flight Data Recorder	Collects user-definable operational efficiency parameters from the ARINC buses 429 and 717, which can be made available for post-flight analysis.

Source: PACE

Customers include more than 50 companies covering aircraft and engine manufacturing, airlines, civil and defence operators, and maintenance, repair and overhaul (MRO), including Airbus, Air France & KLM Engineering, Boeing, COMAC, Delta Airlines, Embraer, GE Aviation, Lufthansa, Rolls-Royce, Safran Group and Sukhoi.

Deal rationale

TXT Next already has a significant aerospace-focused business, providing IT, consulting and R&D services to mainly Italian-based business such as Finmeccanica. The addition of PACE brings specialist aerospace software as well as a larger international customer base. From PACE's perspective, TXT Next has a large number of qualified consultants who are able to provide services to PACE's client base. The business will continue to trade under the PACE brand with the three founders continuing as managing directors.

TXT Perform: Strong performance from Retail business

During FY15 the division made progress with its internationalisation plans, opening an office in Hong Kong and subsequently winning a substantial contract (licence fee of more than €1m) with Duty Free Stores in Q216 out of this office. Exhibit 3 shows how lumpy licensing revenues contribute to variability in divisional revenues on a quarterly basis.

Exhibit 3: TXT Perform revenues

€m	Q114	Q214	Q314	Q414	Q115	Q215	Q315	Q415
Revenues	8.67	7.95	7.71	8.30	8.64	10.16	8.45	9.43
Q-o-Q	11.6%	-8.3%	-3.0%	7.7%	4.1%	17.6%	-16.9%	11.7%
Y-o-Y	10.9%	5.0%	-9.3%	6.8%	-0.4%	27.8%	9.5%	13.6%

Source: TXT e-solutions

In 2015, the division signed software contracts with a variety of international customers, including Columbia Sportsware (US), Adidas (Germany), Gazal (Australia), Swatch (Switzerland), Sonae (Portugal), Furla (Italy), Monoprix (France) and White Stuff (UK).

Outlook and changes to forecasts

The company has highlighted that TXT Perform may see slowing growth in Q116, reflecting the conversion of the pipeline in Q415 and negotiations with customers for contracts likely to fall into Q216.

We have incorporated PACE into our forecasts from the beginning of Q216. We assume a revenue contribution of €5.4m in FY16 rising to €7.6m in FY17. We assume that it has a similar gross margin profile to TXT for software license sales, maintenance, and services. We note that the PACE acquisition adds a higher margin software component to TXT Next, which has traditionally generated revenues from services. This drives an increase in our revenue forecast of 11.2%, dropping down to a normalised EPS increase of 3.3%, after taking into account the PACE minority interest. We have assumed that the contingent consideration of €1.9m is paid out over the course of FY16 and FY17.

We introduce FY17 forecasts for TXT, assuming revenue growth of 2.3% for TXT Perform and 4.2% organic revenue growth for TXT Next. This results in group revenue growth of 6.0% and normalised EPS growth of 8.7%.

We have marginally increased our dividend forecast for FY16 and introduce a €0.27 forecast for FY17.

Exhibit 4: Changes to forecasts

	FY16e old	FY16e new	change	y-o-y	FY17e new	y-o-y
Revenues (€m)	63.2	70.3	11.2%	14.2%	74.5	6.0%
TXT Perform	37.8	38.9	3.0%	6.1%	39.8	2.3%
TXT Next	25.5	31.4	23.3%	26.3%	34.7	10.5%
Gross margin	50.9%	53.6%	2.7%		53.7%	0.1%
Gross profit (€m)	32.2	37.7	17.0%	16.4%	40.0	6.2%
EBITDA (€m)	7.4	7.9	6.6%	18.6%	8.5	7.9%
EBITDA margin	11.7%	11.2%	-0.5%		11.4%	0.2%
Normalised EBIT (€m)	6.8	7.2	4.9%	22.9%	7.8	8.8%
Normalised EBIT margin	10.8%	10.2%	-0.6%		10.4%	0.3%
Normalised net income (€m)	5.4	5.5	3.1%	16.9%	6.0	8.7%
Normalised EPS (€)	0.45	0.47	3.3%	16.2%	0.51	8.7%
Reported basic EPS (€)	0.42	0.43	2.0%	28.8%	0.46	8.1%
Net cash (€m)	14.7	7.2	-50.7%	-12.3%	8.7	20.3%
Dividend (€)	0.25	0.26	5.9%	4.0%	0.27	3.8%

Source: Edison Investment Research

Exhibit 5: 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	70,293	74,484
Cost of sales		(22,351)	(24,854)	(26,455)	(29,189)	(32,623)	(34,487)
Gross profit		24,148	27,706	27,955	32,351	37,670	39,998
EBITDA		5,322	6,263	5,324	6,659	7,900	8,528
Operating Profit (before amort and except)		4,283	5,241	4,284	5,820	7,150	7,778
Amortisation of acquired intangibles		0	(285)	(285)	(285)	(285)	(285)
Exceptionals and other income		939	0	1,468	0	0	0
Other income		0	0	0	(740)	(400)	(500)
Operating Profit		5,222	4,956	5,467	4,795	6,465	6,993
Net Interest		(37)	(435)	(249)	(151)	(100)	(100)
Profit Before Tax (norm)		4,246	4,806	4,035	5,669	7,050	7,678
Profit Before Tax (FRS 3)		5,185	4,521	5,218	4,644	6,365	6,893
Tax		(188)	121	(1,046)	(762)	(1,273)	(1,379)
Profit After Tax (norm)		4,092	4,927	3,226	4,739	5,640	6,142
Profit After Tax (FRS 3)		4,997	4,642	4,172	3,882	5,092	5,514
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	48	52
EPS - normalised fully diluted (c)		34	41	28	40	47	51
EPS - (IFRS) (c)		45	40	36	33	43	46
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	53.6	53.7
EBITDA Margin (%)		11.4	11.9	9.8	10.8	11.2	11.4
Operating Margin (before GW and except) (%)		9.2	10.0	7.9	9.5	10.2	10.4
BALANCE SHEET							
Fixed Assets		18,570	17,850	18,019	18,132	23,617	23,302
Intangible Assets		16,621	15,370	15,078	14,692	20,177	19,862
Tangible Assets		1,154	1,118	1,249	1,361	1,361	1,361
Other		795	1,362	1,692	2,079	2,079	2,079
Current Assets		36,769	34,914	34,892	38,946	39,128	42,418
Stocks		1,388	1,451	1,820	2,075	2,175	2,275
Debtors		19,562	18,642	20,768	27,791	28,888	30,610
Cash		15,819	14,821	12,304	9,080	8,066	9,533
Other		0	0	0	0	0	0
Current Liabilities		(20,651)	(17,864)	(17,451)	(18,349)	(21,440)	(21,432)
Creditors		(15,155)	(14,512)	(15,297)	(17,528)	(20,619)	(20,611)
Short term borrowings		(5,496)	(3,352)	(2,154)	(821)	(821)	(821)
Long Term Liabilities		(8,666)	(6,965)	(6,491)	(5,105)	(5,105)	(5,105)
Long term borrowings		(4,301)	(2,896)	(1,685)	0	0	0
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	36,201	39,183
CASH FLOW							
Operating Cash Flow		2,760	7,630	5,404	2,412	9,194	7,298
Net Interest		(37)	(435)	(249)	(151)	(100)	(100)
Tax		64	(1,615)	(1,344)	(1,461)	(1,273)	(1,379)
Capex		(405)	(483)	(615)	(763)	(720)	(720)
Acquisitions/disposals		(8,450)	19	0	0	(5,200)	(600)
Financing		1,690	(755)	(597)	2,215	0	0
Dividends		0	(2,107)	(2,615)	(2,678)	(2,915)	(3,032)
Net Cash Flow		(4,378)	2,254	(16)	(426)	(1,014)	1,468
Opening net debt/(cash)		(10,266)	(6,023)	(8,575)	(8,465)	(8,259)	(7,245)
HP finance leases initiated		0	0	0	0	0	0
Other		135	298	(94)	220	(0)	0
Closing net debt/(cash)		(6,023)	(8,575)	(8,465)	(8,259)	(7,245)	(8,712)

Source: TXT e-solutions, Edison Investment Research

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