# TXT e-solutions

H117 results

## Focus turns to TXT Next

Software & comp services

**TXT reported H117 revenue growth of 8.9% y-o-y, with a small decline in Q217 revenues of 1.1%. The company has agreed to sell the TXT Retail business for €85m with completion expected by the end of October. While we continue to include TXT Retail in our forecasts until the deal completes, we provide an illustration of the TXT Group income statement taking into account the disposal.**

| Year end | Revenue (€m) | PBT* (€m) | FD EPS* (€) | DPS (€) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 12/15 | 61.5 | 5.7 | 0.40 | 0.25 | 30.0 | 2.1 |
| 12/16 | 69.2 | 8.1 | 0.55 | 0.30 | 21.9 | 2.5 |
| 12/17e | 73.8 | 7.4 | 0.47 | 0.32 | 25.6 | 2.7 |
| 12/18e | 79.4 | 8.9 | 0.55 | 0.33 | 21.9 | 2.7 |

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

## H117: Cost growth outpaced revenue growth

TXT grew revenues 8.9% y-o-y in H117 (21.7% growth in Q117 and -1.1% in Q217). Organic growth was 3.7% in H117. TXT Retail grew 2.6% y-o-y in H117; TXT Next grew 16.2%. Higher growth in operating expenses in the period resulted in a 5.5% decline in EBITDA and 7.9% decline in EBIT y-o-y. The company ended H117 with net cash of €5.5m. Management expects a positive development of revenues and profits for both divisions in Q317. We have revised our forecasts to reflect Q217 performance, higher tax rates, and higher revenues for TXT Next in FY18. Our normalised EPS forecasts fall by 12.7% in FY17e and 6.7% in FY18e.

## Sale of TXT Retail for €85m

The company has agreed to sell TXT Retail for €85m in cash with completion of the deal by the end of October. Our forecasts will include TXT Retail until the deal completes, but we have provided an illustration of the TXT Group income statement assuming completion on 31 October. The amount of special dividend to be paid out in FY18 has not yet been specified, but we assume a proportion of the proceeds will be retained to support investment in TXT Next and TXT Sense.

## Valuation: Good price for TXT Retail

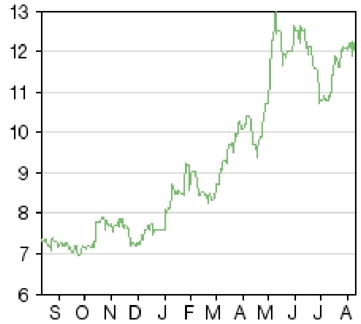
On our revised forecasts, TXT is trading on a P/E of 25.6x FY17e and 21.9x FY18e. We estimate that proceeds of €85m value TXT Retail on an EV/EBITDA multiple of 20.6x for FY17e and 17.5x for FY18e. We estimate that the remaining business is valued on an EV/EBITDA multiple of 10.4x FY17e and 13.7x FY18e. On a special dividend pay-out of €50m (which leaves €35m in the business to support growth plans), we estimate the remaining business would be valued on a P/E of 27.2x FY17e and 35.1x FY18e. This appears high, but does not take into account the use of the remaining €35m of proceeds for value-enhancing acquisitions.

**10 August 2017**

| | |
|---|---|
| **Price** | **€12.03** |
| **Market cap** | **€141m** |

| | |
|---|---|
| Net cash (€m) at end H117 | 5.5 |
| Shares in issue | 11.7m |
| Free float | 45.5% |
| Code | TXT |
| Primary exchange | Borsa Italiana (STAR) |
| Secondary exchange | N/A |

### Share price performance




| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | 11.4 | (6.8) | 61.7 |
| Rel (local) | 7.2 | (8.2) | 23.9 |
| 52-week high/low | | €13.0 | €7.0 |

### Business description

TXT e-solutions has two divisions: TXT Retail, 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 events

| | |
|---|---|
| Q317 results | 7 November 2017 |

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***TXT e-solutions is a research client of Edison Investment Research Limited***

# Review of H117 results

**Exhibit 1: H1 results highlights**

| €m | H117a | H116a | Change |
|---|---|---|---|
| Revenues | 36.1 | 33.2 | 8.9% |
| TXT Retail | 18.2 | 17.8 | 2.6% |
| TXT Next | 17.9 | 15.4 | 16.2% |
| Gross margin | 53.1% | 52.2% | 0.8% |
| EBITDA | 3.4 | 3.6 | -5.5% |
| EBITDA margin | 9.5% | 10.9% | -1.4% |
| Normalised EBIT | 3.1 | 3.3 | -7.9% |
| Normalised EBIT margin | 8.4% | 10.0% | -1.5% |
| Reported EBIT | 2.6 | 2.8 | -7.6% |
| Reported EBIT margin | 7.1% | 8.4% | -1.3% |
| Net cash | 5.5 | 0.5 | 1000.0% |

Source: TXT e-solutions, Edison Investment Research

TXT grew revenues 8.9% y-o-y in H117, 21.7% growth in Q117 and -1.1% in Q217. Organic growth was 3.7% (Q117: 11.4%; Q217: -1.1%). The gross margin improved over the period, even though the mix of licences and services was unchanged. Operating costs (excluding depreciation and amortisation) increased 14.8% y-o-y, resulting in a decline in EBITDA and EBITDA margins over the period. Net cash at the end of H117 had increased marginally from the €5.4m at the end of FY16, as the dividend totalling €3.5m was paid in H1.

## TXT Retail

TXT Retail saw revenue growth of 2.6% in H117, with 14.1% growth in Q117 and a 6.8% decline in Q217. Divisional gross margin of 62.4% was 0.5 percentage points higher than a year ago. For the first time, the company has provided a split of EBITDA by division. TXT Retail generated EBITDA of €1.47m in H117, a margin of 8.1% (versus the group margin of 9.5%).

## TXT Next

TXT Next saw revenue growth of 16.2% in H117, with 38.0% growth in Q117 and 0.3% growth in Q217. PACE was integrated from 1 April 2016; organic growth for H117 was 6% and for Q117 was 8%. The divisional EBITDA of €1.95m equated to a margin of 10.9%.

In May, the company announced that it had created a new sub-division within TXT Next called TXT Sense. This is a start-up business with proprietary technology for augmented and virtual reality. The plan is to market this technology to the industrial, communication and service sectors.

## Changes to forecasts

We have left our H217 forecasts substantially unchanged, bar an increase in the tax rate from 22% to 27% reflecting the higher rate incurred year-to-date. Taking into account lower than expected Q2 revenues, this results in an overall decline in our revenue forecast for FY17e of 1.8%. This flows down to a decline in EBITDA of 6.2% and a reduced EBITDA margin forecast from 11.4% to 10.9%.

Based on management's increased focus on TXT Next after the disposal of TXT Retail, we have increased our revenue growth assumptions for TXT Next in FY18 from 4.5% to 8.1% and increased our tax rate assumption from 22% to 28%.

Exhibit 2: Changes to forecasts

| | FY17e old | FY17e new | change | y-o-y | FY18e old | FY18e new | change | y-o-y |
|---|---|---|---|---|---|---|---|---|
| Revenues (€m) | 75.2 | 73.8 | -1.8% | 6.8% | 78.5 | 79.4 | 1.2% | 7.5% |
| TXT Retail | 38.8 | 37.8 | -2.6% | 4.6% | 40.4 | 40.4 | 0.0% | 7.0% |
| TXT Next | 36.4 | 36.1 | -1.0% | 9.1% | 38.1 | 39.0 | 2.4% | 8.1% |
| Gross margin | 53.9% | 53.7% | -0.2% | 0.1% | 53.9% | 53.8% | -0.1% | 0.1% |
| Gross profit | 40.6 | 39.7 | -2.2% | 6.9% | 42.3 | 42.7 | 1.0% | 7.7% |
| EBITDA (€m) | 8.6 | 8.1 | -6.2% | -7.4% | 9.5 | 9.6 | 1.0% | 18.4% |
| EBITDA margin | 11.4% | 10.9% | -0.5% | -1.7% | 12.1% | 12.0% | 0.0% | 1.1% |
| Normalised EBIT (€m) | 7.9 | 7.3 | -6.8% | -7.9% | 8.7 | 8.8 | 1.0% | 20.2% |
| Normalised EBIT margin | 10.5% | 9.9% | -0.5% | -1.6% | 11.1% | 11.1% | 0.0% | 1.2% |
| Normalised net income (€m) | 6.2 | 5.4 | -12.7% | -15.1% | 6.9 | 6.4 | -6.7% | 18.3% |
| Normalised EPS (€) | 0.53 | 0.47 | -12.7% | -14.8% | 0.59 | 0.55 | -6.7% | 18.4% |
| Reported basic EPS (€) | 0.46 | 0.41 | -10.3% | -13.7% | 0.51 | 0.51 | -0.6% | 24.7% |
| Net cash (€m) | 7.2 | 6.9 | -3.8% | 28.5% | 11.4 | 9.7 | -14.8% | 41.1% |
| Dividend (€) | 0.32 | 0.32 | 0.0% | 6.7% | 0.33 | 0.33 | 0.0% | 3.1% |

Source: Edison Investment Research

# Disposal of TXT Retail business

On 24 July, TXT announced that it had agreed to sell its retail business to Aptos, a North American retail software company. TXT will receive cash proceeds of €85m, which will be adjusted for working capital and cash in the business on the date of completion. There is no deferred or contingent consideration. The deal is expected to complete by the end of October.

TXT will also be entitled to exercise an option to buy up to 10% of the number of shares sold in an IPO, at the IPO price. This option will have a duration of three years from the disposal date.

Based on our current forecasts for TXT Retail, this values the business at an EV/sales multiple of 2.3x for FY17e and 2.1x for FY18e. Assuming that TXT Retail EBITDA margin is the same as the group average for both years, this equates to an EV/EBITDA multiple of 20.6x FY17e and 17.5x FY18e.

## Illustration of remaining business

We have made a first attempt at forecasting how the remaining TXT business will look post-acquisition. We have made the following assumptions to arrive at our estimates:

- We use the revised TXT Next forecasts described above.
- We assume that all TXT Retail results until the date of disposal are recorded in discontinued operations. We use our revised TXT Retail forecasts and a disposal date of 31 October. We apply the same tax rate as the group tax rate.
- We have assumed the remaining group EBITDA margin in FY18 is lower than the existing group average, as it will bear in full the costs of being a public company.
- We use cash proceeds of €85m and make no working capital adjustments.
- We assume the proceeds are retained in full, although we expect a proportion to be paid out as a special dividend next year. We use a 0.5% interest rate for the proceeds.

**Exhibit 3: TXT Group income statement post disposal – illustration**

| €m | FY17e | FY18e |
|---|---|---|
| Revenues | 36.06 | 38.98 |
| Gross profit | 15.78 | 16.91 |
| EBITDA | 4.63 | 3.51 |
| D&A | (0.35) | (0.35) |
| Adjusted EBIT | 4.28 | 3.16 |
| Acquired amortisation | (0.35) | (0.35) |
| Share-based payments | (0.24) | 0.00 |
| Exceptionals* | 0.00 | 0.00 |
| Reported EBIT | 3.69 | 2.81 |
| Net interest | 0.17 | 0.53 |
| Adjusted PBT | 4.46 | 3.68 |
| Reported PBT | 3.86 | 3.33 |
| Tax | (1.04) | (0.93) |
| Normalised tax | (1.20) | (1.03) |
| Adjusted PAT | 3.25 | 2.65 |
| Reported PAT | 2.82 | 2.40 |
| Discontinued operations | 1.55 | 0.00 |
| Reported net income | 4.37 | 2.40 |
| Adjusted EPS (€) | 0.28 | 0.23 |
| Reported EPS (€) | 0.37 | 0.21 |
| No. shares (m) | 11.7 | 11.7 |
| Share price (€) | 11.88 | |
| P/E – uses adjusted EPS | 42.6 | 52.2 |

Source: Edison Investment Research. Note: *not yet known – would expect this to include gain on disposal of TXT Retail plus associated costs.

The company expects to propose a special dividend when FY17 results are approved at the March 2018 annual shareholders' meeting. Management has not specified how much of the sale proceeds will be paid out as a dividend, and we expect a proportion of the proceeds will be retained to fund acquisitions for the TXT Next business and to invest in the growth of the newly created TXT Sense business.

In the table below, we show the implied EV/EBITDA multiples for the remaining business and the impact on the P/E multiples and share price of a special dividend of €50m.

**Exhibit 4: Valuation impact**

| €m | | FY17e | FY18e |
|---|---|---|---|
| Current market cap | 138.4 | | |
| Net cash at end FY16 plus proceeds | 90.4 | | |
| EV | 48.1 | | |
| EV/EBITDA (x) | | 10.7 | 14.2 |
| Assume special dividend | 50 | | |
| New market cap | 88.4 | | |
| New implied share price (€) | 7.58 | | |
| P/E – uses adjusted EPS less net interest on €50m | | 27.2 | 35.1 |

Source: Edison Investment Research

**Exhibit 5: Financial summary**

| €000s | 2012 | 2013 | 2014 | 2015 | 2016 | 2017e | 2018e |
|---|---|---|---|---|---|---|---|
| Year end 31 December | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS |
| **PROFIT & LOSS** | | | | | | | |
| Revenue | 46,499 | 52,560 | 54,410 | 61,540 | 69,152 | 73,827 | 79,383 |
| Cost of sales | (22,351) | (24,854) | (26,455) | (29,189) | (32,039) | (34,151) | (36,662) |
| Gross profit | 24,148 | 27,706 | 27,955 | 32,351 | 37,113 | 39,676 | 42,721 |
| EBITDA | 5,322 | 6,263 | 5,324 | 6,659 | 8,715 | 8,068 | 9,551 |
| Operating profit (before amort and except) | 4,283 | 5,241 | 4,284 | 5,820 | 7,956 | 7,329 | 8,812 |
| Amortisation of acquired intangibles | 0 | (285) | (285) | (285) | (550) | (637) | (637) |
| Exceptionals and other income | 939 | 0 | 1,468 | 0 | (500) | 0 | 0 |
| Other income | 0 | 0 | 0 | (740) | 0 | (243) | 0 |
| Operating profit | 5,222 | 4,956 | 5,467 | 4,795 | 6,906 | 6,449 | 8,175 |
| Net Interest | (37) | (435) | (249) | (151) | 105 | 100 | 100 |
| Profit before tax (norm) | 4,246 | 4,806 | 4,035 | 5,669 | 8,061 | 7,429 | 8,912 |
| Profit before tax (FRS 3) | 5,185 | 4,521 | 5,218 | 4,644 | 7,011 | 6,549 | 8,275 |
| Tax | (188) | 121 | (1,046) | (762) | (1,456) | (1,768) | (2,317) |
| Profit after tax (norm) | 4,092 | 4,927 | 3,226 | 4,739 | 6,387 | 5,423 | 6,416 |
| Profit after tax (FRS 3) | 4,997 | 4,642 | 4,172 | 3,882 | 5,555 | 4,781 | 5,958 |
| Average number of shares outstanding (m) | 11.0 | 11.5 | 11.5 | 11.7 | 11.7 | 11.7 | 11.7 |
| EPS – normalised (c) | 37 | 43 | 28 | 41 | 55 | 47 | 55 |
| EPS – normalised fully diluted (c) | 34 | 41 | 28 | 40 | 55 | 47 | 55 |
| EPS – (IFRS) (c) | 45 | 40 | 36 | 33 | 48 | 41 | 51 |
| Dividend per share (c) | 18.2 | 22.7 | 22.7 | 25.0 | 30.0 | 32.0 | 33.0 |
| Gross margin (%) | 51.9 | 52.7 | 51.4 | 52.6 | 53.7 | 53.7 | 53.8 |
| EBITDA margin (%) | 11.4 | 11.9 | 9.8 | 10.8 | 12.6 | 10.9 | 12.0 |
| Operating margin (before GW and except) (%) | 9.2 | 10.0 | 7.9 | 9.5 | 11.5 | 9.9 | 11.1 |
| **BALANCE SHEET** | | | | | | | |
| Fixed assets | 18,570 | 17,850 | 18,019 | 18,132 | 25,428 | 24,672 | 23,916 |
| Intangible assets | 16,621 | 15,370 | 15,078 | 14,692 | 21,296 | 20,590 | 19,884 |
| Tangible assets | 1,154 | 1,118 | 1,249 | 1,361 | 1,598 | 1,548 | 1,498 |
| Other | 795 | 1,362 | 1,692 | 2,079 | 2,534 | 2,534 | 2,534 |
| Current assets | 36,769 | 34,914 | 34,892 | 38,946 | 37,085 | 40,665 | 45,735 |
| Stocks | 1,388 | 1,451 | 1,820 | 2,075 | 3,146 | 3,246 | 3,346 |
| Debtors | 19,562 | 18,642 | 20,768 | 27,791 | 26,369 | 28,317 | 30,448 |
| Cash | 15,819 | 14,821 | 12,304 | 9,080 | 7,570 | 9,101 | 11,940 |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Current liabilities | (20,651) | (17,864) | (17,451) | (18,349) | (21,051) | (22,347) | (24,432) |
| Creditors | (15,155) | (14,512) | (15,297) | (17,528) | (20,243) | (21,539) | (23,624) |
| Short-term borrowings | (5,496) | (3,352) | (2,154) | (821) | (808) | (808) | (808) |
| Long-term liabilities | (8,666) | (6,965) | (6,491) | (5,105) | (7,180) | (7,180) | (7,180) |
| Long-term borrowings | (4,301) | (2,896) | (1,685) | 0 | (1,391) | (1,391) | (1,391) |
| Other long-term liabilities | (4,365) | (4,069) | (4,806) | (5,105) | (5,789) | (5,789) | (5,789) |
| Net assets | 26,022 | 27,935 | 28,969 | 33,624 | 34,282 | 35,810 | 38,039 |
| **CASH FLOW** | | | | | | | |
| Operating cash flow | 2,760 | 7,630 | 5,404 | 2,412 | 10,676 | 7,915 | 9,405 |
| Net interest | (37) | (435) | (249) | (151) | 105 | 100 | 100 |
| Tax | 64 | (1,615) | (1,344) | (1,461) | (2,022) | (1,768) | (2,317) |
| Capex | (405) | (483) | (615) | (763) | (738) | (620) | (620) |
| Acquisitions/disposals | (8,450) | 19 | 0 | 0 | (5,403) | (600) | 0 |
| Financing | 1,690 | (755) | (597) | 2,215 | (828) | 0 | 0 |
| Dividends | 0 | (2,107) | (2,615) | (2,678) | (2,931) | (3,496) | (3,729) |
| Net cash flow | (4,378) | 2,254 | (16) | (426) | (1,141) | 1,531 | 2,839 |
| Opening net debt/(cash) | (10,266) | (6,023) | (8,575) | (8,465) | (8,259) | (5,371) | (6,902) |
| HP finance leases initiated | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | 135 | 298 | (94) | 220 | (1,747) | 0 | 0 |
| Closing net debt/(cash) | (6,023) | (8,575) | (8,465) | (8,259) | (5,371) | (6,902) | (9,741) |

Source: TXT e-solutions, Edison Investment Research

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