EDISON

TXT e-solutions

FY19 results

Well-funded to ride out the crisis

Software & comp services

TXT e-solutions reported exceptional growth in 2019, with organic growth of 24% and normalised EBIT growth of 90%. Recent acquisitions have put the Fintech division in a stronger position and the company continues to search for new acquisition targets. Measures to contain coronavirus are likely to have an impact on the business, particularly as it is exposed to the airline industry (6% of revenues), but a net cash position of €41m provides more than adequate liquidity for the company to manage its way through the crisis.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/18	40.0	1.5	0.10	0.50	60.1	8.1
12/19	59.1	7.4	0.44	0.00	13.9	0.0
12/20e	62.9	3.4	0.18	0.10	34.3	1.6
12/21e	67.9	5.3	0.30	0.12	20.7	1.9

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

FY19: Strong organic growth

TXT reported 48% revenue growth, of which 24% was organic. Both businesses grew on an organic basis: A&A +25% and Fintech +21%. After a spate of acquisitions in 2018 and 2019, the Fintech division now contributes 35% of revenues (FY18: 22%) and offers a wider range of products and services. Normalised EBIT grew 90% y-o-y (margin 8.8%) and normalised diluted EPS grew 333% y-o-y. Net cash at year-end stood at €41.4m. In recognition of the uncertainty surrounding coronavirus, the company decided not to propose a dividend.

Introducing some caution in FY20

The company closed FY19 in a very strong position, having signed licence deals with several North American aviation customers. However, with the drop off in travel in recent weeks, airlines and aircraft OEMs are unlikely to want to sign new contracts and demand for services may also decline. We have revised down our FY20 forecasts to reflect these factors. We reduce our FY20 revenue forecast by 4%, resulting in a €2.1m/7% reduction in gross profit. On unchanged operating expenses (as we assume this is a temporary issue), this results in a cut to our normalised EPS forecast of 53%. We introduce FY21 forecasts, which assume a rebound in growth.

Valuation: Overreaction

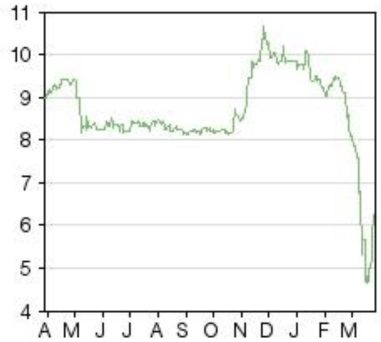
On an EV/sales and EV/EBIT basis, TXT trades at a large discount to its peer group, with EBIT margins forecast to be below the peer group. With €41m net cash, TXT is trading on inflated P/E multiples. Until the remainder of the cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a premium to peers on a P/E basis. The stock has fallen 39% from its peak in January and now has an enterprise value of only €31m. In our view, this decline is overdone.

27 March 2020

Price	**€6.16**
Market cap	**€73m**

Net cash (€m) at end FY19	41.4
Shares in issue	11.8m
Free float	45%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(28.0)	(36.5)	(31.3)
Rel (local)	(2.8)	(12.3)	(15.6)
52-week high/low		€10.7	€4.6

Business description

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

Next events

Q120 results	May 2020

Analyst

Katherine Thompson +44 (0)20 3077 5730

tech@edisongroup.com

Edison profile page

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

Investment summary

Company description: Specialist software and services

TXT e-solutions is an Italy-headquartered software and services company. Having sold TXT Retail, its retail software business, in 2017, TXT now operates solely through the business that was known as TXT Next. TXT is a software solutions and services business focused on the aerospace & aviation and fintech segments, with three-quarters of revenues generated in Italy. The group plans to drive growth through a combination of organic growth and targeted acquisitions, using some of the proceeds from the recent disposal of TXT Retail.

Financials: Strong performance in FY19

TXT reported revenues in line with our forecast, with growth of 48% y-o-y (24% organic). Gross margin was 0.8pp higher than forecast and increased 1.9pp over the year. This dropped through to the EBITDA level, with the normalised EBITDA margin expanding to 11.9% from 10.3% a year ago. Normalised EBIT increased 90% y-o-y and the margin expanded by 1.9pp to 8.8%. This resulted in normalised diluted EPS 7% ahead of our forecast. We have revised our FY20 forecasts to reflect delays to new business and lower demand for services and assume a rebound in demand in FY21.

Exhibit 1: Changes to forecasts

Year end	EPS (€)			PBT (€m)			EBITDA (€m)		
December	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2020e	0.38	0.18	(52.8)	6.6	3.4	(48.5)	8.0	5.6	(30.5)
2021e	N/A	0.30	N/A	N/A	5.3	N/A	N/A	7.5	N/A

Source: Edison Investment Research

Valuation: Overreaction

On an EV/sales and EV/EBITDA basis, TXT trades at a large discount to its peer group, with EBIT margins forecast to be below the peer group. With €41m net cash, TXT is trading on inflated P/E multiples. Until the remainder of the cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a premium to peers on a P/E basis. The share price has declined so much (39% since its peak in January) that a reverse DCF requires very conservative assumptions to match the current share price. In our view, this appears unduly pessimistic.

Sensitivities: Demand, competition, currency

- **General economic activity:** sales will be influenced to a certain extent by the health of the Italian economy, although this is mitigated by the company's strategic focus on the aerospace and aviation market, which exposes it to global players and long-term growth trends. Coronavirus is likely to affect demand over the next few quarters.
- **Competition:** TXT competes against larger, well-funded companies in a market with a limited number of large, global customers. TXT does not have any offshore operations, which may make it more difficult to be price competitive, although its focus on high-value and highly specialised niches mitigates the risk.
- **Acquisition risk:** TXT may make further acquisitions, adding potential integration risk.
- **Currency:** the majority of TXT's revenues and costs are incurred in euros. There is some exposure to sterling, and the US dollar. The impact is mitigated by the costs of staffing local offices in the same currency as revenues.

Company description: Specialist software and services

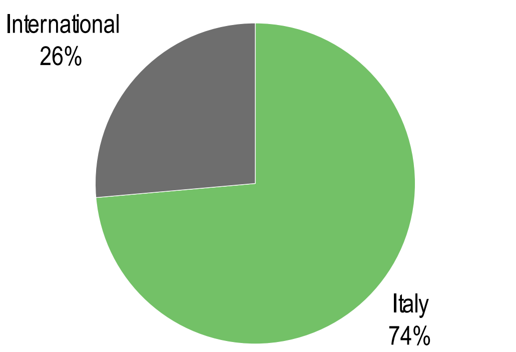
Company background

TXT e-solutions was formed in 1989 as a software and solutions vendor and listed on the STAR segment of the Borsa Italiana in 2000. Until 2017, the company operated through two divisions: TXT Retail (52% of FY16 revenues) and TXT Next (48% of FY16 revenues). In October 2017, the company sold TXT Retail for €85m to APTOS, a US retail software company. The remaining business provides services and software solutions focused on the aerospace and aviation (A&A), and fintech segments, primarily in Italy. Deploying some of the proceeds of the disposal, TXT acquired several banking and finance businesses in 2018 and 2019. The group has more than 650 employees across 11 locations (Italy, Germany, the US, France, Netherlands, Switzerland and the UK).

Provider of specialist software and services

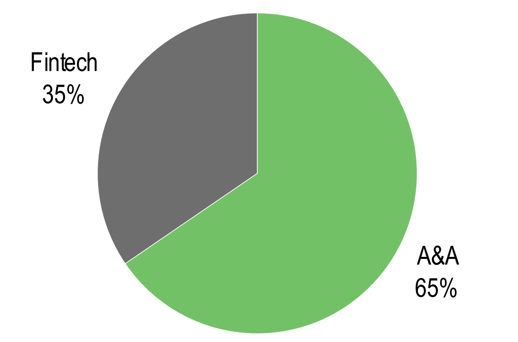
TXT provides specialised software solutions and services through two divisions: A&A, and Fintech. Exhibit 2 below shows how three-quarters of group revenues are generated in Italy, with remaining sales generated elsewhere in Europe and, to a lesser extent, the US. In 2019, TXT generated 88% of revenues from services and 12% from software licences and maintenance (FY18: services 87%, software 13%).

Exhibit 2: FY19 revenues by geography



Source: TXT e-solutions

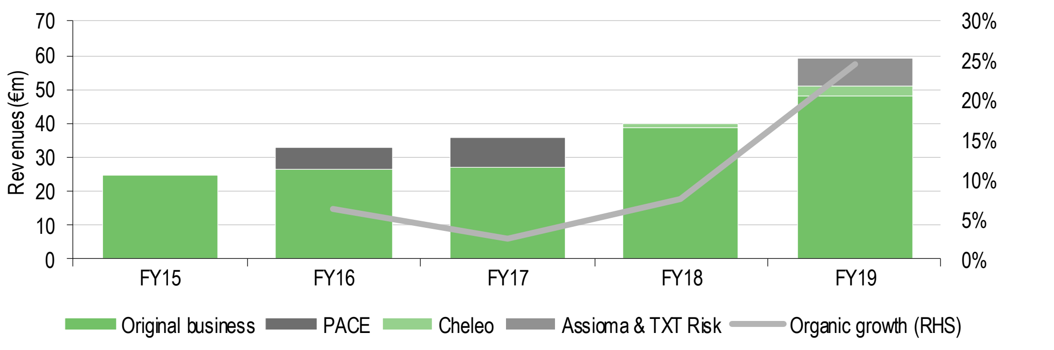
Exhibit 3: FY19 revenues by division



Source: TXT e-solutions

TXT has shown robust organic revenue growth over recent years (CAGR 17.9% FY15–FY19) boosted by the acquisition of PACE in FY16, Cheleo and TXT Risk in 2018 and Assioma in 2019. EBITDA margins have expanded over this period from 10.8% in FY15 to 11.9% in FY19.

Exhibit 4: TXT revenue progression



Source: TXT e-solutions

Growth strategy: Organic and M&A

TXT's strategy is to grow through a mixture of organic growth and acquisitions in the aerospace and aviation and banking and finance markets.

The group offers specialist software solutions across a number of niche verticals. Its services offering comprises product specialists as well as consultants working in four key areas of competence: embedded real-time software, cloud/web, AR/VR and blockchain. To grow the business, the group aims to apply the four competence areas to existing vertical markets as well as potential new markets. It is also seeking to develop or acquire new specialist software solutions, either within existing verticals or possibly in related new verticals.

In terms of funds available for M&A, at the end of FY19, the company had a net cash position of €41m and 1.2 million treasury shares. It also has access to debt facilities worth c €40m.

New management team in place

At the beginning of 2018, E-business Consulting, the largest shareholder in TXT with a stake of 25.6%, sold its entire holding to Laserline SpA. Laserline is a private company majority-owned by entrepreneur Enrico Magni. Mr Magni was subsequently appointed to the TXT board as group CEO. In May 2019, Daniele Misani was appointed to head up the A&A division. Mr Misani has worked at TXT for more than 20 years. In July 2019, Eugenio Forcinito took on the role of CFO; he has worked in the TXT finance team for more than 17 years.

Aerospace & aviation (A&A) division

This business was founded more than 30 years ago and makes up the largest proportion of TXT, generating revenues of €38.7m in FY19 (65% of TXT revenues; +25% y-o-y) and EBITDA of €5.1m (13.0% margin).

The division provides a mix of software and specialised engineering services, providing support to customers' R&D, engineering and manufacturing operations. In FY19 revenues were generated from OEMs and first-tier suppliers (c 75%), airlines (c 10%) and automotive & industrial customers (c 15%). The business was originally staffed out of Italy but partly through a 'follow-my-customer' strategy and partly as a concerted effort to expand internationally (organically and via the PACE acquisition), the division now has more than 350 consultants based in Italy, Germany, France, the UK, the Netherlands, Switzerland and the US. In FY19, the business generated 60% of revenues from Italy, 24% from other EMEA countries and 16% from the US and elsewhere.

Specialist services enhanced by industry-specific software

TXT already had a significant aerospace-focused business, providing IT, consulting and R&D services to mainly Italy-based business such as Leonardo. The acquisition of PACE in 2016 added specialist aerospace software as well as a larger international customer base. Customers included more than 50 companies covering aircraft and engine manufacturing, airlines, civil and defence operators, and maintenance, repair and overhaul (MRO). Until the acquisition, the A&A business had predominantly generated revenues from services; PACE added higher-margin software revenues, which over time should drive higher recurring revenues.

The division is now sub-divided into a specialist software business (15% of FY19 divisional revenue) and a services business (85% of FY19 divisional revenue), each with its own revenue and EBITDA goals.

PACE continues to trade under its own brand, and the original founding members are still managers of the business. TXT has a put/call option for the remaining 21% stake in PACE owned by the three founders exercisable from 1 January 2020 to 31 December 2021.

The A&A division now has a customer base of more than 70 companies. Although much of the work is project based and therefore not recurring, TXT has a very loyal customer base that provides repeat work. Project work, which makes up c 55% of divisional revenues, is roughly three-quarters from turnkey service engagements, with the remainder contracted on a time and materials basis. Exhibit 5 shows key customers and highlights the international nature of the customer base.

Exhibit 5: A&A customer base

OEMs	First tier suppliers	Airlines and lessors	Automotive
Airbus	Air France Industries	AerCap	Brembo
ATR	Aviage Systems	Air Transat	CNH Industrial
BAE Systems	Avio Aero	American Airlines	FIAMM
Boeing	CAE	BoC Aviation	ITT
Bombardier	GE Aviation Systems	Cathay Pacific	Iveco
Comac	Innovint	Delta	Magneti Marelli
Embraer	KLM Engineering & Maintenance	Emirates	Octo
Eurofighter Typhoon	Leonardo	Etihad	Pirelli
Fokker Services	Liebherr	Expressjet	Vodafone Automotive
Irkut	Paustian Airtex	Falko Regional Aircraft	ZF/TRW
Leonardo	Recaro	Finnair	
Lockheed Martin	Reiser	GE Capital Aviation Services	
Mitsubishi Aircraft Corporation	Rolls Royce	Hawaiian Airlines	
Piaggio Aerospace	Safran	Icelandair	
Pilatus	Secondo Mona	Lufthansa Group airlines	
Saab	SR Technics	NetJets	
Sukhoi	UTC Aerospace Systems	Qatar Airways	
Superjet International		Turkish Technic	

Source: TXT e-solutions

Providing end-to-end solutions

TXT provides software and services all the way from initial aircraft design through to product configuration, training and operation. Exhibit 6 shows the fully packaged software offered by PACE.

Exhibit 6: PACE software solutions

Solution	Functionality
Preliminary aircraft design	
Pacelab Suite	Platform that supplies functional and 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 optimising system and sub-system architectures
Aircraft marketing and acquisition	
Pacelab ACE	Helps aircraft buyers, manufacturers and suppliers to efficiently navigate the elaborate aircraft configuration process in a single, clearly structured workflow. It combines server-based business logic, web-based client applications and industry-proven configuration capabilities with the latest communication and collaboration technologies to create a modern digital user experience on tablets, smartphones and other mobile devices.
Pacelab Cabin	Aircraft and cabin configurator that supports aircraft manufacturers, seat and 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 that 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 in flight the most cost-efficient trajectory whenever flight conditions have changed
Pacelab Flight Profile Optimiser (cloud version available)	Complements the functional scope of flight management systems with advanced flight profile optimisation capabilities
PACE WEAVR	Enhanced training and field support leveraging AR/MR/VR

Source: TXT e-solutions

Exhibit 7 shows the range of software and services available for different types of customers within A&A. We note that TXT also serves the automotive and industrial sectors with the services shown below within the digital manufacturing business area; these end markets only made up c 15% of A&A FY19 revenues.

Exhibit 7: Software and services by business area and customer type

Business area	Aircraft manufacturers		Engine manufacturers & Tier 1 suppliers		Airlines & other operators	
	Products	Services	Products	Services	Products	Services
Product development & strategy	Pacelab APD, Pacelab SysArc, Pacelab Suite		Pacelab APD, Pacelab SysArc, Pacelab Suite			
Avionic Systems		Design & develop; independent verification & validation; maintenance & upgrades; support for certification; system engineering & integration services				
Customer engineering	Pacelab Cabin					
Digital Manufacturing		Digital factory, industrial IoT, data analytics, VR/AR/MR, cyber security		Digital factory, industrial IoT, data analytics, VR/AR/MR, cyber security		
Commercial marketing & sales	Pacelab Cabin, Pacelab Mission Suite, Pacelab Route Network Analyzer					
Technical sales			Pacelab APD, Pacelab SysArc			
After sales support	Pacelab WEAVR	Training & simulation	Pacelab WEAVR	Training & simulation		
Cabin refurbishment & refitting	Pacelab Cabin, Pacelab WEAVR	AR/VR/MR field support, virtual training				
Fuel & operational efficiency management					Pacelab FPO, Pacelab CI OPS	
Strategic fleet assignment					Pacelab Mission Suite	
Fleet planning					Pacelab Mission Suite	
Cabin Engineering					Pacelab Cabin	
Crew training					Pacelab WEAVR	Training & simulation; virtual training

Source: TXT e-solutions, Edison Investment Research

Recent product development

TXT has developed Pacelab WEAVR as a platform to create, maintain and deploy training programmes that use AR (augmented reality), VR (virtual reality) or MR (mixed reality). Digitising materials in order to use them in AR/VR/MR can be costly; the platform was developed to make this process simpler.

Over the course of FY18 and FY19, TXT has also focused on developing collaborative elements in its Pacelab FPO solution. Previously, the product was used on a standalone basis within a plane. By adding the ability to collaborate, the software can now be used in connected aircraft, sending data back to a central control room, which helps with post-flight analysis and can be used in pre-flight planning.

With the increasing focus on environmental issues, TXT is keen to highlight that its Pacelab FPO software can help customers to reduce aircraft fuel consumption. For example, it has been shown to reduce fuel consumption in regional aircraft by 4%, the Airbus 230 family by 1.9% and long-range aircraft by 1%.

Growth strategy: Organic and inorganic

One obvious source of organic growth for TXT is to increase its share of wallet with the existing customer base, selling to multiple divisions within each customer. The business is also targeting new international customers. In terms of its product range, the company has started offering managed services; this should increase the level of recurring business. It is also looking to extend the capabilities and range of its software assets. In addition to achieving this through internal R&D, the company is looking to acquire niche software providers and is selectively targeting highly specialised mid-sized companies.

Fintech division

The Fintech business, which has been in operation for more than 15 years, has recently expanded from purely a services business to offering specialist fintech software, via a number of acquisitions. The division generated revenue of €20.4m in FY19 (+132% y-o-y, +21% organic) and EBITDA of €2.0m (9.6% margin). Fintech targets the top 50 Italian banking institutions; customers include Banca IFIS, Banco BPM, Banca Mediolanum, BP Sondrio, Ergo Assicurazioni, Credito Valtellinese, ING Bank, Intesa SanPaolo, Monte dei Paschi di Siena, Nexi, SIA, UBISS, UniCredit, Widiba and Zenith Service. The division has more than 300 employees.

Fintech offers the following products and services:

Software quality services (82% of FY19 Fintech revenues)

This business provides software testing, verification and validation services to banks and insurance companies in Italy. Exhibit 8 shows the services offered across the software quality assurance lifecycle. Functional testing of software accounts for the majority of the division's services. Testing services are performed both onsite and offsite, using the company's Test Factory methodology.

Exhibit 8: Software quality assurance services

Source: TXT e-solutions

In May 2019, TXT acquired Assioma, an Italian software testing business, for c €6m plus a further potential €2.4m in earn-outs. In 2018, the Assioma group generated revenues of €9.4m, EBITDA of €1.3m (13.9% margin) and net income of €0.9m.

Drivers of demand for software quality services include increasingly strict regulation, emerging fintech software and services and the rapidly evolving IT landscape. The company estimates that the market for quality assurance and testing services in the Italian banking sector is worth at least €100m per year.

Also included within this division are payments services. Assioma owns 51% of Assiopay, a payments software business. Assiopay provides software to manage meal vouchers ('Ticket Restaurant' in Italy) and loyalty cards.

Financing, credit and non-performing loan management software (17%)

In July 2018, TXT acquired 51% of Cheleo, an Italian developer of lifecycle management software for financing,[1] and acquired the remaining 49% in January 2019. In total, Cheleo cost €10m (€6m in cash and €4m from the issue of 354,202 shares). Cheleo was majority owned by Laserline, the business owned by Enrico Magni, TXT's CEO and largest shareholder.

Cheleo's portfolio includes software to manage the entire process (initial application, credit management and collection, disposal of loan books) for leasing, mortgages, personal loans, salary-based loans, factoring and non-performing loans. Customers are Italian specialist financial companies. Cheleo reported 2017 revenues of €2.8m and EBITDA of €0.95m (34% margin). We estimate that revenues in 2019 were similar.

Although Cheleo continues to operate on a standalone basis within the Fintech division, the division is focused on cross-selling opportunities across the combined Italian client base. The two founders, Bruno Roma and Flavio Minari, remain on the Cheleo board and will be entitled to a future cash payment based on the 2019 performance of Cheleo.

Risk management and AML software (1%)

In November, TXT made a small acquisition to add risk-assessment software to its Fintech offering. It acquired 51% of T3M Innovation (now TXT Risk Solutions) for €0.3m and has a put/call option in place to buy the remaining 49% at a price based on the performance of TXT Risk Solutions in FY20.

TXT Risk Solutions has developed risk assessment solutions based on predictive, probabilistic models using machine learning and AI techniques. Its cloud-based FARADAY platform is used by customers to carry out checks on potential clients to prevent involvement with money laundering (Faraday AML), corruption (Faraday AC) and terrorist financing (Faraday AT).

The business recently signed up Monte dei Paschi di Siena to use the Faraday platform.

Growth strategy: Cross-selling, more acquisitions

The division intends to take advantage of its large financial institution customer base to cross-sell. It will also consider additional acquisitions.

Market context

TXT has been a beneficiary of the trend to outsource, which gives the customer greater flexibility on cost and better access to specialist skills. Once a customer has outsourced a specialist area of R&D or IT, it is usually very difficult to bring it back in house, as the in-house knowledge and expertise will have diminished. TXT has worked closely with the majority of its customer base for many years, creating a strong partnership and demonstrating its specialist expertise.

The aerospace and aviation markets are characterised by global groups with large investment budgets; many groups have multiple subsidiaries that could each use TXT's software engineering services. The rapid pace of innovation combined with increasing regulation drives growth in R&D. In its 2022 strategic plan, Altran estimates that the global engineering and R&D services market was worth c €155bn in 2017 and is forecast to grow at a CAGR of 9% to 2022. Within that, it forecasts growth in Europe of 4–6% pa and growth in the Americas of 8–10% pa.

---

[1] For further details on the deal, see our update note, Cheleo acquisition drives upgrades.

On the **services** side, TXT's competition is from customers' in-house R&D and IT departments, as well as outsourced engineering services providers and system integrators. The A&A business sees competition from large European engineering services businesses such as Akka Technologies, Altran, Alten and Assystem in France (all listed on Euronext), ESG Group in Germany (private) as well as smaller local providers such as Critical Software (private, based in Portugal), Teoresi (private, based in Italy) and Philotech (private, based in Germany). Both the A&A and Fintech businesses compete with the large offshore BPO providers such as HCL, Tech Mahindra and TATA Consultancy Services, although TXT's specialist knowledge and on-shore capabilities are often preferred for mission-critical work that requires not only technical expertise, but also in-depth industry knowledge and proximity to customers. The Fintech business also competes with specialist outsourced testing providers such as SQS (recently acquired by Assystem Technologies).

On the **software** side, PACE operates in the market for aircraft design and engineering processes, typically served by the large PLM[2] software vendors such as Dassault, PTC and Siemens. PACE offers niche solutions to address specific, critical tasks that complement and integrate with PLM software solutions. Cheleo's software is very specific to the Italian market. TXT Risk Solution's Faraday software competes with BAE's NetReveal and Cedacri's GIANOS, which are rules based, whereas Faraday uses predictive models and machine learning.

Sensitivities

Our forecasts and TXT's share price will be sensitive to the following factors:

- **General economic activity:** sales will be influenced by the health of the Italian economy. The banking and finance business will depend on the health of the Italian banking sector and A&A will depend on the global aerospace and aviation markets. Efforts to contain coronavirus may affect demand and the company's ability to win new business (see p12 for further detail).
- **Competition:** TXT competes against larger, well-funded companies in a market with a limited number of large, global customers. TXT does not have any off-shore operations, which may make it more difficult to be price competitive, although its focus on high-value and highly specialised niches mitigates the risk.
- **Acquisition risk:** TXT may make further acquisitions, adding potential integration risk.
- **Currency:** the majority of TXT's revenues and costs are incurred in euros. There is some exposure to sterling and the US dollar. The impact is mitigated by the costs of staffing local offices in the same currency as revenues.

Financials

Review of FY19 results

TXT reported revenues in line with our forecast, with growth of 48% y-o-y, of which 24% was organic. Gross margin was 0.8pp higher than forecast and increased 1.9pp over the year. This dropped through to the EBITDA level, with the EBITDA margin expanding to 11.9% from 10.3% a year ago. Normalised EBIT increased 90% y-o-y and the margin expanded by 1.9pp to 8.8%. This resulted in normalised diluted EPS 7% ahead of our forecast. Reported EBIT includes a €0.7m charge for restructuring. The company reported an exceptional charge at the financial level of €3.4m for the revised valuation of two contingent consideration provisions: a charge of €4.1m for PACE and a credit of €0.7m for Cheleo. Net financial income also includes an upward revaluation of

[2] PLM: product lifecycle management

the cash held in multi-segment insurance funds of €2.2m, compared to a charge of €1.0m in FY18. The reported tax rate at 81% appears high as the €3.4m charge was not allowable for tax purposes.

The company announced it would not be proposing a dividend for FY19 to preserve cash to deal with coronavirus-related issues (see p12 for further detail). It would consider an extraordinary dividend later in the year depending on how the business performs.

Exhibit 9: FY19 results highlights

	FY18	FY19e	FY19	diff	y-o-y
Revenues (€m)	40.0	59.2	59.1	(0.2%)	47.9%
Gross margin	44.2%	45.3%	46.1%	0.8%	1.9%
Gross profit (€m)	17.7	26.9	27.3	1.5%	54.3%
EBITDA (€m)	4.1	6.6	7.0	6.5%	70.9%
EBITDA margin	10.3%	11.1%	11.9%	0.7%	1.6%
Normalised EBIT (€m)	2.8	5.0	5.2	4.3%	89.7%
Normalised EBIT margin	6.9%	8.5%	8.8%	0.4%	1.9%
Normalised net income (€m)	1.2	4.9	5.2	7.2%	332.5%
Normalised EPS (€)	0.10	0.41	0.44	7.1%	333.5%
Reported basic EPS (€)	0.05	0.28	0.03	(90.5%)	(44.3%)
Net cash (€m)	60.4	50.1	41.4	(17.4%)	(31.4%)
Dividend (€)	0.50	0.13	0.00	(100.0%)	(100.0%)

Source: TXT e-solutions, Edison Investment Research

At the end of FY19, the company had a net cash position of €41.4m. Net cash reduced from the end FY18 as a result of the dividend (€5.8m), Assioma acquisitions (€6m), net increase in contingent liabilities (see below) and a new lease taken out for offices in Berlin.

Contingent liabilities for acquisitions are included within short-term debt (PACE €5.9m, Cheleo €0.8m) and long-term debt (TXT Risk €1.6m). TXT has fully consolidated the three acquisitions, with the value of the minority interests treated as debt.

Exhibit 10: Net financial position

€m	FY19	FY18
Cash & cash equivalents	11.4	5.6
Trading securities at fair value	87.3	103.9
Other short-term fixed assets	0.0	5.0
Short-term debt	(25.3)	(17.3)
Long-term lease debt	(4.5)	(2.1)
Other long-term debt	(27.5)	(34.8)
Net cash	41.4	60.4

Source: TXT e-solutions

Divisional progress – organic growth plus M&A

The A&A division grew revenues 24% y-o-y, all organic. It signed licences with major OEMs and airlines in North America in Q4, much of which should be recognised as revenue in FY20 and FY21. The Fintech division grew 132% y-o-y, of which 21% was organic. The division acquired Assioma in April 2019, which contributed revenues of €9.7m, and benefited from a full 12 months of TXT Risk and Cheleo (both acquired in FY18).

Exhibit 11: Divisional revenues

Revenues (€m)	FY19	FY18	y-o-y
Aerospace & Aviation (A&A)	38.7	31.1	24.4%
Software licences & maintenance	5.9	5.0	18.4%
Services	32.8	26.1	25.6%
Fintech	20.4	8.8	131.8%
Software licences & maintenance	1.0	0.4	179.4%
Services	19.4	8.4	129.8%
Software licences & maintenance – group	6.9	5.3	29.2%
Services – group	52.2	34.6	51.0%

Source: TXT e-solutions

Managing through coronavirus

As an Italy-headquartered company, a large proportion of the workforce moved to working remotely some weeks ago; the remainder of locations are now also doing so. In the Fintech division, software quality testing services can be provided remotely. Activities in both divisions are deemed by the Italian government to be essential services (falling under the categories of transport and finance), so staff are not part of the general nationwide lockdown.

In the A&A division, the company has not yet seen any reduction in demand from customers but is aware that new business is likely to be harder to sign with aviation customers, given the drastic cuts to airline travel. The company has a strong licence backlog entering FY20 as it has previously signed term and subscription licences that will allow revenue to be recognised over FY20 and FY21. Its aviation relationships are with the larger airlines that have more resources to weather this difficult period. We note that airlines made up c 6% of group revenues in FY19, with the majority of A&A business providing services to OEMs to help with the design of avionics for future aircraft, including pre-design and configuration work.

Outlook and changes to forecasts

While trading in the first two months of the year was in line with expectations (both revenue and margins), management estimates the crisis could reduce Q120 profitability. We have revised our forecasts to reflect potential disruption from efforts to contain coronavirus extending into H220. The £2.6m cut to our FY20 revenue forecast and a reduction in gross margin based on mix results in a £2.1m reduction in gross profit. Assuming no cut to our opex forecasts at this point, as we believe the company would want to be prepared for a resumption in demand once containment efforts are reduced, this results in a 52% reduction in normalised EBIT and a 53% reduction in normalised diluted EPS.

We note that while we have factored in 6.4% revenue growth for FY20 (down from 10.6%), this includes a full 12 months of revenue from Assioma (consolidated from 1 April 2019), which accounts for two-thirds of the growth.

Exhibit 12: Changes to forecasts

	FY20e old	FY20e new	change	y-o-y	FY21e new	y-o-y
Revenues (€m)	65.5	62.9	(3.9%)	6.4%	67.9	7.9%
Gross margin	45.8%	44.3%	(1.5%)	(1.8%)	45.2%	0.8%
Gross profit (€m)	30.0	27.9	(7.0%)	2.3%	30.7	10.0%
EBITDA (€m)	8.0	5.6	(30.5%)	(20.3%)	7.5	34.7%
EBITDA margin	12.3%	8.9%	(3.4%)	(3.0%)	11.1%	2.2%
Normalised EBIT (€m)	6.3	3.1	(51.8%)	(41.5%)	5.0	63.4%
Normalised EBIT margin	9.7%	4.9%	(4.8%)	(4.0%)	7.4%	2.5%
Normalised net income (€m)	4.5	2.1	(52.8%)	(59.4%)	3.5	65.9%
Normalised EPS (€)	0.38	0.18	(52.8%)	(59.6%)	0.30	65.9%
Reported basic EPS (€)	0.32	0.12	(62.4%)	351.2%	0.24	97.9%
Net cash (€m)	53.9	43.8	(18.8%)	5.7%	47.1	7.6%
Dividend (€)	0.15	0.10	(33.3%)	#DIV/0!	0.12	20.0%

Source: Edison Investment Research

Valuation

Multiples-based valuation

Our peer group includes European IT services and engineering services companies as well as software providers with a similar customer base. On an EV/sales and EV/EBITDA basis, TXT trades at a large discount to its peer group, with EBIT margins forecast to be below the peer group. With €41m net cash, TXT is trading on inflated P/E multiples. Until the remainder of the cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a premium to peers on a P/E basis.

Exhibit 13: Peer group financial and valuation metrics

Company	Share price	Market cap (m)	Rev growth		EBIT margin		EBITDA margin		EV/sales (x)		EV/EBIT (x)		P/E (x)	
			CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	**€ 6.16**	**€ 73**	**6.4%**	**7.9%**	**4.9%**	**7.4%**	**8.9%**	**11.1%**	**0.5**	**0.5**	**10.2**	**6.2**	**34.3**	**20.7**
European IT services companies														
AKKA Technologies	€ 26.75	€ 538	6.4%	6.6%	7.2%	7.9%	10.0%	10.5%	0.6	0.5	7.8	6.7	6.3	5.2
Alten	€ 62.10	€ 2,092	8.1%	5.6%	9.8%	9.9%	11.7%	11.7%	0.8	0.8	8.1	7.6	10.3	9.5
Altran	€ 14.49	€ 3,692	5.3%	5.5%	11.4%	11.9%	15.6%	16.1%	1.5	1.4	13.1	11.8	15.8	13.9
AtoS	€ 62.66	€ 6,784	2.8%	2.3%	9.8%	10.2%	14.8%	15.2%	0.8	0.8	8.4	7.9	7.4	6.8
Cap Gemini	€ 72.54	€ 12,187	3.7%	5.4%	12.0%	12.3%	15.4%	15.8%	1.0	1.0	8.4	7.8	10.8	9.8
Devoteam	€ 58.40	€ 482	8.4%	5.6%	10.4%	10.8%	12.1%	12.4%	0.6	0.6	5.8	5.3	10.3	9.3
ESI Group	€ 29.60	€ 175	47.9%	5.2%	6.6%	7.6%	10.1%	10.9%	1.5	1.4	22.5	18.6	28.9	21.5
Exprivia	€ 0.64	€ 33	-10.1%	7.9%	2.9%	4.3%	6.4%	7.6%	0.5	0.4	16.4	10.1	-16.0	6.4
Reply	€ 53.40	€ 1,981	6.3%	8.5%	12.7%	12.9%	15.6%	15.7%	1.5	1.4	11.9	10.8	17.6	16.1
Sopra Steria	€ 93.70	€ 1,908	6.5%	4.4%	8.0%	8.7%	11.3%	12.0%	0.5	0.5	6.8	6.0	8.2	7.0
Average			**8.5%**	**5.7%**	**9.1%**	**9.7%**	**12.3%**	**12.8%**	**0.9**	**0.9**	**10.9**	**9.3**	**9.9**	**10.5**
(Discount)/premium to peers									*(46%)*	*(47%)*	*(6%)*	*(32%)*	*247%*	*97%*

Source: Edison Investment Research, Refinitiv. Note: Priced at 26 March.

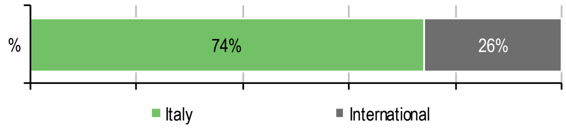
Reverse DCF

The share price has declined so much that a reverse DCF requires very conservative assumptions to match the current share price. In fact, we can get to the current share price by assuming that from FY21, revenue only grows at 1% per annum, the EBITDA margin is 10% in perpetuity, and long-term growth is 1%. In our view, this is unduly pessimistic.

Exhibit 14: 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	62,899	67,898
Cost of sales	(18,954)	(20,224)	(22,289)	(31,825)	(35,016)	(37,226)
Gross profit	14,106	15,628	17,668	27,266	27,884	30,672
EBITDA	4,260	3,536	4,098	7,003	5,584	7,522
Operating Profit (before amort and except)	3,954	3,180	2,755	5,226	3,056	4,994
Amortisation of acquired intangibles	(264)	(439)	(610)	(960)	(960)	(960)
Exceptionals and other income	(557)	0	(300)	(4,145)	0	0
Other income	0	(69)	0	0	0	0
Operating Profit	3,133	2,672	1,845	121	2,096	4,034
Net Interest	48	(208)	(1,284)	2,194	300	300
Profit Before Tax (norm)	4,002	2,972	1,471	7,420	3,356	5,294
Profit Before Tax (FRS 3)	3,181	2,464	561	2,315	2,396	4,334
Tax	(661)	(710)	4	(1,867)	(671)	(1,213)
Profit After Tax (norm)	3,170	2,170	1,204	5,342	2,416	3,811
Profit After Tax (FRS 3)	2,520	1,754	565	448	1,725	3,120
Ave. Number of Shares Outstanding (m)	11.7	11.7	11.7	11.7	11.8	11.8
EPS – normalised (€)	0.271	0.186	0.103	0.444	0.180	0.298
EPS – normalised fully diluted (€)	0.271	0.186	0.103	0.444	0.180	0.298
EPS – (IFRS) (€)	0.475	5.874	0.048	0.027	0.121	0.239
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	44.3	45.2
EBITDA Margin (%)	12.9	9.9	10.3	11.9	8.9	11.1
Operating margin (before GW and except) (%)	12.0	8.9	6.9	8.8	4.9	7.4
BALANCE SHEET						
Fixed Assets	25,428	8,860	22,942	34,635	32,068	29,500
Intangible Assets	21,296	7,332	17,751	24,380	23,393	22,405
Tangible Assets	1,598	793	3,680	7,929	6,349	4,769
Other	2,534	735	1,511	2,326	2,326	2,326
Current Assets	37,085	109,426	134,674	127,052	123,799	121,062
Stocks	3,146	2,528	3,141	4,156	4,456	4,756
Debtors	26,369	17,215	16,992	24,150	26,748	28,874
Cash	7,570	89,683	114,541	98,746	92,595	87,432
Other	0	0	0	0	0	0
Current Liabilities	(21,051)	(13,612)	(29,366)	(43,129)	(44,084)	(45,336)
Creditors	(20,243)	(12,937)	(12,062)	(17,823)	(18,778)	(20,030)
Short term borrowings	(808)	(675)	(17,304)	(25,306)	(25,306)	(25,306)
Long Term Liabilities	(7,180)	(4,781)	(41,903)	(36,538)	(28,038)	(19,538)
Long term borrowings	(1,391)	(1,688)	(36,882)	(32,029)	(23,529)	(15,029)
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	83,746	85,688
CASH FLOW						
Operating Cash Flow	10,676	119	2,039	(355)	3,640	6,349
Net Interest	105	(208)	(69)	3,102	300	300
Tax	(2,022)	379	(624)	(229)	(671)	(1,213)
Capex	(738)	(661)	(548)	(916)	(920)	(920)
Acquisitions/disposals	(5,403)	82,250	1,314	(2,178)	0	0
Financing	(828)	(6)	(7,208)	(4,287)	0	0
Dividends	(2,931)	(3,496)	(11,710)	(5,781)	0	(1,179)
Net Cash Flow	(1,141)	78,377	(16,806)	(10,644)	2,349	3,337
Opening net debt/(cash)	(8,259)	(5,371)	(87,320)	(60,355)	(41,411)	(43,760)
HP finance leases initiated	0	0	(2,788)	(2,500)	0	0
Other	(1,747)	3,572	(7,371)	(5,800)	0	0
Closing net debt/(cash)	(5,371)	(87,320)	(60,355)	(41,411)	(43,760)	(47,097)

Source: TXT e-solutions accounts, Edison Investment Research

Contact details	Revenue by geography (FY19)
Via Frigia, 27 20126 Milano Italy +39 02 257711 www.txtgroup.com	

Management team	
CEO: Enrico Magni	**CFO: Eugenio Forcinito**
In March 2018, through Laserline SpA, Mr Magni became the largest shareholder of TXT and was appointed group CEO. Mr Magni founded Laserline (Car Alarms and Electronic components for automotive), and in 2003 he acquired Lutech, an IT company, spin-off of a large industrial group. He drove the company growth (from €40m to €175m) through solid organic development and several acquisitions until 2017, when it was sold to One Equity Partner.	Mr Forcinito was appointed group CFO in 2019. He is been a member of the Order of Chartered Accountants and Auditors of Milan since 2003 and has more than 20 years' experience in the administration and finance sector and a deep knowledge of managerial dynamics. Mr Forcinito has developed his professional career at TXT over the last 15 years.
Chairman: Alvise Braga Illa	
Mr Braga Illa led the optical communications group and the network systems at the Massachusetts Institute of Technology. He directed the R&D Labs at Italtel, founded Zeltron and managed the restructuring of Ducati Energia. He founded TXT Automation Systems, sold to ABB in 1997, and TXT e-solutions in 1989.	

Principal shareholders	(%)
Laserline SpA	25.6
Kabouter Management	9.5
Treasury shares	9.2
Alvise Braga Illa	4.8
Marco Guida	2.2
Paolo Colombo	1.3
Allianz SE	1.1

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia