TXT e-solutions

FY20 results

Expansion continues through a difficult year

Software & comp services

Despite a tough year, TXT reported organic revenue and EBITDA growth and acquired two profitable fintech businesses. To deal with COVID-19 restrictions, management quickly shifted operations to remote working, which will now be a permanent feature. From a demand perspective, long-term contracts and a focus on sectors less hit by the pandemic have helped support the business. TXT is now positioned to benefit as hard-hit sectors gradually see demand return and its earlier-stage fintech investments increasingly win business.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/19	59.1	7.6	0.46	0.00	15.2	N/A
12/20	68.8	7.1	0.47	0.04	14.9	0.6
12/21e	84.6	8.2	0.51	0.06	13.7	0.9
12/22e	90.0	9.3	0.57	0.08	12.2	1.1

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

FY20 revenue and profit growth

TXT reported 16% revenue growth in FY20, of which 5% was organic. EBITDA grew 22% y-o-y (5% ahead of our forecast; +11% organic), with margin expansion of 0.6pp to 12.5%. Normalised EPS was 33% higher than our estimate through a combination of higher operating profit (5% ahead), higher net finance income and a lower tax rate (20% vs our 28% forecast). The company ended the year with net cash of €22.1m and announced a dividend of €0.04 for the year, payable in May.

Expanding the Fintech business

The Aerospace & Aviation (A&A) business managed to generate 5% organic revenue growth despite COVID-19 reducing demand from certain sectors, helped by TXT's long-term relationships and shift to unaffected sectors and advanced technologies. The Fintech business benefited from the MAC Solutions and HSPI acquisitions in H2, which combined with the benefits of recent restructuring resulted in a substantial increase in profitability. Post year-end, TXT has made further investments in the fintech space for a total cost of €16m. We have made minimal changes to our FY21 revenue and normalised operating profit forecasts; the buyout of Assiopay minority interests combined with share buy-backs results in an 8.5% increase in our normalised EPS forecast. We introduce FY22 forecasts for 6% revenue growth and 13% normalised EPS growth.

Valuation: Discount to peers

TXT continues to trade at a discount to its peer group on all measures, despite the deployment of a large proportion of the company's cash balance into fintech acquisitions, and revenue growth and profitability above the group average. Evidence of improving demand in the A&A division and growing revenues from the earlier-stage fintech businesses should help to reduce this discount.

17 March 2021

Price	**€6.98**
Market cap	**€82m**
Net cash (€m) at end FY20	22.1
Shares in issue	11.7m
Free float	51%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(4.3)	(5.3)	48.8
Rel (local)	(7.4)	(14.2)	(7.8)

52-week high/low	€8.43	€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 FY20 results

The table summarises group performance for FY20 versus FY19 and our FY20 forecasts.

Exhibit 1: FY20 results highlights

	FY19a	FY20e	FY20a	diff	y-o-y
Revenues (€m)	59.1	67.2	68.8	2.3%	16.4%
Gross margin	46.1%	43.9%	42.6%	(1.3%)	(3.6%)
Gross profit (€m)	27.3	29.5	29.3	(0.7%)	7.4%
EBITDA (€m)	7.0	8.1	8.6	5.1%	22.2%
EBITDA margin	11.9%	12.1%	12.5%	0.3%	0.6%
Normalised EBIT (€m)	5.4	6.2	6.5	5.1%	20.9%
Normalised EBIT margin	9.2%	9.3%	9.5%	0.3%	0.4%
Reported operating profit (€m)	3.6	4.5	3.2	(30.0%)	(11.1%)
Normalised net income (€m)	5.3	4.1	5.5	32.8%	2.2%
Reported net income (€m)	0.3	3.5	4.5	29.1%	1324.8%
Normalised EPS (€)	0.46	0.35	0.47	33.4%	2.7%
Reported basic EPS (€)	0.03	0.30	0.38	29.7%	1332.0%
Net cash (€m)	41.4	28.0	22.1	(21.1%)	(46.7%)
Dividend (€)	0.00	0.10	0.04	(60.0%)	N/A

Source: TXT e-solutions, Edison Investment Research

TXT reported revenue growth of 16.4% for FY20, with revenue of €68.8m 2.3% ahead of our forecast. Excluding the €6.5m contribution from the MAC Solutions and HSPI acquisitions, the group grew 5.1% y-o-y. EBITDA increased 22.2% y-o-y and was 5% ahead of our forecast, resulting in an EBITDA margin of 12.5% compared to 11.9% a year ago.

The company reported a number of exceptional items in FY20:

- a €0.6m charge for restructuring;
- a €1.3m goodwill write-down relating to TXT Risk Solutions; and
- a €2.2m financial credit relating to a reduction in earn-out or put/call option provisions.

Net financial income (excluding the one-off credit above) of €0.6m relates to income earned from cash that is invested in multi-segment insurance funds (which are marked to market). As the company has made use of a portion of these funds for recent acquisitions, the lower balance combined with higher volatility has reduced the income compared to the €2.2m reported in FY19.

The company reported a tax rate of 20%, well below our 28% forecast.

Having decided not to pay a dividend for FY19 due to COVID-19 uncertainty, the company has reinstated the dividend for FY20 and will pay a dividend of €0.04 per share in May.

Net cash at year-end was €22.1m, down from €41.4m a year ago. Exhibit 2 shows how this breaks down. Key movements over the year include:

- payment of earn-outs for Cheleo and PACE: €5.9m (although this had zero impact on net cash, it reduced gross cash and short-term liabilities);
- acquisition of MAC Solutions and HSPI: €14.1m;
- a new earn-out put in place for TXT Working Capital Solutions: €2.7m;
- acquisition of treasury shares: €5.3m;
- a working capital outflow due to elevated levels of trade receivables at year-end: €7.7m; and
- operating cash inflow before working capital: €6.7m.

Exhibit 2: TXT e-solutions net financial position		
€m	**FY19**	**FY20**
Cash & cash equivalents	11.4	11.9
Trading securities at fair value	87.3	68.2
Short-term bank debt	(17.4)	(28.2)
Short-term leases	(1.3)	(1.5)
Short-term earn outs	(6.6)	(1.0)
Long-term bank debt	(23.5)	(18.9)
Long-term lease debt	(4.5)	(3.6)
Long-term earn outs	(4.0)	(4.9)
Net cash	**41.4**	**22.1**

Source: TXT e-solutions

Divisional performance

The table below shows divisional revenue performance by type.

Exhibit 3: Divisional revenues, FY19–20			
Revenues (€m)	**FY20**	**FY19**	**y-o-y**
Aerospace & Aviation (A&A)			
Software licences & maintenance	7.4	5.9	26.7%
Services	33.4	32.9	1.5%
Total	40.8	38.7	5.4%
Fintech			
Software licences & maintenance	1.2	1.0	15.9%
Services	26.7	19.3	38.5%
Total	28.0	20.4	37.5%
Software licences & maintenance	**8.6**	**6.9**	**25.1%**
Services	**60.1**	**52.2**	**15.2%**
Total revenues	**68.8**	**59.1**	**16.3%**

Source: TXT e-solutions

A&A: Steady performance despite market turmoil

The A&A division reported growth of 5% y-o-y, all of which was organic. This was despite the backdrop of COVID-19 causing disruption in demand for many of TXT's customer base, including those in the civil aviation, manufacturing, automotive and transportation sectors. The company benefited from relationships it has developed over many years, where it often has long-term contracts in place; these are compensating for the difficulty in signing up new business. The company also shifted its focus to serve customers in areas that are not negatively affected by COVID-19 (eg defence, cargo airlines) and to provide solutions for advanced technology such as extended reality (XR). With its Pacelab WEAVR XR training solution, TXT was recently selected as a verified solutions partner by Unity Software. Unity is an NYSE-listed software company with the leading platform for creating and operating interactive, real-time 3D content.

The division generated EBITDA of €5.1m (-10% y-o-y), with a margin of 12.5% (down from 14.7% in FY19).

Fintech: Both organic and acquisition-driven growth

The Fintech division reported 37% growth year-on-year, of which 32% (€6.5m) was from the contribution of MAC Solutions (acquired 14 July 2020) and HSPI (acquired 19 October 2020). Excluding acquisitions, the underlying business grew 5% y-o-y. We note that Assioma was acquired on 1 May 2019 and was integrated with the existing TXT software testing business during 2019 making it impossible to disclose the Assioma contribution separately, therefore its contribution is included in organic revenues. Management noted that two of the division's early-stage businesses – Faraday (part of TXT Risk Solutions) and Polaris (part of TXT Working Capital Solutions) – were loss-making, consuming €1.1m in investment. The division is currently in negotiations with several large potential customers for Faraday's AML and compliance software and Cheleo's non-performing loan software. The recent HSPI acquisition has performed well, and the business has already signed several multi-million-euro, multi-year contracts in the public sector since the start of the year.

The division generated EBITDA of €3.5m (+164% y-o-y), with a margin of 12.4% (up from 6.4% in FY19).

Post balance sheet investments

At the end of January, TXT made a €14.3m cash investment in Banca del Fucino SpA for 9% of the share capital (post money). Banca del Fucino is the parent company of Gruppo Bancario Igea Banca, which in turn wholly controls IGEA Digital Bank (IGEA). IGEA is a digital-only bank. Management explained that the rationale for the investment was to seek better returns for the funds that have been invested in multi-segment insurance funds (described as 'Trading securities at fair value' in Exhibit 2). The company views this as a two- to three-year investment, with the expectation that the bank will become a publicly listed company, at which point TXT would exit. Management also noted that this investment could increase the company's contacts within the fintech space, which could be of benefit to its fintech business.

In January, the company noted that it had acquired the remaining 49% of Assiopay for €1.65m, split 50/50 cash/equity.

Outlook and changes to forecasts

So far this year, management continues to find it more difficult to sign new business in those areas most hit by COVID-19 (civil aviation, automotive, industrial), but is compensating for this through its focus on areas such as the defence and public sectors. It is also closely managing its cost base. The company noted that it has made remote working a permanent option for staff, which should help its ability to retain and hire staff after the pandemic.

We have revised our forecasts to take account of FY20 results and to introduce forecasts for FY22. Our FY21 forecasts are substantially unchanged at a normalised level. Reported profitability measures factor in amortisation of acquired intangibles relating to MAC Solutions and HSPI for the first time. We note that there is no longer a minority interest deduction since the company acquired the remaining 49% of Assiopay.

Exhibit 4: Changes to forecasts

	FY21e old	FY21e new	change	y-o-y	FY22e new	y-o-y
Revenues (€m)	84.2	84.6	0.5%	23.1%	90.0	6.4%
Gross margin	42.2%	42.0%	(0.2%)	(0.6%)	41.9%	(0.2%)
Gross profit (€m)	35.6	35.6	0.1%	21.5%	37.7	5.9%
EBITDA (€m)	10.5	10.5	(0.8%)	22.1%	11.5	10.5%
EBITDA margin	12.5%	12.4%	(0.2%)	(0.1%)	12.8%	0.5%
Normalised EBIT (€m)	8.3	8.3	0.3%	27.7%	9.4	13.1%
Normalised EBIT margin	9.9%	9.9%	(0.0%)	0.4%	10.5%	0.6%
Reported operating profit (€m)	7.0	6.4	(7.3%)	104.2%	7.5	
Normalised net income (€m)	5.6	5.9	5.6%	8.9%	6.7	13.3%
Reported net income (€m)	4.6	4.6	(1.5%)	2.2%	5.4	17.2%
Normalised EPS (€)	0.47	0.51	8.5%	8.4%	0.57	13.1%
Reported basic EPS (€)	0.39	0.39	1.2%	1.7%	0.46	17.1%
Net cash (€m)	30.9	13.9	(55.0%)	(36.9%)	20.2	45.3%
Dividend (€)	0.12	0.06	(50.0%)	50.0%	0.08	33.3%

Source: Edison Investment Research

Valuation

The table below shows TXT's valuation versus its peer group of European software and services providers. TXT continues to trade at a discount to its peer group on all measures, despite the deployment of a large proportion of the company's cash balance into fintech acquisitions, and revenue growth and profitability above the group average. In our view, the company's exposure to the aerospace and aviation market is likely to be weighing on the share price, as is uncertainty over the likely performance of the recent spate of acquisitions. We expect this discount to reduce as TXT provides evidence of:

- A&A: performance remaining stable at least, until customers in COVID-19-hit sectors feel more confident of their futures and resume/accelerate orders.
- Fintech: the early-stage businesses (TXT Risk Solutions, TXT Working Capital Solutions) starting to generate material revenues and reaching break-even; banks resuming normal activity for software testing; international revenues growing.
- Overall, software revenues growing as a percentage of the total, as these generate much higher gross margins.

Exhibit 5: Peer financial and valuation metrics

Company	Share price	Market cap	Rev growth		EBIT margin		EBITDA margin		EV/sales		EV/EBIT		P/E		Dividend yield	
	€	€m	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	**6.98**	**82**	**23.1%**	**6.4%**	**9.9%**	**10.5%**	**12.4%**	**12.8%**	**0.7**	**0.7**	**7.2**	**6.3**	**13.8**	**12.2**	**0.9%**	**1.1%**
European IT services companies																
AKKA Technologies	29.15	649	5.8%	6.2%	3.7%	0.8%	7.6%	-5.6%	0.8	0.7	20.6	11.3	31.6	12.7	0.0%	0.4%
Alten	98.20	3,357	7.7%	6.4%	7.5%	8.8%	10.2%	11.2%	1.3	1.2	17.7	14.0	24.4	19.5	1.0%	1.0%
AtoS	64.52	7,081	1.4%	2.8%	8.4%	9.1%	14.2%	15.0%	0.8	0.8	9.7	8.7	9.1	8.2	1.9%	2.3%
Cap Gemini	143.50	24,166	6.5%	5.1%	11.6%	11.9%	15.3%	15.6%	1.8	1.8	16.0	14.8	19.0	17.0	1.4%	1.6%
Devoteam	103.60	861	4.7%	6.6%	10.0%	1.1%	11.6%	9.7%	1.0	1.0	10.4	9.5	19.8	17.6	0.6%	1.1%
ESI Group	48.20	286	38.9%	6.7%	7.0%	7.9%	13.0%	13.5%	2.3	2.1	32.3	26.7	68.6	49.4	0.0%	0.0%
Reply	95.20	3,553	12.3%	9.8%	13.1%	2.8%	16.1%	13.0%	2.5	2.2	18.9	16.9	28.0	25.0	0.6%	0.6%
Sopra Steria	136.70	2,801	5.5%	3.8%	7.0%	7.8%	10.9%	11.7%	0.8	0.7	10.7	9.3	13.3	11.4	1.7%	1.9%
Average			**10.4%**	**5.9%**	**8.5%**	**6.3%**	**12.4%**	**10.5%**	**1.4**	**1.3**	**17.0**	**13.9**	**26.7**	**20.1**	**0.9%**	**1.1%**
(Discount)/premium to peers									***(50%)***	***(49%)***	***(58%)***	***(54%)***	***(48%)***	***(39%)***	***(5%)***	***3%***

Source: Edison Investment Research, Refinitiv (as at 11 March)

Exhibit 6: Financial summary

€'000s	2016	2017	2018	2019	2020	2021e	2022e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	33,060	35,852	39,957	59,091	68,753	84,614	90,004
Cost of sales	(18,954)	(20,224)	(22,289)	(31,825)	(39,470)	(49,045)	(52,335)
Gross profit	14,106	15,628	17,668	27,266	29,283	35,569	37,669
EBITDA	4,260	3,536	4,098	7,004	8,560	10,452	11,546
Operating Profit (before amort and except)	3,954	3,180	2,755	5,408	6,538	8,349	9,442
Amortisation of acquired intangibles	(264)	(439)	(610)	(1,142)	(1,417)	(1,900)	(1,900)
Exceptionals and other income	(557)	0	(300)	(713)	(1,963)	0	0
Other income	0	(69)	0	0	0	0	0
Operating Profit	3,133	2,672	1,845	3,553	3,158	6,449	7,542
Net Interest	48	(208)	(1,284)	2,194	562	(100)	(100)
Profit Before Tax (norm)	4,002	2,972	1,471	7,602	7,100	8,249	9,342
Profit Before Tax (FRS 3)	3,181	2,464	561	2,315	5,877	6,349	7,442
Tax	(661)	(710)	4	(1,867)	(1,162)	(1,778)	(2,084)
Profit After Tax (norm)	3,170	2,170	1,204	5,473	5,696	5,939	6,726
Profit After Tax (FRS 3)	2,520	1,754	565	448	4,715	4,571	5,358
Ave. Number of Shares Outstanding (m)	11.7	11.7	11.7	11.7	11.7	11.7	11.7
EPS - normalised (€)	0.271	0.186	0.102	0.456	0.468	0.507	0.573
EPS - normalised fully diluted (€)	0.271	0.186	0.102	0.456	0.468	0.507	0.573
EPS - (IFRS) (€)	0.475	5.874	0.048	0.027	0.384	0.390	0.457
Dividend per share (€)	0.30	1.00	0.50	0.00	0.04	0.06	0.08
Gross margin (%)	42.7	43.6	44.2	46.1	42.6	42.0	41.9
EBITDA Margin (%)	12.9	9.9	10.3	11.9	12.5	12.4	12.8
Operating Margin (before GW and except) (%)	12.0	8.9	6.9	9.2	9.5	9.9	10.5
BALANCE SHEET							
Fixed Assets	25,428	8,860	22,942	34,635	47,411	60,139	56,918
Intangible Assets	21,296	7,332	17,751	24,380	37,652	37,278	35,255
Tangible Assets	1,598	793	3,680	7,929	7,460	6,262	5,064
Other	2,534	735	1,511	2,326	2,299	16,599	16,599
Current Assets	37,085	109,426	134,674	127,052	126,036	114,861	115,924
Stocks	3,146	2,528	3,141	4,156	4,749	5,049	5,349
Debtors	26,369	17,215	16,992	24,150	41,193	46,364	49,317
Cash	7,570	89,683	114,541	98,746	80,094	63,447	61,258
Other	0	0	0	0	0	0	0
Current Liabilities	(21,051)	(13,612)	(29,366)	(43,129)	(55,446)	(60,413)	(62,100)
Creditors	(20,243)	(12,937)	(12,062)	(17,823)	(24,811)	(29,778)	(31,465)
Short term borrowings	(808)	(675)	(17,304)	(25,306)	(30,635)	(30,635)	(30,635)
Long Term Liabilities	(7,180)	(4,781)	(41,903)	(36,538)	(32,138)	(23,638)	(15,138)
Long term borrowings	(1,391)	(1,688)	(36,882)	(32,029)	(27,398)	(18,898)	(10,398)
Other long term liabilities	(5,789)	(3,093)	(5,021)	(4,509)	(4,740)	(4,740)	(4,740)
Net Assets	34,282	99,893	86,347	82,020	85,863	90,949	95,603
CASH FLOW							
Operating Cash Flow	10,676	119	2,039	(354)	1,167	9,948	9,980
Net Interest	105	(208)	(69)	3,102	(988)	(100)	(100)
Tax	(2,022)	379	(624)	(229)	(1,332)	(1,778)	(2,084)
Capex	(738)	(661)	(548)	(916)	(1,156)	(782)	(782)
Acquisitions/disposals	(5,403)	82,250	1,314	(2,178)	(11,701)	(14,965)	0
Financing	(828)	(6)	(7,208)	(4,287)	(2,641)	0	0
Dividends	(2,931)	(3,496)	(11,710)	(5,781)	0	(469)	(704)
Net Cash Flow	(1,141)	78,377	(16,806)	(10,643)	(16,651)	(8,146)	6,310
Opening net debt/(cash)	(8,259)	(5,371)	(87,320)	(60,355)	(41,412)	(22,061)	(13,914)
HP finance leases initiated	0	0	(2,788)	(2,500)	0	0	0
Other	(1,747)	3,572	(7,371)	(5,800)	(2,700)	0	0
Closing net debt/(cash)	(5,371)	(87,320)	(60,355)	(41,412)	(22,061)	(13,914)	(20,225)

Source: TXT e-solutions, Edison Investment Research

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