EDISON

Xchanging

Institutional update

Strong IMS and encouraging investor day

Support services

Xchanging's upbeat investor day gave a detailed insight into the group's increasing technology-enablement across the divisions, which we believe to be a key medium-term driver of both top-line growth and margin progression. This strong medium-term potential, coupled with solid trading as displayed by the group's latest IMS and an undemanding valuation, continues to make the shares attractive in our view.

Year end	Revenue* (£m)	PBT (£m)	EPS** (p)	Net cash (£m)	P/E (x)	Yield (%)
12/11	530.4	39.1	8.0	45.2	16.9	0.0
12/12	528.0	46.3	10.4	76.8	13.0	0.7
12/13e	511.9	51.2	10.2	131.9	13.2	1.5
12/14e	455.1	51.5	10.4	153.6	13.0	1.8

Note: * Net basis **PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Investor day focusing on technology enablement

The group's investor day displayed the significant progress Xchanging has made in expanding the group's technology enablement. In Procurement, the MM4 acquisition provides a new technology platform for the division to build on and offers significant synergies and cross-selling opportunities, while also helping the group build a stronger US presence. In Technology, the Xuber software presents a unique offering and is well-placed to capitalise on insurers' increased need to replace legacy systems. In Insurance, the group can leverage its capabilities developed for the London market in other geographies via Netsett, while providing further innovative solutions (such as X-presso) in its traditional markets.

IMS shows robust trading

Xchanging's positive IMS pointed to an upgrade in numbers, driven by the strong performance of XTB, increasing volumes for Fondsdepot Bank and a weak rupee. Xuber, the group's insurance software product, has won its first major US contract with Everest Re (on a licence and implementation basis). We continue to see Xuber as a key driver for the business and believe this contract win is an important milestone, showing Xuber's potential to also gain traction in the US. The performance in Procurement has improved after a slow H1 as a result of several new contracts and extensions with blue-chip names. The group's latest acquisition MM4 had an encouraging start with eight new customer wins within a short period of time.

Estimates and valuation

We change our numbers following the group's November IMS; our group level adjusted PBT forecast increases from £46.8m to £51.2m for FY13 and from £49.2m to £51.5m for FY14. Also, in line with the company's new KPI structure, we move to net revenue reporting and exclude pass-through revenue (with no margin impact) from our forecasts as well as from our historic reported numbers. Overall, with the valuation still undemanding (13x FY14 P/E, sub-4x EV/EBITDA) despite the recent uptick in the share price and with Xchanging continuing to transform into a higher value-add business, we remain buyers of the stock. Our updated valuation of 163p (versus 156p before) points to 21% upside to the current share price.

26 November 2013

Price	135p
Valuation	163p
Difference	21%
Market cap	£326m
Net cash (£m) as at end-FY12	76.8
Shares in issue	241.3m
Free float	92%
Code	XCH
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	15.2	12.3	22.6
Rel (local)	15.8	9.0	4.5
52-week high/low		150.0p	117.0p

Business description

Xchanging is a global technology-led provider of business processing, technology and procurement services across many sectors. It operates through four divisions: Insurance Services, Financial Services, Technology and Procurement and other business process outsourcing (BPO).

Next events

FY13 results	27 Feb 2014

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Investor day: Focus on technology-enablement

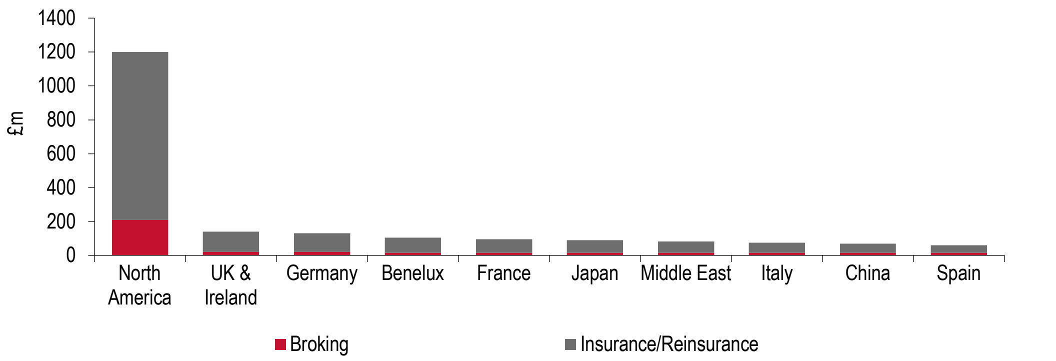
Xchanging's investor day on 15 November focused on the group's increasing technological capabilities, which are expected to be a key driver of top-line growth as well as continued margin expansion. Business processing, as a relatively immature industry, continues to evolve rapidly, requiring a high degree of flexibility from companies in the sector. While offshore service provision was a key differentiator a few years ago, now it is a standard offering as customers demand higher added value. Therefore, technology enablement is becoming the key differentiator in the market and we believe Xchanging remains well-positioned to capitalise on these trends. In this note we highlight three areas where we believe technological capabilities play a fundamental part in the group's evolution.

Technology: Xuber gaining traction, but it is only the beginning

In October 2012, the group re-launched its insurance software business under the name Xuber. Xuber provides software solutions for insurers (by handling policy administration, claims management, quotes/submissions, credit control and ceded reinsurance recoveries), reinsurers (submission registration, contract administration, claims management, retrocession calculations, etc), brokers (quotes, firm orders, transaction processing, claims, accounting and document production) and managing general agents (support for managing binding authority agreements, rating options, quoting and policy administration, claims processing, etc). As Xuber can be sold on a pure licence basis as well as via a software-as-a-service (Xuber software managed by XCH) or business process-as-a-service (business processing on Xuber software managed by XCH) arrangement, Xchanging can differentiate its offering across the potential customer base. This enables clients to receive the level of support/service with Xuber they require.

It is worth noting that Xuber's addressable market remains large, as displayed in Exhibit 1. Non-life commercial software spending in the US alone amounted to c £1.2bn in 2012, which means that even a very rapid growth in Xuber sales would not require ambitious market share assumptions. In addition, the US dominance in insurance software spending also shows why it is crucial for Xuber to penetrate the US market and why we believe Xuber's first major contract win in the US (with Everest Re on a licence and implementation basis) represents an important milestone.

Exhibit 1: Non-life commercial packaged software spend in 2012



Source: PA Consulting, Ovum, Sigma, ABI

We believe the market is not only large, but also displaying trends on which Xuber can capitalise. There is increasing evidence of major firms prioritising the replacement of legacy systems, giving Xuber the opportunity to secure new client wins. Gartner's 2012 CIO survey (with 85 insurance CIOs participating) concludes that the modernisation of legacy systems is the second most important priority in the technology space for the next three years. This trend is confirmed by Novarica, which found that over a third of insurers are substituting their core policy administration systems and c 25% are replacing their claims systems, billing rating and underwriting (source: US Insurer IT Budgets and Projects 2014, Novarica).

We believe Xuber is well-placed to capitalise on these trends, given its unique offering. Exhibit 2 shows Xuber's capabilities versus competitors' software: Xuber provides a one-of-a-kind end-to-end solution with full lifecycle processing that caters for insurers, reinsurers as well as brokers. We believe Xuber is a highly differentiated product that represents a very strong offering and, while it is still early days, major contract wins with blue-chip names (such as Marsh or Everest Re) are a strong positive signal in terms of product quality.

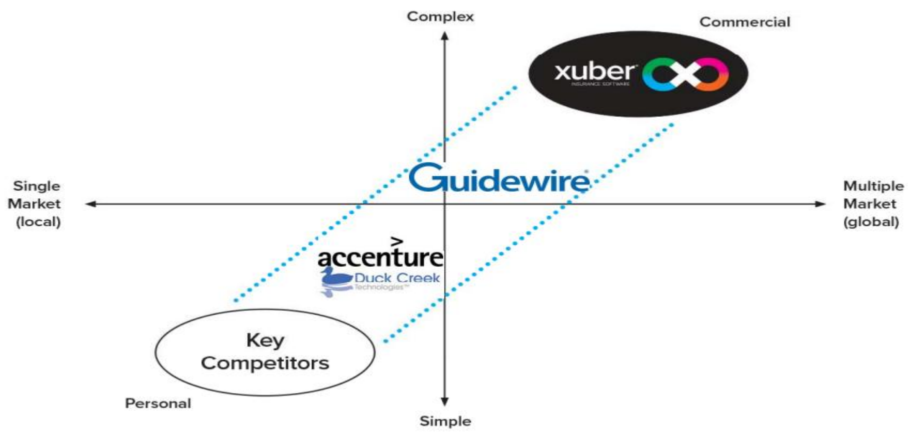
Exhibit 2: Xuber represents a unique offering

	Number of people in comparable unit (company)	Insurance software locations	New technology products	Broker solutions	Insurer solutions	Reinsurer solutions	London market support	US admitted/ workers comp. support	Complex commercial lines	SME	Personal lines	Modules
Xuber (Xchanging)	370 (8,000)	US, UK, EU, APAC	Yes	Yes	Yes	Yes	Yes	From 2014	Yes	Yes	No	Policy, claims, billing, ceding, broking
Guidewire	1,100	US, UK, EU, APAC	Yes	No	Yes	Partial	No	Yes	Growing	Yes	Yes	Policy, claims, billing
Duck Creek (Accenture)	600 (250,000)	US, UK	Yes	No	Yes	No	No	Yes	Growing	Yes	Yes	Policy, claims, billing
Fineos	350	US, UK	Yes	No	Yes	No	Yes	Yes	Yes	Yes	No	Claims
Total Objects	150	UK	Yes	Yes	No	Yes	Yes	No	Yes	Yes	No	Broking, ceding
CSC	N/A (90,000)	US, EU, APAC	No	No	Yes	Yes	No	Yes	Yes	Yes	No	Policy, claims, billing, ceding
Sequel Business Solutions	150	UK	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No	Policy, claims, billing, ceding
Room (NIIT)	200 (4,500)	UK	No	No	Yes	Yes	Yes	No	Yes	No	No	Policy, claims, billing, ceding

Source: Company data, Edison Investment Research

Meanwhile, Xuber's two closest competitors, Guidewire and Duck Creek (owned by Accenture), are moving away from their traditional markets where they have a strong presence (US personal and small commercial insurance), towards more complex commercial markets. While this clearly results in more intense competition, it also shows that Xuber is positioned in a highly attractive segment. We also believe Xuber has a significant head start and, as shown in the exhibit above, represents a highly differentiated offering in terms of segments, services and geographical offering. In addition, Xchanging's continued investment in the product (the group has spent over £20m on Xuber over the past years and an additional expenditure of c £5m in FY13 and FY14 is expected to further broaden Xuber's offering) should help sustain its competitive advantage in the commercial insurance software space and enable the group to secure further major contract wins.

Exhibit 3: Xuber's market positioning



Source: Company presentation

Overall, we continue to view Xuber as an exciting growth opportunity for Xchanging that can provide significant upside in the medium term. Assuming a £35m revenue base by FY16 with a c 20% margin would mean c £7m of additional operating profits, equivalent to over 70% of the Technology division's FY12 operating profits. As shown in the sensitivity analysis in Exhibit 4, a £7m operating profit contribution by Xuber would result in a15%+ PBT uplift on the group level compared to FY12.

Exhibit 4: PBT sensitivity to Xuber profits (£m)

FY12 adjusted operating profit	50.4	50.4	50.4	50.4	50.4
Potential Xuber operating profit	**3.0**	**5.0**	**7.0**	**9.0**	**11.0**
FY12 PBT	46.3	46.3	46.3	46.3	46.3
PBT with Xuber	49.3	51.3	53.3	55.3	57.3
Upside	6.5%	10.8%	15.1%	19.4%	23.8%

Source: Company data, Edison Investment Research

Procurement: MM4 acquisition provides the perfect strategic fit

The group acquired MarketMaker4 (MM4) in September 2013. MM4 is a US-based e-sourcing business with a wide international client base, using a subscription fee based model. MM4 has market-making capabilities (essentially working as a reverse eBay in the procurement space by bringing suppliers together on a platform that allows buyers to define their requirements and invite sellers to provide a quote, generating a 'reverse auction'), while also providing business intelligence and market insight. It helps clients with supplier identification and vetting, tailoring market intelligence to individual client needs as well as event management and evaluation, which places it in a unique position in the procurement space, as shown in Exhibit 5. It also offers a consumer friendly interface via its launch pad and easy implementation as it can be added on to any system.

Exhibit 5: MM4 is well-positioned to add value

Source: Company presentations

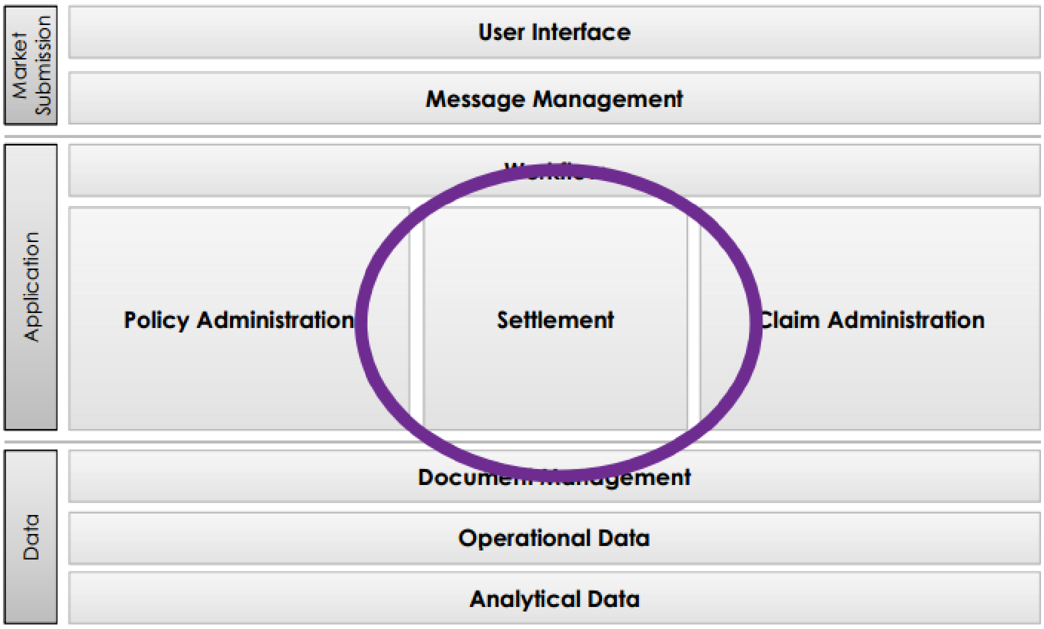
While the acquisition is small ($11m cash payment up front with a further $11m consideration contingent on hitting profitability and upselling targets), in our view it is a perfect strategic fit. We believe that MM4 will, in addition to enhancing the division's technology enablement, strengthen the group's Procurement business in several ways:

- **Expanding the offering:** Xchanging's procurement division was only engaged in managing indirect spend (ie non-core areas, such as stationery, fleet, telecom, etc) for its customers pre-acquisition, while MM4's engagement in handling both direct and indirect spending broadens the division's offering. Given that direct spending is a crucial part of customers' supply chains, it allows Xchanging to add more value and increase customer stickiness.
- **Providing opportunities to cross-sell and upsell:** Being part of Xchanging creates significant new opportunities for MM4. It will benefit not only from Xchanging's sales capabilities and ability to invest in the business, but also from the group's wide client base, which offers significant scope for cross-selling. In addition, the group can utilise MM4 as an entry into new customers (due to its simple implementation and easy-to-use nature) and build on these relationships to then upsell and broaden the service level provided to the customer.
- **Providing synergies:** The MM4 acquisition will also provide the group with synergies in several segments. Firstly, the group will benefit from an enhanced knowledge bank which, given the information-based nature of the procurement business, remains crucial in being able to offer high service levels. Secondly, the group will benefit from the technology integration. For example, the MM4 launch pad will be integrated into the group's existing infrastructure, which will enable it to provide access to the full range of Xchanging's services and products (such as Vault etc). Thirdly, it will allow to group to improve savings delivered to customers via higher volumes and handling more product categories.
- **Providing cost-effective geographical expansion:** Extending the group's geographical footprint, especially in the US, remains a key element of the division's strategy. With MM4 headquartered in Chicago and with a strong presence in its domestic market, the acquisition significantly improves Xchanging's capabilities to address the US market. In addition, MM4 is also present in China and Dubai, which could provide further growth opportunities for the group. We believe the acquisition represents a low risk and cost-effective way of penetrating new markets, while also substantially improving technology-enablement, which has been the division's weakness historically.

Insurance: Global aspirations with Netsett

Xchanging has developed strong capabilities over the last 10 years by servicing the London insurance market. The group was fundamental in modernising the London market's back-office system and has gradually built a full architecture around it, as displayed in Exhibit 6. The system is critical for the market's operations, which, coupled with the risk-averse nature of the industry, creates high barriers to entry and makes it extremely hard for competitors to penetrate this market. In addition to driving continued innovation and further increasing service levels in its existing markets (for example via X-presso, Xchanging's mobile application for claims handlers, insurers and brokers, which allows customers to access the Insurance Market Repository and view claims files on their mobile devices, while also digitally facilitating the market's appointment system), the group can leverage its expertise developed for the London market globally.

Exhibit 6: Xchanging's architecture for the London market



Source: Company presentations

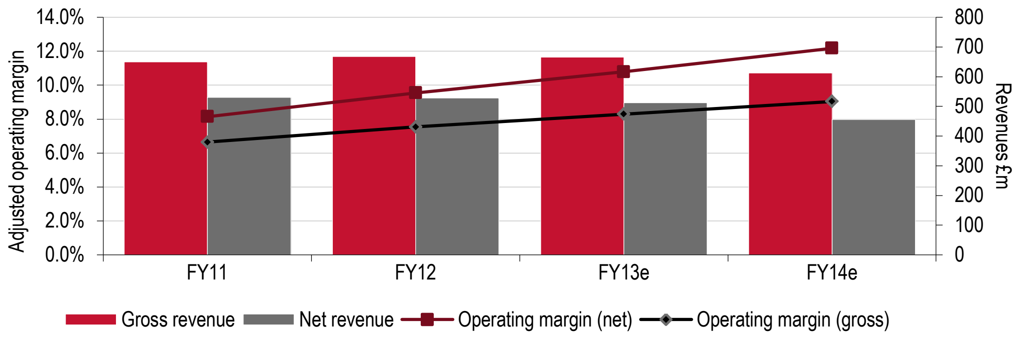
One way of taking the skills and products developed for the London market global is via building on the group's settlement capabilities via Netsett (Xchanging's global net settlement solution, which helps handle the cash flow between participants across geographies and currencies). Netsett processes all the outstanding payments to be made (for premiums, claims, etc) between market participants and arranges settlement on a net basis, which reduces the number of payments drastically as well as the total transaction value (from a total annual value of £54bn to £11bn in the London market). This leads to significant improvements in operational efficiency (50% efficiency savings by removing the need to manage the payment cycle and by allowing for the reconciliation of incoming and outgoing payments to the ledger), capital efficiency (by reducing working capital, improving cash flow and optimising foreign exchange execution) and transparency and control (by eliminating unmatched balances, increasing transparency and reducing credit risk). There is an additional network effect as the number of users increases, given that gains from netting grows as the overall transaction volume rises. Since the London market only represents a small fraction of the overall addressable market, and as many of Xchanging's customers in London operate across the globe, we believe the scope for leveraging the group's London capabilities is considerable. The group is already undertaking a pilot with RSA (to improve settlement efficiency across currencies and geographies) and has agreed on an additional pilot with the Ruschlikon group (a steering group consisting of major reinsurers, such as Swiss Re and Aon, with the objective of improving operational excellence and reducing costs) for H114, which, if successful, could be the first step towards significantly expanding Netsett's geographical reach.

IMS shows robust performance

Xchanging's positive IMS on 13 November pointed to an upgrade in numbers, driven predominantly by the strong performance of XTB, increasing volumes for Fondsdepot Bank and a weak rupee. Xuber has won its first major US contract with Everest Re (on a licence and implementation basis). As mentioned above, we continue to see Xuber as a key driver for the business and believe this contract win is an important milestone, showing Xuber's potential to gain traction in the US. The performance in Procurement has improved after a slow H1 as a result of several new contracts and extensions with blue-chip names. The group's latest acquisition, MM4, had an encouraging start with eight new customer wins within a short period of time. The Insurance division, in line with H1 trends, has remained strong, reflecting the continued growth in the London market as well as an increased contribution from IT development income.

We update our numbers on the back of the group's IMS to reflect divisional trading trends as well as group level changes. Also, in line with the company's new KPI structure, we move to net revenue reporting and exclude pass-through revenue (with no margin impact) from our forecasts as well as from our historic reported numbers, as displayed in Exhibit 7.

Exhibit 7: Historical split of gross and net revenues



Source: Company data, Edison Investment Research

Exhibit 8 summarises the changes in our group level forecasts. We upgrade our revenue numbers by c 4% for both FY13 and FY14, predominantly driven by the strong performance in Financial Services (with both XTB and Fondsdepot Bank outperforming) and by a small contribution from Technology and Insurance. However, as previously mentioned, we introduce our net revenue estimates at £511.9m for FY13 and £455.1m for FY14, which will be the basis on which we report our estimates and changes going forward. Due to strong margin performance in Insurance and the abovementioned outperformance in Financial Services, our adjusted operating profit rises by 11% in FY13, despite a significant downgrade in procurement due to a weak H1. Due to an increase in our net interest charge estimates (from £3.6m to £4.5m in FY13) and in our minorities' share of profit after tax (as a result of the strong performance in Financial Services and Insurance, where the majority of the non-controlling interests sit), the upgrade is somewhat lower on an adjusted PBT and EPS level, at 9% and 5%, respectively. With these changes flowing through to FY14 (except for XTB, where the handover to Deutsche Bank was completed at the end of August 2013), we increase our FY14 adjusted PBT forecast by 5% and our adjusted EPS forecast by 1%. We also change our unadjusted numbers to reflect the one-off gain on the XTB disposal, where management guided to a c £10-15m uplift for FY13. We also note that group is expected to realise an exceptional gain in the region of c £5m over FY13 and FY14 as a result of the early surrender for the lease on the group's Leadenhall Street premises. However, due to uncertainties around timing and the exact amount, we do not include this exceptional gain in our unadjusted numbers until we get more visibility at the full-year results.

Exhibit 8: Estimates overview

	FY13e			FY14e		
£m	Old	New	Change	Old	New	Change
Gross revenue	642.8	665.5	4%	589.4	612.5	4%
Net revenue	N/A	511.9	N/A	N/A	455.1	N/A
Adjusted operating profit	49.9	55.2	11%	51.9	55.4	7%
Adjusted PBT	46.8	51.2	9%	49.2	51.5	5%
Adjusted EPS (fully diluted, pence)	9.7	10.2	5%	10.4	10.4	1%

Source: Edison Investment Research

Sensitivities

Macroeconomic environment

Xchanging's performance would be adversely affected by a deterioration in the macroeconomic outlook. It is particularly sensitive to developments in the outsourcing market as well as to Europe, which represents over 70% of total revenues (41% UK, 32% Continental Europe). The group is continuously reviewing forward-looking economic indicators to identify potential signs of deteriorating market conditions and to enable a rapid response to changing circumstances.

Competition and industry dynamics

The development of, and competition in, the Lloyd's and London insurance market remain key risk factors for the group. While the replacement of the revolutionary Darwin Project with the more evolutionary Central Services Review has significantly strengthened the group's position, we believe medium-term insurance margins (especially on the claims-adjusting side) are likely to come under pressure. However, the better revenue mix, geographical diversification and the division's new innovative products that increase value added for customers could (partially) mitigate this impact.

Enterprise Partnerships and customer concentration

In some cases and under certain circumstances, partners in the Enterprise Partnerships(joint ventures around large deals with its clients through which the outsourcing activity is carried out) can put their shares to XCH (such is the case in the group's partnership with Allianz in Fondsdepot Bank and with the 1% minority in Kedrios), lowering the visibility on some parts of the business. In addition, the group relies on a number of key customers to achieve its sales and profit targets, and hence the termination of certain customer contracts could affect operational performance. To mitigate the impact, the group has a structured service management programme with dedicated account managers who work closely with customers to identify potential issues early and trigger corrective actions.

Technological capabilities and new products

The rapidly changing nature of technology in the current business environment means technology trends have a significant impact on XCH's business, both directly and indirectly, via its customers. The group regularly reviews its product portfolio and continuously invests in the development of new offerings to increase the value added to customers. The group has recently introduced some key new products (such as Xuber and Netsett) to grow business with current customers and to generate opportunities for new contract wins. While we believe these products represent significant growth opportunities, there are also risks related to this initiative (such as slower than expected uptake, pricing problems, etc).

Currency

XCH is exposed to foreign exchange rate risk, both transactional and translational. The group has transaction exposure in its Indian operations, which generates revenues in sterling and US dollars, but has its cost base denominated in Indian rupees. The principal transaction exposure arising during FY12 included net sterling cash flows of c £18.0m and net US dollar cash flows of $15.3m. The group hedges some of its exposure in cases where the underlying cash flows are deemed to be highly probable. Foreign exchange contracts hedging revenue against the Indian rupee amounting to £11.4m, $8.2m and €3.3m were outstanding at FY12.

Valuation

We update our valuation to reflect our new numbers and the change in peer multiples. Our updated valuation (which averages our SOTP and DCF methodologies shown below) stands at 163p (versus 156p before), representing a 21% upside to the current share price.

Exhibit 9 shows XCH's valuation versus its broader peer group. Xchanging trades at a c 21% discount on an FY13e P/E basis and a 65% discount on an FY13e EV/EBITDA basis.

Exhibit 9: Peer comparison table

	FY13 P/E	FY13 EV/EBITDA	FY14 P/E	FY14 EV/EBITDA	FY12 EBITDA margin
Capita	17.2x	13.6x	15.8x	11.5x	19.1%
Serco	10.0x	7.6x	10.3x	7.8x	7.6%
Genpact	16.0x	11.6x	16.0x	10.6x	18.1%
WNS	15.2x	11.0x	14.3x	9.5x	17.6%
Infosys	17.5x	12.5x	16.4x	11.4x	28.6%
Computacenter	14.3x	6.9x	12.8x	6.5x	3.5%
ATOS	15.0x	6.1x	13.7x	5.6x	10.4%
CapGemini	15.7x	7.2x	13.9x	6.8x	9.2%
Accenture	17.4x	9.9x	16.0x	9.3x	16.0%
Cognizant	21.5x	13.4x	19.0x	11.8x	20.7%
Temenos	21.6x	14.6x	19.0x	12.7x	24.0%
EXL Service	14.4x	7.2x	14.2x	7.2x	18.7%
Innovation Group	22.9x	10.2x	18.9x	8.8x	12.3%
IBM	10.8x	8.3x	10.0x	7.8x	24.0%
Average	16.4x	10.0x	15.0x	9.1x	15.9%
Xchanging	**13.0x**	**3.5x**	**12.8x**	**3.3x**	**12.1%**
Premium/(discount)	(20.6%)	(65.5%)	(14.5%)	(64.6%)	(23.8%)

Source: Bloomberg, Edison Investment Research

SOTP valuation

Exhibit 10: Sum-of-the-parts valuation

£m	EBIT	PAT	Min	Base	Max	Min	Base	Max	Peers
Insurance	43.5	31.3	18.0x	18.5x	22.0x	563	579	688	Innovation Group,Capita, EXL, WNS, Infosys
Financial services	11.9	8.5	9.0x	10.1x	13.0x	77	86	111	Capita, EXL, Genpact, WNS,Infosys, Serco
Technology	9.8	7.1	15.5x	17.9x	20.0x	109	126	141	Capita, Computacenter, Cognizant, Infosys, Serco,IBM, ATOS, Temenos, Accenture, CapGemini, Genpact, IBM
Procurement	4.2	3.0	5.0x	7.9x	10.0x	15	24	30	ATOS, CapGemini, Computacenter Accenture, Genpact
Corp costs	(14.1)	(14.1)	15.3x	16.4x	19.5x	(217)	(231)	(275)	
Total						547	584	695	
Minorities						(173)	(180)	(216)	
Firm value						374	404	479	
No of shares						241	241	241	
SOTP						**156**	**168**	**199**	
Price (pence)						135	135	135	
Upside/downside						**14%**	**23%**	**46%**	

Source: Edison Investment Research

Given the different nature and market position of the group's divisions, we continue to value Xchanging primarily on an SOTP basis. We allocate divisional profit after tax (PAT) in proportion of divisional operating profits and base case multiples are derived by comparing XCH's divisional EBITDA margins to those of the division's peers, and accordingly applying a discount or premium to the average multiple of those companies. The multiple attached to corporate costs is a profit-weighted average of divisional multiples, while the minorities multiple is a weighted average of the Insurance and the Financial Services divisions (which represent the vast majority of minority interests). Our SOTP methodology gives a valuation of 168p, a 23% upside to the current share price.

DCF valuation

Our DCF analysis (Exhibit 11), based on scoping estimates up to 2023, gives a similar picture. We assume that by 2023 revenue growth fades to our terminal growth rate of 1%. We conservatively use flat operating margins post-FY15 and a 10.5% discount rate to obtain a fair value of 158p.

Exhibit 11: DCF valuation

£m	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	TV	Total
Sales	512	455	464	478	492	502	512	523	533	541	546		
PBT	51	52	54	56	58	59	60	62	64	65	66		
Tax	(15)	(15)	(16)	(17)	(17)	(18)	(19)	(19)	(19)	(19)	(20)		
NOPAT	36	36	38	39	41	41	42	44	45	45	46		
Minorities	(11)	(11)	(11)	(12)	(12)	(12)	(13)	(13)	(13)	(13)	(14)		
D & A	29	29	30	30	31	32	33	33	34	34	35		
Capex	(23)	(24)	(24)	(26)	(27)	(28)	(29)	(30)	(32)	(33)	(34)		
Total	30	31	32	32	33	33	33	34	34	34	34	357	
Discounted	28	25	23	22	20	18	16	15	14	12	11	119	324
Net cash													56
Equity value													380
Average no of shares													241
Valuation (p)													**158**

Source: Company data, Edison Investment Research

Averaging the two different methodologies above yields a final valuation of 163p, providing 21% upside to the current share price.

Financials

Income statement

Exhibit 12: Divisional summary

	FY11	FY12	FY13e	FY14e
Net revenues				
Insurance	189.0	197.5	202.2	207.5
Financial Services	179.8	163.0	148.3	94.9
Technology	97.9	98.8	101.8	91.6
Procurement and other BPO	63.7	68.7	59.6	61.1
Total	**530.4**	**528.0**	**511.9**	**455.1**
Y-o-y growth		0%	-3%	-11%
Adjusted operating profits				
Insurance	36.6	37.5	43.5	45.0
Financial Services	12.3	10.6	11.9	8.4
Technology	7.0	9.6	9.8	10.1
Procurement and other BPO	7.2	8.0	4.2	4.6
Corporate costs	(19.9)	(15.3)	(14.1)	(12.7)
Total	**43.2**	**50.4**	**55.2**	**55.4**
Y-o-y growth		17%	10%	0%
Operating margins	**8.1%**	**9.5%**	**10.8%**	**12.2%**

Source: Company data, Edison Investment Research

As mentioned above, we change our revenue reporting and move to a net basis. In FY13 we expect revenues to mildly decline as a result of the XTB sale, while for FY14 we forecast revenues to decline by c 11% (c +3% underlying) due to the annualised effect of the XTB disposal and the early termination of the LME contract (c £17m impact for FY14). On margins, we expect group level adjusted operating margins to grow from 9.5% in FY12 to 10.8% in FY13 and 12.2% in FY14, mainly driven by the improving profitability of the joint AR-Kedrios business, the growing contribution from the group's German fund administration business, further cost-saving initiatives and improvements in the Technology margin.

Cash flow

We expect cash flow generation to remain strong despite elevated capex levels (forecast at c £23m in FY13). The sale of XTB will result in a one-off inflow of £33m, of which we estimate over £18m will be used for loan repayment.

Balance sheet

XCH has a healthy balance sheet with a net cash position of £76.8m at year-end 2012. Of this, c £21m is customer cash in FDB, reducing the actual net cash position to c £56m. We forecast net cash to increase to c £132m in FY13 due to the factors mentioned above, and to £154m in FY14. The group's principal source of debt is a £75m revolving facility and a £20m term loan maturing in August 2015.

Exhibit 13: Financial summary

£m	2011	2012	2013e	2014e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	650.0	668.3	665.5	612.5
Net revenue	530.4	528.0	511.9	455.1
EBITDA	76.6	80.9	83.7	84.4
Operating Profit (before amort. and except.)	65.6	71.3	73.7	74.4
Intangible Amortisation	(22.4)	(20.9)	(18.5)	(19.0)
Exceptionals	(36.6)	(4.4)	10.3	(3.6)
Other	0.0	0.0	0.0	0.0
Operating Profit	6.6	46.0	65.5	51.8
Net Interest	(9.1)	(4.6)	(4.5)	(4.5)
Profit Before Tax (norm)	39.1	46.3	51.2	51.5
Profit Before Tax (FRS 3)	(2.5)	41.5	61.4	47.9
Tax	(5.9)	(13.1)	(14.6)	(14.7)
Profit After Tax (norm)	24.9	31.7	35.7	36.1
Profit After Tax (FRS 3)	(8.4)	28.4	46.8	33.2
Average Number of Shares Outstanding (m)	239.5	239.7	240.5	241.3
EPS - normalised (p)	8.0	10.6	10.4	10.5
EPS - normalised and fully diluted (p)	8.0	10.4	10.2	10.4
EPS - (IFRS) (p)	(5.8)	9.1	15.0	9.3
Dividend per share (p)	0.0	1.0	2.0	2.4
EBITDA Margin (%)	11.8	12.1	12.6	13.8
Operating Margin (before amort. and except.) (%)	10.1	10.7	11.1	12.1
Operating Margin (after amort.) (%)	6.6	7.5	8.3	9.0
BALANCE SHEET				
Fixed Assets	294	307	294	292
Intangible Assets	220	229	215	212
Tangible Assets	20	18	18	19
Investments	53	61	61	61
Current Assets	229	245	299	323
Stocks	0	0	0	0
Debtors	130	127	145	150
Cash	98	116	153	172
Other	1	1	1	1
Current Liabilities	(212)	(221)	(251)	(263)
Creditors	(208)	(213)	(243)	(255)
Short term borrowings	(4)	(8)	(8)	(8)
Long Term Liabilities	(115)	(131)	(125)	(122)
Long term borrowings	(49)	(32)	(13)	(10)
Other long term liabilities	(67)	(99)	(112)	(112)
Net Assets	196	200	217	231
CASH FLOW				
Operating Cash Flow	53	86	96	79
Net Interest	(1)	(3)	(1)	(1)
Tax	(10)	(10)	(14)	(14)
Capex	(15)	(15)	(23)	(24)
Acquisitions/disposals	(10)	(18)	26	0
Financing	(2)	(14)	(18)	(3)
Dividends	(8)	(7)	(13)	(15)
Net Cash Flow	8	19	53	23
Others	(2)	1	2	(1)
Opening net debt/(cash)	10	(45)	(77)	(132)
HP finance leases initiated	0	0	0	0
Others	49	12	0	(0)
Closing net debt/(cash)	(45)	(77)	(132)	(154)

Source: Company data, Edison Investment Research

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