

GFT

Q3 results

Q3 organic growth remains robust at 12%

Q3 numbers were in line with expectations and management has maintained both its FY16 and long-term guidance. The backdrop remains broadly unchanged, with demand for IT projects (predominantly digitisation) in the European commercial banking sector outweighing weakness in the Anglo Saxon investment banking markets. A recovery in the latter is largely dependent on improvements in the financial performance of investment banks. However, we note the investment banking sector needs to invest in IT to remain competitive. Given that the outlook is sustained, we believe the shares are attractive on c 13x our FY18 earnings.

Year end	Revenue (€m)	EBT* (€m)	EPS* (c)	Adj EPS** (c)	P/E (x)	Yield (%)
12/14	279.2	25.4	75.8	96.5	19.6	1.3
12/15	373.5	32.5	96.2	119.5	15.8	1.6
12/16e	420.0	33.0	92.9	115.2	12.2	1.7
12/17e	460.0	39.4	105.1	127.1	14.9	1.9

Note: *Earnings before tax and EPS are statutory, after the amortisation of acquired intangibles and exceptional items. **Adjusted EPS is before amortisation and exceptionals.

Investment case: Scaling up, outsourcing benefits

GFT is diversifying geographically and broadening its stable customer base, and we estimate that two-thirds of its revenues are recurring. It benefits from high levels of IT spending and complex business requirements in the financial services industry. It also benefits from favourable outsourcing trends in banking and has significant near-shore centres in Spain, Brazil, Poland and Costa Rica.

Q3 results: Total group revenue up 15% in Q3

Q3 organic revenue grew 12% (FX impact was negligible). Revenue from Adesis Netlife, acquired in June 2015, and Habber Tec, acquired in April 2016, took total Q3 revenue to €106.3m. Q3 adjusted EBITDA rose by 8% to €12.5m, reflecting a 43bp decline in the margin. For the nine-month period, organic revenue grew 12%, or 14% at constant currencies, to €300.6m. Acquisitions took the total nine-month revenue to €314.3m, up 16%. Net debt slipped from €70.3m to €60.3m over the period, and we note the group typically generates its strongest cash flows in Q4. Outstanding acquisition liabilities of €16.1m take adjusted net debt to €76.4m.

Forecasts: Revenues and margins maintained

We have maintained our forecasts, but have eased the tax charge in FY17 from 31% to 30% and from 30% to 29% in FY18. This pushes EPS up by 1% in each of FY17 and FY18. We continue to forecast end FY16 with net debt of €22.7m.

Valuation: Attractive if it can sustain the growth

The stock trades on 1.2x FY17e EV/sales and 10.0x EV/EBITDA, broadly in line with its larger global IT services peers, which typically trade in the ranges of c 1.5-2.1x revenues and c 8.4-11.3x EBITDA. Our DCF model (which assumes a WACC of 9%, 10% pa revenue growth to 2020 and 12% long-term EBITDA margins) values the shares at €27.37, c 45% above the current share price.

Software & comp services

15 November 2016

Price €18.91

Market cap €498m

Net debt (€m) at 30 September 2016 60.3

Shares in issue 26.3m

Free float 64%

Code GFT

Primary exchange Frankfurt (Xetra)

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 9.7 (8.4) (34.9)

Rel (local) 8.5 (8.2) (34.8)

52-week high/low €32.28 €16.39

Business description

GFT (legal name: GFT Technologies SE) is a global technology services business primarily focused on banks and insurance companies.

Next events

German Equity Forum 21-23 November

Q4 results Early March 2017

Annual report Late March 2017

Q1 results May 2017

AGM June 2017

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Q3 results review

Q3 constant currency organic revenue growth decelerated to a still respectable 12%, down from 19% in Q2 but above the 8% growth achieved in Q1. The backdrop remains unchanged as strong demand for digitisation projects in the commercial banking sector in Europe outweighed weak Anglo Saxon investment banking markets. Commercial banks require modern digital infrastructure to reduce costs, improve sales strategies and boost customer loyalty. However, investment banks have been deferring IT projects mainly because of poor financial results across the sector and, to a lesser degree, due to the uncertainties created from the Brexit vote. The deferrals have resulted in lower utilisation on the Anglo Saxon markets (c 50% in the US and c 67% in the UK); this continues to weigh on margins, as shown in the Americas and UK segment in Exhibit 1.

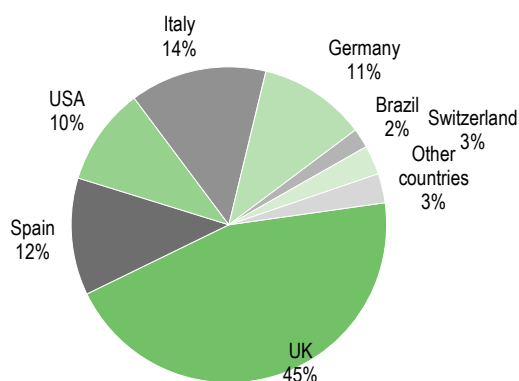
Exhibit 1: Revenue and EBITDA per segment

€m	Revenue		Growth				EBITDA			EBITDA margins	
	9M15	9M16	Organic	M&A	FX	Total	9M15	9M16	Change	9M15	9M16
Americas and UK	157.11	166.24	5.9%	3.8%	(3.9%)	5.8%	15.72	11.34	(28.0%)	10.0%	6.8%
Continental Europe	114.37	145.62	23.5%	4.3%	0.0%	27.8%	17.89	22.10	24.0%	15.6%	15.2%
Others		2.42	N/A	N/A	N/A	N/A	(2.31)	0.56	N/A	N/A	23.1%
GFT	271.48	314.28	14.0%	4.0%	(2.1%)	15.9%	31.30	34.00	9.0%	11.5%	10.8%

Source: GFT

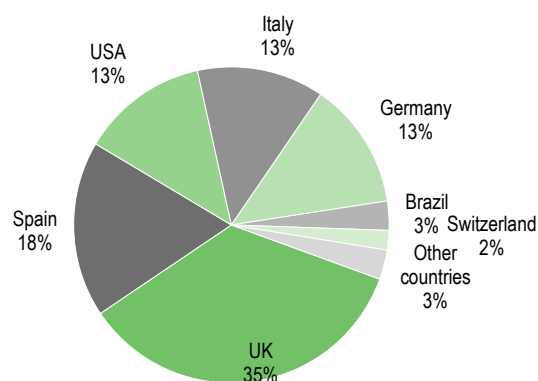
UK revenue fell 12% in 9M16 to represent 34% of total group revenues. While this is down from 45% a year earlier, the UK remains the group's largest market. Around half of UK revenue is billed in sterling, with the balance in euros; UK revenue is closely linked to US revenues as customers' budgets can move freely. Revenue in Spain jumped 77% to €56.7m, bolstered by a project for Banco Sabadell, which involved the integration of TSB in the UK. Consequently, 60-70% of revenues from Spain are non-recurring, which means this performance is not likely to be sustained. US revenues rose 51% to €41.6m, although this number includes c €10m from two customers that switched their billing from the UK. Revenues from Germany rose by 29% to €39.6m, which is entirely organic. Brazil grew 136% to €12.3m, including the acquisition of Haber Tec.

Exhibit 2: Revenue by country (9M15)



Source: GFT

Exhibit 3: Revenue by country (9M16)



Source: GFT

58% of group costs are denominated in euros along with 64% of revenues, sterling represents 17% of costs and 21% of revenues and the US dollar represents 7% of costs and 8% of revenues. Deutsche Bank generates c 40% of revenues but is expected to grow at a slower pace than the rest of the group.

Group headcount rose from 4,493 to 4,749 over the quarter, driven by growth in the group's offshore/nearshore facilities in Spain, Brazil and Poland. GFT is also expanding its nearshore facility in Costa Rica, where it recently opened new offices, to service the North American markets.

The decision to expand the Costa Rican nearshoring operation was due to the similar cultures and the availability of candidates with strong technical expertise.

Management does not expect the US election result to affect the group. There is some concern about exporting services to the group's nearshore centres outside of the US. However, we note these are highly skilled jobs that might not be possible to fill in the US.

The operating cash outflow (after interest and tax) was €2.0m in the first nine months of 2016, compared with a €20.6m inflow in the corresponding period in 2015. Therefore, the group generated €12.8m of operating cash flow in Q3, compared with €22.5m in the corresponding period. However, we note a project involving the implementation of an Avaloq core banking system for BHF-Bank has grown c 60% to €16m, of which €10-11m remains outstanding. The project has been put on hold due to a dispute between the software vendor and the bank and GFT has recently billed the software vendor for the outstanding amount.

Exhibit 3: Quarterly analysis

Quarterly analysis	2015					2016				
€000s	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4e	FYe
GFT (continuing)	88,510	90,250	89,910	98,370	367,040	94,086	105,669	100,848	97,601	398,204
Adesis Netlife			2,810	3,610	6,420	3,300	3,750	3,090	6,406	16,546
WG Systems (Habber Tec)							1,220	2,320	1,710	5,250
Other/misc	0	0	0	50	50	0	0	0	0	0
Total revenue	88,519	90,243	92,720	102,030	373,510	97,386	110,639	106,258	105,717	420,000
Cost of materials	(16,229)	(14,968)	(15,329)	(15,963)	(62,489)	(14,614)	(15,963)	(15,080)	(17,343)	(63,000)
Gross profit	72,290	75,274	77,391	86,067	311,021	82,772	94,676	91,178	88,374	357,000
Op costs before depreciation	(62,735)	(65,029)	(65,886)	(71,853)	(265,504)	(72,554)	(83,285)	(78,717)	(75,874)	(310,430)
Adjusted EBITDA	9,555	10,245	11,504	14,213	45,517	10,218	11,391	12,461	12,500	46,570
Depreciation	(1,222)	(1,237)	(1,280)	(1,415)	(5,154)	(1,356)	(1,405)	(1,538)	(1,301)	(5,600)
Adjusted operating profit	8,333	9,008	10,224	12,798	40,363	8,862	9,986	10,923	11,199	40,970
Operating Margin	9.4%	10.0%	11.0%	12.5%	10.8%	9.1%	9.0%	10.3%	10.6%	9.8%
Net interest	(313)	(423)	(338)	(630)	(1,703)	(344)	(503)	(440)	(813)	(2,100)
Edison profit before tax (norm)	8,020	8,585	9,886	12,169	38,660	8,518	9,483	10,483	10,386	38,870
Associates	(4)	(5)	(14)	(8)	(30)	(15)	22	4	(12)	0
Amortisation of acquired intangibles*	(1,136)	(1,227)	(1,355)	(2,387)	(6,105)	(1,467)	(1,522)	(1,380)	(1,500)	(5,869)
Exceptionals - other	0	0	0	0	0	0	(421)	0	0	0
Profit before tax (FRS 3)	6,881	7,353	8,517	9,774	32,525	7,036	7,563	9,107	8,874	33,001

Source: GFT (actuals), Edison Investment Research (forecasts)

Outlook and guidance

GFT expects increasing demand for solutions to digitize business processes will lead to further growth in the Continental Europe segment. The company anticipates that investments in projects to implement regulatory requirements will continue despite Brexit. However, growth in earnings is slightly lower than hoped due to the devaluation of sterling and lower utilization in the Anglo-Saxon markets.

We have maintained our forecasts, although we have eased the tax charge from FY17. We forecast a higher tax charge in Q416 and beyond as tax benefits in Spain have been exhausted. Hence our forecasted tax rates are 26% in FY16 (unchanged), 30% in FY17 (from 31%) and 29% in FY18 (from 30%). This pushes EPS up by 1% in each of FY17 and FY18. The Q4 mix is likely to differ slightly from Exhibit 1, as Adesis Netlife has been performing below expectations, while Habber Tec is beating them. Nevertheless, our forecasts are for Q4 continuing revenues (including Adesis Netlife) of €104m, which is unchanged sequentially over Q2 and €2m above the corresponding period in 2015.

Exhibit 4: Presentation of GFT and Edison definitions, based on GFT guidance

	Actual	Actual	GFT guidance	Edison numbers
€000s	FY14	FY15	FY16e	FY16e
Group revenue	279.235	373.507	420.000	420.000
Profit measures				
GFT	38.268	48.857		
Holding company	(4.081)	(3.370)		
(A) Operating profit (GFT definition)	34.187	45.486	46.570	46.570
Add back: exceptional items, misc	1.040	0.000	0.000	0.000
Add back: associates	0.012	0.030	0.000	0.000
Adjusted EBITDA (Edison definition)	35.239	45.516	46.570	46.570
(E) Normal depreciation	(3.365)	(5.154)	(5.600)	(5.600)
Adjusted operating profit (Edison definition)	31.874	40.362	40.970	40.970
Total net interest	(1.015)	(1.703)	(2.100)	(2.100)
Profit before tax norm (Edison definition)	30.859	38.659	38.870	38.870
(B) Earn-out accruals	0.309	0.000	0.000	0.000
(C) PPA order book (amort of acquired)	(1.675)	(0.931)	(0.070)	(0.070)
(F) PPA amortisation (amort of acquired)	(3.036)	(5.174)	(5.800)	(5.800)
Exceptional items, misc	(1.040)	0.000	0.000	0.000
Associates	(0.012)	(0.030)	0.000	0.000
EBT (GFT definition)	25.406	32.524	33.000	33.000
(D) EBITDA (GFT definition) (A+B+C)	32.821	44.555	46.500	46.500
EBIT (GFT definition) (D+E+F)	26.421	34.227	35.100	35.100

Source: GFT, Edison Investment Research

Financial position

GFT receives a disproportionate level of cash in Q4, as some of its largest customers utilise their budgets at the end of the financial year. Q1 and Q2 typically have weaker cash flows.

The remaining acquisition liabilities relate to Sempla and Habber Tec. The group limits its net debt to around 2x EBITDA, which leaves cash acquisition headroom of c €31m on our estimates.

Exhibit 5: Financial position

€m	31-Dec-14	31-Mar-15	30-Jun-15	30-Sep-15	31-Dec-15	31-Mar-16	30-Jun-16	03-Sep-16
Cash	(38.1)	(32.5)	(31.2)	(56.8)	(47.0)	(42.9)	(42.2)	(44.1)
Financial debt	80.2	94.3	96.3	112.0	83.4	91.9	112.6	104.4
Net (cash)/debt	42.0	61.8	65.1	55.2	36.5	49.0	70.3	60.3
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding acquisition liabilities	12.8	12.8	12.9	13.0	13.9	14.1	15.9	16.1
Adjusted net (cash)/debt	54.9	74.6	78.0	68.2	50.4	63.1	86.2	76.4

Source: GFT accounts. Note: *Includes earn-outs and deferred payments. Excludes €1m deferred payment for emagine.

Peer analysis

GFT trades at a modest premium to its peers in terms of EV/EBITDA and P/E, which reflects the group's attractive offshore/nearshore business model and strong revenue growth rates.

Exhibit 6: Peers

	Share price	Market cap	EV/sales (x)		EV/EBITDA (x)		PE (x)	
	local curr	local curr (m)	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
GFT Technologies	18.91	498	1.26	1.15	11.4	10.0	16.4	14.9
1) European-based IT services / financial sector consulting								
REPLY (€m)	109.3	1,022	1.27	1.16	9.3	8.2	15.8	13.8
Cap Gemini (€)	72.64	12,507	1.18	1.15	8.96	8.4	13.7	12.6
Devoteam (€m)	49.51	406	0.67	0.62	8.1	7.0	20.8	16.3
First Derivatives (£m)	2073	512	3.77	3.40	19.8	17.7	36.4	33.4
Indra Sistemas (€m)	9.721	1,596	0.84	0.82	9.97	8.1	19.3	12.3
2) US-based IT services / financial sector consulting								
Accenture (\$m)	117.25	76,130	2.0	1.9	12.1	11.3	19.8	18.0
Cognizant (\$m)	53.95	32,732	2.0	1.9	9.3	9.1	15.9	14.7
Luxoft (\$m)	54.85	1,821	2.0	1.8	11.9	10.5	19.3	16.0
EPAM (\$m)	61.95	3,162	2.1	2.0	12.5	11.6	21.0	17.9
3) Indian-based IT services / financial sector consulting								
HCL Technologies (Rs m)	770.75	1,087,340	2.2	2.1	10.1	9.5	13.4	12.1
Tata Consultancy Svcs (Rs m)	2121.3	4,179,869	3.1	2.9	11.6	10.8	16.0	14.8
Wipro (Rs m)	447.95	1,088,844	1.6	1.5	7.8	7.5	12.9	11.7
Medians excluding GFT			2.0	1.9	10.0	9.3	17.7	14.7
Source: GFT calculated by Edison Investment Research, others Bloomberg data. Note: Priced as at 15 November 2016.								

Exhibit 7: Financial summary

	€'000s	2013	2014	2015	2016e	2017e	2018e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		264,285	279,235	373,507	420,000	460,000	506,000
Cost of Materials		(108,559)	(52,194)	(62,486)	(63,000)	(69,000)	(75,900)
Gross Profit		155,726	227,042	311,021	357,000	391,000	430,100
EBITDA		22,256	32,822	44,556	46,501	52,900	59,202
Adjusted EBITDA		20,845	35,240	45,517	46,570	52,900	59,202
EBIT		17,760	26,421	34,228	35,101	41,120	46,824
Adjusted Operating Profit		18,599	31,875	40,363	40,970	46,920	52,624
Amortisation of acquired intangibles		(2,250)	(4,711)	(6,105)	(5,869)	(5,800)	(5,800)
Exceptionals		1,420	(731)	0	0	0	0
Associates		(9)	(12)	(30)	0	0	0
Operating Profit		17,760	26,421	34,228	35,101	41,120	46,824
Net Interest		(241)	(1,015)	(1,703)	(2,100)	(1,700)	(1,450)
Profit Before Tax (norm)		18,358	30,860	38,660	38,870	45,220	51,174
Earnings Before Tax		17,519	25,406	32,525	33,001	39,420	45,374
Tax		(3,890)	(6,819)	(5,979)	(8,551)	(11,757)	(13,305)
Net inc from discontinued ops		0	1,368	(1,209)	0	0	0
Profit After Tax (norm)		14,468	25,409	31,472	30,319	33,463	37,869
Profit After Tax (FRS 3)		13,628	19,955	25,336	24,450	27,663	32,069
BALANCE SHEET							
Average Number of Shares Outstanding (m)		26.3	26.3	26.3	26.3	26.3	26.3
EPS - normalised (c)		55.0	96.5	119.5	115.2	127.1	143.8
EPS - normalised & fully diluted (c)		55.0	96.5	119.5	115.2	127.1	143.8
EPS - FRS 3 (c)		51.8	75.8	96.2	92.9	105.1	121.8
Dividend per share (c)		25.00	25.00	30.00	33.00	36.00	40.00
Gross Margin (%)		58.9	81.3	83.3	85.0	85.0	85.0
EBITDA Margin (%)		8.4	11.8	11.9	11.1	11.5	11.7
Adjusted Operating Margin (%)		7.0	11.4	10.8	9.8	10.2	10.4
Fixed Assets		80,761	148,732	173,451	180,451	177,871	173,083
Intangible Assets		68,210	125,852	139,480	143,680	137,880	132,080
Tangible Assets		7,666	17,780	26,488	29,288	32,508	33,520
Other		4,885	5,100	7,484	7,484	7,484	7,484
Current Assets		125,616	152,921	153,357	178,897	212,512	245,593
Stocks		0	0	0	0	0	0
Debtors		73,010	108,216	94,828	106,632	116,787	128,466
Cash		47,149	38,129	46,978	60,714	84,173	105,576
Current Liabilities		(70,769)	(140,614)	(90,628)	(102,659)	(113,010)	(124,914)
Creditors		(70,037)	(94,582)	(90,017)	(102,048)	(112,399)	(124,303)
Short term borrowings		(732)	(46,032)	(611)	(611)	(611)	(611)
Long Term Liabilities		(48,460)	(60,628)	(111,733)	(111,733)	(111,733)	(111,733)
Long term borrowings		(27,006)	(34,131)	(82,817)	(82,817)	(82,817)	(82,817)
Other long term liabilities		(21,453)	(26,497)	(28,916)	(28,916)	(28,916)	(28,916)
Net Assets		87,148	100,412	124,447	144,957	165,640	182,030
CASH FLOW							
Operating Cash Flow		9,531	23,357	54,019	46,570	52,900	59,202
Net Interest		384	231	109	(2,100)	(1,700)	(1,450)
Tax		(2,091)	(8,152)	(11,424)	(7,774)	(10,853)	(12,282)
Capex		(5,484)	(9,680)	(14,456)	(8,400)	(9,200)	(7,590)
Acquisitions/disposals		(15,254)	(58,472)	(16,760)	(6,662)	1,000	(7,000)
Shares issued		587	(1,494)	(620)	0	0	0
Dividends		(3,949)	(6,584)	(6,584)	(7,898)	(8,688)	(9,477)
Net Cash Flow		(16,276)	(60,794)	4,284	13,736	23,459	21,403
Opening net debt/(cash)		(35,912)	(19,410)	42,034	36,449	22,713	(746)
Other		(225)	(650)	1,301	0	0	0
Closing net debt/(cash)		(19,410)	42,034	36,449	22,713	(746)	(22,149)

Source: Edison Investment Research (forecasts). Note: *€1m receipt in FY17 is a deferred payment relating to the disposal of emagine. The €7m payment in FY18 relates to the acquisition of GFT Italy

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