GFT

Q4 results & Annual Report

Consolidation in FY17, acceleration in FY18

Software & comp services

While GFT reported FY16 revenues and EBITDA slightly ahead of our forecasts, the shares fell in response to unexpectedly weak FY17 guidance and higher than expected debt. The guidance reflected the challenging investment banking backdrop, which has been holding back profits in the UK and North America. Nevertheless, GFT's retail banking activities remain buoyant, benefiting from digital banking projects in continental Europe, and management expects group growth to return to trend levels from FY18 on digitisation strength and recovering investment banking markets. Hence, we believe the shares look attractive on c 14x our FY18 earnings.

Year end	Revenue (€m)	EBT* (€m)	EPS* (c)	Adjusted EPS** (c)	P/E (x)	Yield (%)
12/15	373.5	32.5	96.2	119.4	14.8	1.7
12/16	422.6	33.0	92.0	115.4	15.3	1.7
12/17e	455.0	35.1	92.2	116.9	15.1	1.9
12/18e	500.5	40.7	109.0	129.9	13.6	2.1

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

Q4 results: Q4 organic revenue growth was 5%

Q4 revenues grew by 6% to €108.3m, including 5% organic growth and 1% from acquisitions. The growth was driven by digital banking projects in the European retail banking sector. Adjusted EBITDA slipped by 10% to €12.8m reflecting the challenging environment in investment banking. FY16 revenues grew 13% to €422.6m, representing constant currency organic growth of 12% and 3% from acquisitions, less a 2% currency headwind. End FY16 net debt was €42.1m. In addition, there are acquisition liabilities of €34.1m and a pension deficit of €8.7m.

Management changes: Marika Lulay is CEO from May

GFT announced in January that Marika Lulay will take on the position of CEO from 31 May. Ulrich Dietz, the current CEO, who founded the company in 1987, will become chairman of the administrative board and remains the company's major shareholder. As Ms Lulay has been chief operating officer (COO) since 2002, we do not expect any imminent change in group strategy, but continued evolutionary change as the group continues its internationalisation strategy.

Forecasts: FY17 eased, trend maintained thereafter

Management guidance is for revenues of €450m in FY17 (which reflects 6.5% revenue growth against the c 10%+ trend) along with EBITDA of €48.5m. It expects the long-run revenue trend to resume in FY18. Consequently, we cut our FY17 revenues by 1% to €455m, while adjusted EBITDA comes back by 8% to €48.5m.

Valuation: Attractive if it can improve margins

The stock trades on 1.0x our FY18e EV/sales and 9.3x EV/EBITDA, while its larger global IT services peers typically trade in the ranges of c 1.8-2.1x revenues and c 8.5-11.7x EBITDA. Our DCF model (which assumes a WACC of 9%, 10-year revenue CAGR of 7.3% and 12% long-term EBITDA margins) values the shares at €22.84 (previously €27.37), c 29% above the current share price.

31 March 2017

Price	**€17.70**
Market cap	**€466m**
Net debt (€m) at 31 December 2016	42.1
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	(11.1)	(15.0)	(16.8)
Rel (local)	(13.8)	(20.2)	(32.6)
52-week high/low		€23.0	€16.4

Business description

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

Next events

Q1 results	11 May
ESN European Champion (equinet), Frankfurt	19 May
AGM	31 May

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Edison profile page

GFT is a research client of Edison Investment Research Limited

Investment summary: A global player in IT services

Company description: Technology partner in financial sector

GFT is an IT services and consulting business based in Stuttgart, Germany, specialising in the financial services sector. The two primary growth areas have been around digitalisation in the commercial banking sector and regulation in the investment banking sector. GFT is increasingly international, with c 6% of its c 4,870 staff in Germany, c 42% in Spain, c 16% in Brazil, 12% in Poland and 11% in Italy. The group has offices in 12 countries and customers include Deutsche Bank, Barclays, HSBC, UBS, RBS, KKR, Sabadell, Intesa San Paolo, LBBW, Santander and BBVA.

Financials: Twelve consecutive years of profitability

GFT has recorded 12 consecutive years of healthy profits in the wake of the technology sector depression of 2002-04 and weathered the global financial crisis and the eurozone debt crisis well. The business has a core of stable maintenance contracts, around which it offers specialist business and IT consulting. This leads to additional work, divided into changes to existing systems, which is regular work, and development of new applications, which is specific non-recurring projects. Originally, GFT operated predominantly in retail banking, but over 2010-12 the group shifted more to investment banking in anticipation of strong growth in regulatory driven projects. From 2016, the focus has been shifting back towards retail banking. The group has generated a 17% CAGR in revenues over 2007-16 including 12% organic growth. We forecast revenues to grow by 8% in FY17 and by 10% in FY18 and in FY19, with EBIT margins rising from 8.2% to 9.2%. End FY16 net debt was higher than we expected at €42.1m (€22.7m forecast), due to c €8m debtor payments falling into January and a c €11m disputed contract, now in litigation. Additionally, outstanding acquisition liabilities rose by €18m to €34m, which reflects the highly successful Sempla acquisition.

Exhibit 1: Revenue and EBITDA per segment

€m	Revenue (€m)		Growth				EBITDA (€m)			EBITDA margins	
	FY15	FY16	Organic	M&A	FX	Total	FY15	FY16	Change	FY15	FY16
Americas and UK	210.78	219.42	4.8%	3.2%	(3.9%)	4.1%	22.21	16.11	(27.0%)	10.5%	7.3%
Continental Europe	162.68	200.52	20.3%	3.0%	(0.1%)	23.3%	25.72	31.65	23.0%	15.8%	15.8%
Others	0.05	2.62	N/A	N/A	N/A	N/A	(3.37)	(0.99)	N/A	N/A	(37.8%)
GFT	373.51	422.56	12.1%	3.1%	(2.1%)	13.1%	44.56	46.77	5.0%	11.9%	11.1%

Source: GFT

Sensitivities: Financial services exposure, but broadening

GFT has significant exposure to the financial services industry. Recent acquisitions have broadened its customer base and diversified the risk profile. As a consequence, revenues in Germany have fallen to 12% of FY16 group revenues from 38% in FY12, while other countries have risen: UK 33%, Spain 19%, Italy 13% and US 13%. Deutsche Bank has slipped to c 35% of group revenues (2003: 80%). IT budgets are subject to pressure in economic slowdowns. However, slowdowns can also speed up the pace of outsourcing as customers seek to reduce costs.

Valuation: DCF indicates 29% upside on conservative assumptions

The stock trades on 15.1x our FY17 EPS, falling to 13.6x in FY18 and to 11.5x in FY19. Our DCF model (which assumes a WACC of 9%) values the shares at €22.84, or 29% above the current share price. This is down from €27.37 in our Q3 update, which reflects the higher than anticipated adjusted net debt position and the forecast downgrades as well as slightly higher investment assumptions. Nevertheless, in our view, this valuation is underpinned by the group's good record of profitability, long-term relationships with its large customers, which provide relatively stable revenue streams, and the increasing scale of the business, which should help to lift operating margins.

Company description: Technology partner for banks

GFT is a provider of IT services, primarily to commercial and investment banks. The business offers a combination of onsite and nearshore/offshore services, with facilities in Brazil and Costa Rica servicing the Americas, and offices in Spain and Poland serving its European customers. The group's office in Mexico services its Mexican customers. GFT offers customers a range of services including business/IT consulting, application development, application management/business process outsourcing and solution-based development. The customer base is close to 100% financial services. New business is generated via requests for proposals (RFPs) or through direct selling. In the latter case, consultants with direct access to customers are incentivised to close sales. Projects are often done in an agile way, ie, in partnership with the customer.

GFT has c 4,870 employees including 170 in sales, marketing and business development. The group has operated in Spain since 1996 and this is this now comfortably GFT's largest subsidiary with more than 2,000 employees based in six Spanish offices. Salaries for Spanish employees are typically c 50-55% of German salaries.

The predominant growth drivers in recent years have been regulatory projects on the investment banking side and digitisation for retail banks. Management expects stable growth from regulatory projects and strong growth from digitisation, particularly in the retail banking sector, but also from investment banking. Deutsche Bank remains GFT's biggest customer, and represents c 35% of revenues. However, GFT continues to drive its goal of becoming an IT partner for all banks. The group rarely loses customers as the sensitive nature of the customers' applications would make switching suppliers difficult. Q1 is typically the weakest quarter and there is an H2 weighting. However, in FY16, Q2 was unusually the strongest quarter, due to the tough Q4, and given that Q2 benefited from Easter being in Q1, and hence more working days in Q2.

GFT offers tailored solutions incorporating third-party and open-source software, which are developed on an agile basis within GFT's Applied Technologies Group (ATG). ATG has a goal of promoting open innovation and bringing ideas to market. The group's flagship lab is in Barcelona, Spain, and mainly focuses on newer technologies around retail banking. A banking lab in London is focused on technology to improve investment banking. Recently it has handled much work on blockchain technology, and the group has done many proof of concepts (POCs) and some have already gone live, including a high-profile project with RBS. There is also an ATG lab in Alphaville, Greater Sao Paulo, Brazil, to support the Latin American markets. The main focus of ATG is on newer technologies and GFT has its first POCs with artificial intelligence, interestingly in Italy, and its first project around PDS2 (the revised payment services directive), which affects the entire retail banking sector.

FY16 results: Constant currency organic growth was 12%

FY16 revenues grew by 13% to €422.6m (we forecast €420.0m), representing constant currency organic growth of 12% and 3% from two small acquisitions, less a 2% currency headwind (the decline of the British pound after the vote for Brexit). EBITDA rose by 5% to €46.8m (we forecast €46.5m) as strong growth in continental Europe outweighed the sharp decline in the Anglo Saxon markets (see Exhibit 1). We summarise our revised forecasts below, which we eased on back of management's cautious FY17 guidance. More detail is provided in Exhibit 7 on page 9.

Exhibit 2: Forecast changes

	Revenue (€m)			EBITDA (€m)			Adjusted EPS (c)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2017e	460.0	455.0	(1.1)	52.9	48.5	(8.3)	127.1	116.9	(8.0)
2018e	506.0	500.5	(1.1)	59.2	54.5	(7.9)	143.8	129.9	(9.7)
2019e	N/A	550.6	0	N/A	63.6	0	N/A	153.8	0

Source: Edison Investment Research

Strategy

GFT is focused on developing its IT services/consulting business, which generates good levels of recurring revenues and cash flow, both organically and via acquisition, via both organic client expansion and geographical expansion. The acquisition strategy continues to be focused on Europe and the Americas and the aim is to add an additional c €200m to annual group revenues by 2020 through acquisitions. The group has executed roughly an acquisition a year over the last six years. The acquisition strategy is focused on North America and EMEA.

Recent acquisitions

GFT's first significant acquisition in recent years was in 2013 when it acquired Sempla, an Italian IT services and solutions provider, which boosted the group's presence in Italy. GFT acquired an initial 80% of Sempla, and the remaining 20% is expected to be purchased in FY18, putting the deal on 5.2x EBITDA. Given the success at Sempla, (now GFT Italy), the deferred acquisition payment has risen to c €32m, which includes €4m of accrued dividend payments. In 2014, GFT acquired Rule Financial, a UK-based provider of consultancy and IT services to investment banks. Rule significantly broadened GFT's customer base, as it served nine of the 10 largest investment banks globally, most of which were not GFT customers. Further, it added near-shore centres in Costa Rica and Poland. In 2015, GFT disposed of emagine, a contractor recruitment business, and purchased Madrid-based Adesis Netlife, which complemented GFT's Barcelona-based operations in Spain and added an office and customer base in Mexico. In 2016, GFT acquired Habber Tec Brazil, which specialises in the implementation and ongoing support of business process management (BPM), big data, analytics and mobile solutions and is Brazil's largest IBM partner for BPM.

Exhibit 3: Acquisition history

Acquired company	Acquisition date	Share-holding	Initial price (€m)	Deferred (€m)	Revenues	Main regions	Headcount	Description
Asymo	09/06/2011	100%	7.9	4.6*	N/A	Switzerland	17-18	Swiss IT consultancy for the core banking solution Avaloq
G2 Systems	07/10/2011	100%	1.5	3.6*	N/A	US	small	Provision of IT consulting services to investment banks. Technology skills include Geneva (Advent)
Sempla	03/07/2013	initial 80%	20.7	c 32	€44m in 2012	Italy	441	Provision of IT solutions to commercial and private banks
Rule Financial	27/06/2014	initial 98%	43.7	19.3*	£48.3m in FY13	UK & North America	>800	Provision of business consulting, IT consulting and IT services to capital markets and investment banking. Added near-shore centres in Poland and Costa Rica
Adesis Netlife	28/07/2015	100%	22.3	0.0	€13.39m in FY14	Spain & Mexico	273	Provision of IT services and consulting for the development of integrated digital solutions with a special focus on the financial sector
Habber Tec Brazil	12/04/2016	100%	6.7	1.6	c €5.4m in FY15	Brazil	105	The implementation and ongoing support of BPM, big data, analytics and mobile solutions with c 60% of revenues coming from the financial services industry

Source: GFT. Note: *Initial estimates.

Competitive environment

The main competitors in North America and the UK are Accenture and Indian-based consultancies Wipro, HCL and TCS, and occasionally Infosys. The Indian companies are seen much less in Europe, where the main competitors are Accenture and local players including Luxoft, Steria and Intelligence AG. GFT does not come up against Cap Gemini or Atos, and IBM rarely.

CODE_n (see www.code-n.org/about)

Established by GFT in 2011, CODE_n is a competition-based networking festival. Its goal is to support young entrepreneurs and help them to establish contacts with potential business partners and investors. After four years at the CeBIT, CODE_n is changing, and in 2016 it was held as a standalone event at Karlsruhe. It is expected to be held every two years at varied locations. GFT's CODE_n costs were €1.47m in FY16, which includes a €0.4m investment write down (Parkpocket).

Investment case: Leveraging a growing market

Having weathered a decade of turbulent conditions in the European technology and banking sectors, GFT recorded a strong performance over 2012-16 as it developed into a stronger and more focused organisation. Non-core businesses have been sold, cost-effective nearshore centres expanded, and acquisitions made to strengthen the core business.

Banking and securities IT spending growth. Gartner (2017) forecasts global IT spending in the banking and securities sector to rise by a 3.2% CAGR over 2015-20 to $557.6bn. Within that number, Gartner forecasts IT services (GFT's segment) to increase by 5.0% to $214.9bn.

Digitisation. Digital banking remains in a strong growth phase across the globe, boosted by the advent of smartphones and tablets; smartphones are expected to take 80% of the online banking market by 2020 (AT Kearney). The constant threat from challenger banks and fintechs puts existential pressure on commercial banks to offer modern digital banking solutions and they need to hire companies like GFT to design and implement their tailored solutions. Particularly strong growth is expected in North America as it catches up with the rest of the world. The main growth in the retail bank digitisation has been in Southern Europe (Spain and Italy), which has led Northern Europe, while, unusually, North America is the laggard. According to Gartner, by 2021 49% of EMEA banking revenues will be from digital banking, up from 20% in 2016. The corresponding figures are 55% up from 20% for Latin America, 43% up from 17% in Asia-Pacific, and 36% up from 9% in North America. GFT is using its references from success stories in Southern Europe to win new business in North America and the UK, and it already has considerable traction.

Regulation/de-regulation. GFT has been benefiting from the "tsunami" of new regulations in recent years, such as EMIR, MiFID II, Basel 3 and FRTB. These new regulations have been forcing institutions to increase spending on governance, risk management and compliance-driven projects to meet reporting and transparency obligations. The new US government's deregulation plans in the banking section could release some budgets for technology growth investment. Meanwhile, there remain plenty of new European regulations to drive the group's compliance business.

Customer's margin pressure/outsourcing. Outsourcing has been a key driver in the financial services sector in recent years, driven by regulatory and technology changes and the pressure on customers to reduce costs. The projects that GFT works on are typically highly technical and increasingly difficult for financial services firms to manage internally. In our view, ongoing competitive and financial pressures are making outsourcing more relevant for financial services organisations that are looking for more efficient operating environments at lower costs.

Nearshoring/offshoring. Offshore and nearshore (ie in adjacent countries or similar time zones) facilities extend the outsourcing growth driver by offering customers substantial cost reductions and growing GFT's margins. We believe offshoring can provide customers with a 40-50% cost reduction on headcount alone. Following the change in US regime, GFT has not seen any indication that US domiciled banks will change their delivery strategy.

Recurring revenues. We estimate that c 60% of GFT's revenues are recurring in nature. These relate to maintenance work, typically on one-year rolling contracts that automatically renew, and changes to existing systems. Customer relationships are "sticky" as the group establishes a detailed knowledge of its customers' systems.

Expanded footprint. One of GFT's goals has been to reduce its reliance on Deutsche Bank (c 35% of revenues). Recent acquisitions have given the group a bridgehead into a number of significant financial institutions. Further acquisitions could broaden the customer base into new countries, generate further benefits from the offshore centres and increase the potential to cross-sell applications and services.

Financials: Strong track record of profitable growth

The group has recorded 12 consecutive years of healthy profits in the wake of the technology sector depression of 2002-04, and in spite of the global financial crisis years of 2008-09 and the European financial crisis in 2012.

Business model

The business has a core of stable maintenance contracts, around which it offers specialist business and IT consulting. This leads to additional work divided into changes to existing systems, which is regular work, and development of new applications, which is specific non-recurring projects. GFT pitches project concepts to its clients, some of which will move to a proof-of-concept stage of which a proportion will eventually turn into projects.

Managed services (c 40% of annual revenues): GFT supports customers with their business functions on the technical side, and application maintenance is the biggest part. The work can be done remotely (offshore or nearshore) or through single staffing on a customer's premises. The work involves both mainframe computers operating the legacy cobol programming language, along with modern systems utilising SAP and other technologies.

Recurring projects (c 20%): GFT offers specialist consulting work to ensure that existing systems are adapted to new regulations. This leads to regular work that covers both new and legacy systems. We note that programmes running on old cobol programming language in a mainframe computer environment are still common and must be kept up to date.

Non-recurring projects (c 40%): GFT offers specialist consulting work to help management with IT strategies, and this covers areas including post-merger IT integration strategies and business architecture design, along with transformation and sourcing strategies. Consulting work will often lead to specific development projects and GFT develops tailored applications for customers utilising both standard enterprise and open-source applications.

Revenue model: Around half of contracts are fixed-price and half based on time and materials (T&M). Fixed-price contracts are typically one-year rolling contracts and are generally recurring in nature, as they automatically renew. We note that, historically, the investment banking business was entirely based on T&M, but this is shifting to fixed price. Cash flow for fixed-price contracts is typically based on advanced milestones while T&M is on standard business terms.

Utilisation rates (production days/potential workdays) are high at c 90% in most nearshore centres (the 10% balance on training), but lower elsewhere, as onshore consultants spend more time on pre-sales. New employees are rapidly chargeable, after two to four weeks of induction and training. Margins are similar in retail and investment banking, but nearshore revenues are more lucrative than onshore revenues. Hence, margins are a function of utilisation rates in conjunction with the level of nearshore revenues. In times of high demand, the group will make greater use of freelancers, but employees usually bring in a better margin.

FY16 and Q416 results: Underlying Q4 revenue growth was 5%

In FY16, the group achieved 13% revenue growth in spite of a downturn in the investment banking sector, resulting in tight budgets, and the Brexit vote, which led to a sharp decline in the British pound. M&A contributed c 3% to the growth while currency headwind reduced growth by 2%, hence the underlying organic growth was 12%. There was a €2m FX hit in H1, mainly relating to the fall in the British pound after Brexit, and a further €1m hit in H2, relating to the strength of the Polish zloty against the British pound, as many revenues invoiced in the UK are delivered from Poland. This effect continues to burden the group by €0.5m per quarter. UK revenues dipped from 45% of group in FY15 to 33% in FY16, due to project deferrals after the Brexit vote and €15m of budgets were switched from customers' accounts in the UK to the US. US and UK revenues when combined slipped by 2% from €198.9m to €194.0m. Revenues from Deutsche Bank grew by 7.5% in FY16, which was a bit stronger than management anticipated at the beginning of 2016, representing a flat performance from investment banking and c 30% growth in retail banking.

Operating cash flow after interest and tax dipped 54% to €19.8m in FY16, partly due to payments slipping into January. Had the balance date been 5 January 2017, operating cash flow on this basis would have been €28m according to GFT. Additionally, there is the issue over an Avaloq contract, of which €10-11m remains outstanding, and which is now in litigation (no provision has been made).

For Q416, group revenues rose by 6% to €108.3m, representing 5% organic growth and a small contribution from Habber Tec. Adjusted EBITDA slipped by 10% to €12.8m. Cash and investments rose by €18.2m to €62.3m over Q4, as seasonal inflows lifted cash flow from operations to €21.8m.

Exhibit 4: Quarterly analysis

€000s	2015	2015	2015	2015	2015	2016	2016	2016	2016	2016
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Q4	FY
GFT (continuing)	88,510	90,250	89,910	98,370	367,040	94,086	105,669	100,848	104,086	404,689
Adesis Netlife			2,810	3,610	6,420	3,300	3,750	3,090	3,450	13,590
WG Systems (Habber Tec)							1,220	2,320	740	4,280
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	108,276	422,559
Cost of materials	(16,229)	(14,968)	(15,329)	(15,963)	(62,489)	(14,614)	(15,963)	(15,080)	(14,190)	(59,848)
Gross profit	72,290	75,274	77,391	86,067	311,021	82,772	94,676	91,178	94,085	362,711
Op costs before depreciation	(62,735)	(65,029)	(65,886)	(71,853)	(265,504)	(72,554)	(83,285)	(78,717)	(81,321)	(315,456)
Adjusted EBITDA	9,555	10,245	11,504	14,213	45,517	10,218	11,391	12,461	12,765	47,255
Depreciation	(1,222)	(1,237)	(1,280)	(1,415)	(5,154)	(1,356)	(1,405)	(1,538)	(1,953)	(6,252)
Adjusted operating profit	8,333	9,008	10,224	12,798	40,363	8,862	9,986	10,923	10,811	41,003
Operating Margin	9.4%	10.0%	11.0%	12.5%	10.8%	9.1%	9.0%	10.3%	10.0%	9.7%
Net interest	(313)	(423)	(338)	(630)	(1,703)	(344)	(503)	(440)	(459)	(1,746)
Edison profit before tax (norm)	8,020	8,585	9,886	12,169	38,660	8,518	9,483	10,483	10,352	39,257
Associates	(4)	(5)	(14)	(8)	(30)	(15)	22	4	(66)	(54)
Amortisation of acquired intangibles*	(1,136)	(1,227)	(1,355)	(2,387)	(6,105)	(1,467)	(1,522)	(1,380)	(1,365)	(5,734)
Exceptionals - other	0	0	0	0	0	0	(421)	0	0	(421)
Profit before tax (FRS 3)	6,881	7,353	8,517	9,774	32,525	7,036	7,563	9,107	8,921	33,048

Source: GFT

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 (now GFT Italy), which are scheduled for payment in early 2018, and Habber Tec (c €1.6m). The Sempla earnout was increased by €18.3m in the latest period due to a strong performance. The total price for Sempla is €48m (c €21m + c €27m deferred), which represents 5.17x average EBITDA over the over the years FY15-17. In addition, there are €4m of accrued dividends that will be paid along with the earnout. The group limits its net debt to around 2x EBITDA, which leaves cash acquisition headroom of c €57m on our estimates, or c €23m after the remaining acquisition liabilities are settled by 2018.

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	30-Sep-16	31-Dec-16
Cash	(38.1)	(32.5)	(31.2)	(56.8)	(47.0)	(42.9)	(42.2)	(44.1)	(62.3)
Financial debt	80.2	94.3	96.3	112.0	83.4	91.9	112.6	104.4	104.3
Net (cash)/debt	42.0	61.8	65.1	55.2	36.5	49.0	70.3	60.3	42.1
Outstanding acquisition liabilities*	12.8	12.8	12.9	13.0	13.9	14.1	15.9	16.1	34.1
Pension deficit	7.3	8.0	8.7	8.7	8.3	8.7	8.8	8.9	8.7
Adjusted net (cash)/debt	62.1	82.6	86.7	76.9	58.7	71.8	95.0	85.3	84.9

Source: GFT accounts. Note: *Includes earn-outs and deferred payments. Excludes €0.15m deferred payment for emagine.

Outlook and guidance

GFT's FY17 revenue guidance of €450m disappointed the markets, as it implies 6.5% revenue growth compared with trend guidance of 10% (which would translate to c €465m). The cautious FY17 guidance reflects the current challenging investment banking environment. While management does see improved sentiment on the investment banking side, current IT spending remains cautious. Hence, management expects a weak H117 in investment banking, with a pickup in H2. In spite of the weak FY17 guidance, management is very optimistic on the future, particularly regarding the digitisation of banks over the next few years, while regulation is expected to drive a lot of interesting projects in investment banking. The main near-term growth is from digitisation projects in retail banking as well as some in investment banking. It is just a matter of time before investment banks will need to accelerate investment in projects for growth. Hence, management is confident that growth will return to normal levels of 10%+ from FY18. This is why GFT maintains its longer-term projection of €800m and 12% EBITDA margins by 2020, which includes €200m of revenues from acquisitions. The main investment focus is on the US and UK where management sees growing demand and GFT will continue investing in EMEA and Latin America as well.

Of the €450m FY17 guidance, one third is order book, 16-20% is running projects and the rest is "trusted pipeline". Across geographies, the pipeline is the strongest in the UK, while it is flat in Italy because Italy is already more advanced in digitisation.

There are two FY17 exceptional items: a €1m earn-out accrual relating to Habber Tec and a €1m restructuring in the UK relating to the business consulting division, which was focused on advisory for the business side of the banks. As banks have been restructuring in the UK over the last two to three years, the market has become flooded with advisers while demand has not changed. Hence, GFT has decided to streamline this consulting business and focus on the IT.

Exhibit 6: Presentation of GFT and Edison definitions, based on GFT guidance

€m	GFT guidance	Actual	GFT guidance	Edison numbers
	FY16	FY16	FY17e	FY17e
Group revenue	420.000	422.559	450.000	455.000
Profit measures:				
(A) Operating profit (GFT definition)	46.570	46.834	50.500	50.500
(G) Exceptional items	0.000	0.000	(1.000)	(1.000)
Adjusted EBITDA (Edison definition)	46.570	46.834	49.500	49.500
(E) Normal depreciation	(5.600)	(6.252)	(6.000)	(5.915)
Adjusted operating profit (Edison definition)	40.970	40.582	43.500	43.585
Total net interest	(2.100)	(1.746)	(2.000)	(2.000)
Profit before tax norm (Edison definition)	38.870	38.782	41.500	41.585
(B) Earn-out accruals	0.000	0.000	(1.000)	(1.000)
(C) PPA order book (amort of acquired)	(0.070)	(0.069)	0.000	0.000
(F) PPA amortisation (amort of acquired)	(5.800)	(5.665)	(5.500)	(5.500)
EBT (GFT definition)	33.000	33.048	35.000	35.085
(D) EBITDA (GFT definition) (A+B+C+G)	46.500	46.765	48.500	48.500
EBIT (GFT definition) (D+E+F)	35.100	34.848	37.000	37.085

Source: GFT, Edison Investment Research

Forecasts

We have eased our FY17 revenues to stand slightly above what we consider to be conservative management guidance. We maintain our 10% growth trend thereafter. We have also eased our FY17 EBITDA forecast to match management guidance, which includes €1m restructuring costs. Given the higher than expected end-FY16 net debt, we now forecast the group to end FY17 with net debt of €24.6m (previously €0.7m net cash), which rises to €38.3m a year later (previously €22.1m net cash), after the increased final payment for Sempla, and then declines to €11.7m at the end of FY19. Our FY17 cash flow forecasts are potentially conservative given the c €8m of payments received in early January and the disputed Avaloq contract, which has not been provisioned.

Exhibit 7: Forecasts

(€000s)	Old 2016e	Actual 2016	% change	Old 2017e	New 2017e	% change	Old 2018e	New 2018e	% change	New 2019e
Existing GFT revenues	398,204	404,689	1.6	434,318	434,292	(0.0)	477,750	477,721	(0.0)	525,493
Adesis Netlife revenues	16,546	13,590	(17.9)	18,047	14,584	(19.2)	19,852	16,043	(19.2)	17,647
Habber Tec Brazil	5,250	4,280	(18.5)	7,635	6,124	(19.8)	8,398	6,737	(19.8)	7,410
GFT Group revenue	420,000	422,559	0.6	460,000	455,000	(1.1)	506,000	500,500	(1.1)	550,550
Growth (%)	12.4	13.1		9.5	7.7		10.0	10.0		10.0
Gross profit	357,000	362,711	1.6	391,000	386,750	(1.1)	430,100	425,425	(1.1)	467,968
Gross margin (%)	85.0	85.8		85.0	85.0		85.0	85.0		85.0
Operating expenses before depn	(310,499)	(315,946)	1.8	(338,100)	(338,250)	0.0	(370,898)	(370,970)	0.0	(404,354)
(A) EBITDA (GFT definition)	46,501	46,765	0.6	52,900	48,500	(8.3)	59,202	54,456	(8.0)	63,613
(B) Normal depreciation	(5,600)	(6,252)	11.6	(5,980)	(5,915)	(1.1)	(6,578)	(6,507)	(1.1)	(7,432)
PPA amortisation	(5,800)	(5,665)	(2.3)	(5,800)	(5,500)	(5.2)	(5,800)	(5,500)	(5.2)	(5,500)
EBIT (GFT definition)	35,101	34,848	(0.7)	41,120	37,085	(9.8)	46,824	42,449	(9.3)	50,681
EBIT margin (%)	8.4	8.2		8.9	8.2		9.3	8.5		9.2
Growth (%)	2.6	1.7		17.1	6.4		13.9	14.5		19.4
(H) Associates	0	(54)		0	0		0	0	0	0
Net interest	(2,100)	(1,746)	(16.8)	(1,700)	(2,000)	17.6	(1,450)	(1,750)	20.7	(1,450)
Earnings Before Tax (GFT definition)	33,001	33,048	0.1	39,420	35,085	(11.0)	45,374	40,699	(10.3)	49,231
(C) Taxation	(8,551)	(8,819)	3.1	(11,757)	(10,812)	(8.0)	(13,305)	(12,012)	(9.7)	(14,230)
Net income	24,450	24,229	(0.9)	27,663	24,273	(12.3)	32,069	28,687	(10.5)	35,001
Adjustments for normalised earnings:										
(D) PPA order book adjustment	(69)	(69)		0	0		0	0		0
(E) Exceptional items	0	(421)		0	(1,000)		0	0		0
(F) Adjusted EBITDA (Edison)(A-D-E)	46,570	47,255	1.5	52,900	49,500	(6.4)	59,202	54,456	(8.0)	63,613
(G) Adj'd operating profit (Edison)(F+B)	40,970	41,003	0.1	46,920	43,585	(7.1)	52,624	47,949	(8.9)	56,181
Adjusted operating margin (%)	9.8	9.7		10.2	9.6		10.4	9.6		10.2
PBT norm (Edison)(G+C+H)	38,870	39,203	0.9	45,220	41,585	(8.0)	51,174	46,199	(9.7)	54,731
Statutory EPS (c)	92.9	92.0	(0.9)	105.1	92.2	(12.3)	121.8	109.0	(10.5)	133.0
P/E - Statutory EPS (x)	21.3	19.6		18.8	19.6		16.2	16.5		13.6
Adjusted EPS (c)	115.2	115.4	0.2	127.1	116.9	(8.0)	143.8	129.9	(9.7)	153.8
P/E - Adjusted EPS (x)		**15.3**			**15.1**			**13.6**		**11.5**

Source: GFT Technologies (historicals), Edison Investment Research (assumptions and forecasts)

Sensitivities: Financial services, Southern Europe

The group has significant exposure to the financial services industry and has high exposure to the UK, the US, Italy, Spain and Germany. GFT benefits from the abundance of highly skilled workers in Spain, which is largely a cost centre. Recent acquisitions have significantly diversified the group's geographical exposure, product offerings and skills base. We highlight the following points:

Economic downturn. IT budgets are subject to pressure in economic slowdowns. However, slowdowns can also speed up the pace of outsourcing as customers seek to reduce costs. We note GFT has long-term-relationships with its customers, including a high level of project work, which typically operates on one-year rolling contracts and therefore has recurring features. Exposure to Southern European countries increases the risk profile, but the increasing international profile of the group reduces its exposure to any particular country or region.

Sector and customer concentration. About 95% of revenues are from financial services. Deutsche Bank represented c 35% of FY16 revenues (down from 80% in 2003), and is likely to decline as stronger growth is more likely to come from customers where the group has a smaller bridgehead.

Operational risk. Within GFT Solutions, there is the risk of fixed-price projects going over budget or deadlines not being met. We note that GFT introduced an extensive project risk assessment process in 2010 and there have been no significant project overruns in the last two years.

Competitive environment. While competition in global IT services is fierce, it could intensify, eg India-based rivals could make headway in continental Europe.

Customer considerations. IT departments might be reluctant to outsource, in particular mission-critical tasks. GFT's growth might be limited by potential conflicts of interest related to supply of services to competing firms in similar key business areas.

Currency and regions. The group has cost centres in Spain, Poland and Brazil, while revenues are from North America, the UK and continental Europe. Additionally, 6% of costs are in Polish zloty, mainly addressing the UK market, with negligible zloty revenues, while disproportionate costs are in Brazilian reals (7% costs, 4% revenues) and disproportionate revenues are in British pounds (19% revenues, 11% costs).

Acquisitions. There is implementation risk in the acquisition strategy.

Valuation: Metrics dip to very attractive levels

GFT is an interesting proposition for equity investors, as a leading European-based pure play financial consulting and solutions provider. The group has an excellent track record of profitable growth and is set to benefit from favourable industry growth drivers, supported by its nearshore/offshore facilities. We note the following points on valuation:

- **Cash flow**. The group generated free cash flow (FCF) of €9.8m (after interest, tax and capex) , providing a FCF yield of c 2%. We forecast FCF to rise to €25m in FY17, £29m in FY18 and €36m in FY19. These provide FCF yields of c 5%, c 6% and c 8% in the respective years.
- **Discounted cash flow valuation**. Based on our forecasts, and assumptions which include a 10- year revenue CAGR of 7.3%, 2% terminal growth rate, a long-term EBITDA margin target of 12%, a weighted average cost of capital (WACC) of 9%, net debt of €42m, acquisition liabilities of €34m and the €9m pension deficit, our DCF model values the shares at €22.84, 27% above the current share price. Discounting back from our forecasts, the market is attributing a break-even WACC of 10.5% to the stock.
- **Traditional valuation measures**. In traditional valuation terms, the stock trades on 15.2x our earnings forecasts in FY17, falling to 13.7x FY18 and 11.6x in FY19.
- **Peer analysis**. GFT has seen a de-rating over the last 18 months and now trades at a discount to with its peers in terms of both EV/EBITDA and P/E. This is in spite of the group's attractive offshore/nearshore business model and strong revenue growth rates.

Exhibit 8: Peer analysis

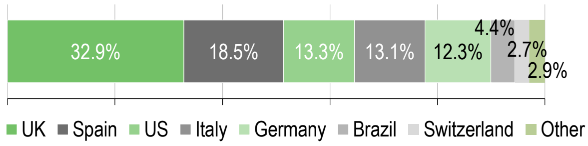
	Share price	Market cap	EV/sales (x)		EV/EBITDA (x)		PE (x)	
	local curr	local curr (m)	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
GFT Technologies	**18.05**	**475**	**1.14**	**1.03**	**10.4**	**9.5**	**15.4**	**13.9**
1) European-based IT services / financial sector consulting								
REPLY (€)	148.4	1,388	1.57	1.47	11.2	10.2	18.1	16.4
Cap Gemini (€)	85.68	14,493	1.24	1.19	9.1	8.5	14.4	13.3
Devoteam (€)	63.49	520	0.81	0.77	8.7	7.9	19.5	17.3
First Derivatives (£)	2707	674	4.79	4.31	25.8	23.0	48.3	44.0
Indra Sistemas (€)	11.82	1,940	0.90	0.87	9.0	7.8	16.3	12.4
2) US-based IT services / financial sector consulting								
Accenture ($)	120.21	77,910	2.2	2.0	13.0	12.0	20.5	18.7
Cognizant ($)	59.17	36,013	2.2	2.0	9.6	8.5	16.2	13.8
Luxoft ($)	60.4	2,003	2.4	2.0	14.1	11.7	20.7	17.5
EPAM ($)	75.41	3,860	2.5	2.1	13.8	11.4	22.5	18.8
3) Indian-based IT services / financial sector consulting								
HCL Technologies (INR)	875.85	1,236,017	2.4	2.1	10.8	9.7	15.1	13.8
Tata Consultancy Svcs (INR)	2441	4,809,815	3.7	3.4	13.6	12.3	18.3	17.0
Wipro (INR)	515.95	1,254,219	2.0	1.8	9.7	9.1	15.0	13.9
Medians excluding GFT			**2.2**	**2.0**	**11.0**	**10.0**	**18.2**	**16.7**

Source: GFT calculated by Edison Investment Research, others Bloomberg data. Note: Priced as at 30 March 2017.

Exhibit 9: Financial summary

€'000s	2014	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	279,235	373,507	422,559	455,000	500,500	550,550
Cost of Materials	(52,194)	(62,486)	(59,848)	(68,250)	(75,075)	(82,583)
Gross Profit	227,042	311,021	362,711	386,750	425,425	467,968
EBITDA	32,834	44,586	46,765	48,500	54,456	63,613
Adjusted EBITDA	35,240	45,517	47,255	49,500	54,456	63,613
EBIT	26,433	34,258	34,848	37,085	42,449	50,681
Adjusted Operating Profit	31,875	40,363	41,003	43,585	47,949	56,181
Amortisation of acquired intangibles	(4,711)	(6,105)	(5,734)	(5,500)	(5,500)	(5,500)
Exceptionals	(731)	0	(421)	(1,000)	0	0
Associates	(12)	(30)	(54)	0	0	0
Operating Profit	26,421	34,228	34,794	37,085	42,449	50,681
Net Interest	(1,015)	(1,703)	(1,746)	(2,000)	(1,750)	(1,450)
Profit Before Tax (norm)	30,848	38,630	39,203	41,585	46,199	54,731
Earnings Before Tax	25,406	32,525	33,048	35,085	40,699	49,231
Tax	(6,819)	(5,979)	(8,819)	(10,812)	(12,012)	(14,230)
Net inc from discontinued ops	1,368	(1,209)	0	0	0	0
Profit After Tax (norm)	25,397	31,441	30,384	30,773	34,187	40,501
Profit After Tax (FRS 3)	19,955	25,336	24,229	24,273	28,687	35,001
Average Number of Shares Outstanding (m)	26.3	26.3	26.3	26.3	26.3	26.3
EPS - normalised (c)	96.5	119.4	115.4	116.9	129.9	153.8
EPS - normalised & fully diluted (c)	96.5	119.4	115.4	116.9	129.9	153.8
EPS - FRS 3 (c)	75.8	96.2	92.0	92.2	109.0	133.0
Dividend per share (c)	25.00	30.00	30.00	33.00	37.00	41.00
Gross Margin (%)	81.3	83.3	85.8	85.0	85.0	85.0
EBITDA Margin (%)	11.8	11.9	11.1	10.7	10.9	11.6
Adjusted Operating Margin (%)	11.4	10.8	9.7	9.6	9.6	10.2
BALANCE SHEET						
Fixed Assets	148,732	173,451	175,538	174,133	172,136	169,114
Intangible Assets	125,852	139,480	136,920	131,420	125,920	120,420
Tangible Assets	17,780	26,488	30,908	35,003	38,506	40,984
Other	5,100	7,484	7,710	7,710	7,710	7,710
Current Assets	152,921	153,357	190,504	216,999	215,925	256,448
Stocks	0	0	28	30	33	36
Debtors	108,216	94,828	117,308	126,314	138,946	152,840
Cash	38,129	46,978	62,290	79,777	66,069	92,694
Current Liabilities	(140,614)	(90,628)	(114,723)	(121,643)	(132,037)	(143,471)
Creditors	(94,582)	(90,008)	(96,414)	(103,334)	(113,729)	(125,163)
Short term borrowings	(46,032)	(620)	(18,308)	(18,308)	(18,308)	(18,308)
Long Term Liabilities	(60,628)	(111,733)	(135,418)	(135,418)	(101,292)	(101,292)
Long term borrowings	(34,131)	(82,817)	(86,035)	(86,035)	(86,035)	(86,035)
Other long term liabilities	(26,497)	(28,916)	(49,383)	(49,383)	(15,257)	(15,257)
Net Assets	100,412	124,447	115,901	134,071	154,732	180,799
CASH FLOW						
Operating Cash Flow	24,585	55,575	28,772	47,225	51,953	60,861
Net Interest	(997)	(1,447)	(1,613)	(2,000)	(1,750)	(1,450)
Tax	(8,152)	(11,424)	(7,164)	(9,980)	(11,088)	(13,135)
Capex	(9,680)	(14,456)	(10,160)	(10,010)	(10,010)	(9,910)
Acquisitions/disposals	(58,472)	(16,760)	(6,662)	150	(34,126)	0
Shares issued	(1,494)	(620)	1,578	0	0	0
Dividends	(6,584)	(6,584)	(7,898)	(7,898)	(8,688)	(9,741)
Net Cash Flow	(60,794)	4,284	(3,147)	17,487	(13,708)	26,625
Opening net debt/(cash)	(19,410)	42,034	36,449	42,053	24,566	38,275
Other	(650)	1,301	(2,457)	0	0	0
Closing net debt/(cash)	42,034	36,449	42,053	24,566	38,275	11,650

Source: GFT accounts, Edison Investment Research (forecasts). Note: *€0.15m receipt in FY17 is a deferred payment relating to the disposal of emagine. The €34.1m payment in FY18 relates to the acquisition of Sempla (now GFT Italy).

Contact details	Revenue by geography
Filderhauptstraße 142 70599 Stuttgart Germany +49 711 62042-0 +49 711 62042-101 www.gft.com	

Management team

Chairman of the Executive Board, Chief Executive Officer: Ulrich Dietz	Chief Operating Officer & CEO designate, GFT Solutions: Marika Lulay
Mr Dietz founded GFT in 1987. He is responsible for the key operational areas of marketing, strategy, corporate communications and investor relations. Mr Dietz is a member of the Presiding Committee of BITKOM (the German Association for Information Technology, Telecommunications and New Media) where his responsibilities include the international promotion and expansion of the German IT industry. He is a member of the task force that represents “IT in small and medium-sized companies” within the scope of the federal government’s National IT Summit. The task force’s main aim is to improve IT availability for small and medium-sized companies and develop further education. Since 2010, Mr Dietz has represented the German government as a speaker of the committee for IT/ICT covering Eastern European Economic Relations.	Ms Lulay joined the executive board as COO in 2002, assuming responsibility for GFT Global Solutions, the key account management and the key operational areas of technology and quality management. Previously, Ms Lulay was chief production and sales officer of GFT Technologies. In February she was appointed CEO, effective from 31 May.
Chief Financial Officer: Dr Jochen Ruetz	
Dr Ruetz has been chief financial officer, personnel director and a member of the executive board at GFT Technologies since 2003 and serves as chief accounting officer. Prior to joining GFT, Dr Ruetz held management positions at STRABAG and Deutsche Bank.	

Principal shareholders	(%)
Ulrich Dietz	26.2
Maria Dietz	9.7
FIL Ltd	3.0

Companies named in this report

Accenture (NYSE:ACN), Cap Gemini (EPA:CPA), Cognizant (NASDAQ:CTSH), Devoteam (EPA:DVT), EPAM ((NYSE:EPAM), First Derivatives (AIM:FDP), HLC Technologies (BOM:532281), Indra Sistemas (IDR.MC), Luxoft (NYSE:LXFT), REPLY (BIT:REY), Tata Consultancy Services (BOM:532540), Wipro (BOM:507685)