TXT e-solutions

Q317 results

Well funded for growth

Software & comp services

TXT has reported its first set of results showing TXT Next as a standalone business. We have revised our forecasts to reflect the new structure of the group. The group is now focused on growing the TXT Next business organically and through targeted acquisitions of niche software solution and specialised engineering service providers in the aerospace and aviation market. Of the €85m proceeds from selling TXT Retail, we expect the company to retain funds for acquisition as well as paying a special dividend next year.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/15**	24.9	1.7	0.13	0.25	76.0	2.5
12/16**	33.1	4.0	0.27	0.30	36.2	3.1
12/17e**	35.5	3.1	0.19	0.15	50.7	1.5
12/18e**	38.5	3.5	0.22	0.16	45.6	1.6

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Treats TXT Retail as discontinued operations.

Q317 results on new basis

TXT Next reported flat revenues in Q317 and a decline in EBITDA margins due to higher R&D and commercial expenses y-o-y. Discontinued operations contributed €0.24m at the net income level, out of a total reported net income of €0.66m. Net cash stood at €3.2m at the end of Q317 – proceeds of €85m were received when the TXT Retail disposal completed on 2 October. We have revised our forecasts to reflect the new structure. We have not yet factored in the special dividend as this is to be proposed at the AGM in April 2018.

Setting targets for organic and acquisitive growth

The company is targeting organic growth of 8-10% for the aerospace & aviation business and 5% growth for the banking & finance business, with targeted group EBITDA margins of 12% (vs 9M17 margin of 10.3%). On top of this, the company wants to acquire profitable businesses active in the aerospace & aviation market, in order to bolster its product offering, expand its customer base and/or increase share of wallet with existing customers.

Valuation: Factoring in accretive acquisitions

Compared to our revised peer group, which reflects the focus of the remaining business, TXT trades at a discount on an EV/Sales and EV/EBITDA basis. Its EBITDA margins are currently below the peer group, although the company is targeting EBITDA margins of 12% in the medium term. With €85m in gross proceeds from the sale of TXT Retail in the bank, TXT is trading on an inflated P/E multiples. We would expect the share price to fall once the special dividend is paid out, reducing price multiples to more normal levels. Until the remainder of the cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a premium to peers on a P/E basis.

17 November 2017

Price	**€9.81**
Market cap	**€114m**
Net cash (€m) at end Q317	3.2
Shares in issue	11.7m
Free float	45.5%
Code	TXT
Primary exchange	Borsa Italiana (STAR)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(15.2)	(17.5)	28.9
Rel (local)	(14.1)	(18.4)	(4.4)
52-week high/low		€13.0	€7.2

Business description

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

Next events

FY17 results	March 2018

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Edison profile page

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

Investment summary

Company description: Specialist software solutions

TXT e-solutions is an Italy-headquartered software and services company. Having recently sold TXT Retail, its retail software business, TXT now operates solely through its TXT Next business. TXT Next is a software solutions and services business focused on the aerospace and aviation, and banking and finance segments, with roughly two-thirds of revenues generated in Italy. The group plans to drive growth through a combination of organic growth and targeted acquisitions, using some of the proceeds from the recent disposal of TXT Retail. The remainder of the proceeds are expected to be paid out as a special dividend in H118, after approval at the AGM in April.

Financials: TXT Next on a standalone basis

This is the first set of results since the disposal of TXT Retail, which is now accounted for within discontinued operations. We have revised our forecasts according. We have nudged down our TXT Next forecasts to reflect the impact of higher commercial and G&A costs. We forecast net cash will increase to €86.9m by the end of FY17 and €87.2m by end FY18 (before accounting for the special dividend).

Exhibit 1: Changes to forecasts

	EPS (€)			PBT (€m)			EBITDA (€m)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2017e	0.47	0.19	(58.4)	7.4	3.1	(58.4)	8.1	3.5	(56.8)
2018e	0.55	0.22	(61.0)	8.9	3.5	(61.0)	9.6	3.6	(61.8)

Source: Edison Investment Research

Valuation: Cash proceeds skew price multiples

On an EV/Sales and EV/EBITDA basis, TXT trades at a premium to its peer group. Its EBITDA margins are currently below the peer group, although the company is targeting EBITDA margins of 12% in the medium term. With €85m in gross proceeds from the sale of TXT Retail in the bank, TXT is trading on an inflated P/E multiple. We would expect the share price to fall once the special dividend is paid out, reducing price multiples to more normal levels. Until the remainder of the cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a premium to peers on a P/E basis. Our reverse DCF shows that the current share price is factoring in revenue CAGR of 4.2% from FY19-26 with an average EBITDA margin of 9.9% over that period. In our view, this appears conservative.

Sensitivities: Demand, competition, currency

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

Company description: Engineering services specialist

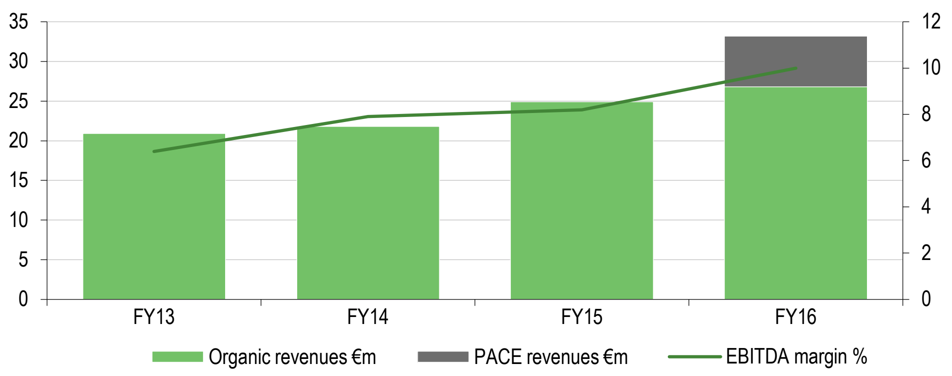
Company background

TXT e-solutions was formed in 1989 as a software and solutions vendor and listed on the STAR segment of the Borsa Italiana in 2000. Until recently, the company operated through two divisions: TXT Retail (52% of FY16 revenues) and TXT Next (48% of FY16 revenues). In October, the company sold TXT Retail for €85m to APTOS, a US retail software company. TXT Next is a services and software solutions business, focused on the aerospace and aviation, and banking and finance segments, primarily in Italy. In FY16, the aerospace and aviation business generated 56% of revenues in Italy and 44% from international customers. The banking and finance business generates all revenues in Italy. The business has grown organically and via the acquisition of PACE in 2016 and has increased its international exposure.

TXT Next – established in Italy, growing internationally

TXT Next has shown robust organic growth over recent years (CAGR 7.9% FY12-FY16) boosted by the acquisition of PACE in FY16, and EBITDA margins have expanded over this period. Now that it is a standalone business, its strategy is to grow through a mixture of organic growth and acquisitions in the aerospace and aviation markets.

Exhibit 2: TXT Next revenue and margin progression



Source: TXT e-solutions

Maintain organic growth rate

In Exhibit 3 below, we show the group's divisional growth targets and what this means for group revenue growth, as well as the group EBITDA margin target. In FY16, TXT Next achieved a higher EBITDA margin than this target, although it is running at a lower rate year-to-date.

Exhibit 3: Growth and margin targets

Organic revenue growth targets	
Aerospace & aviation	8-10%
Banking & finance	+5%
Estimated group target based on FY16 pro forma revenues	7.3-8.8%
Group EBITDA margin target	12.0%
Actual EBITDA margin for TXT Next in FY16	12.9%
Actual EBITDA margin for TXT Next in 9M17	10.3%

Source: TXT e-solutions, Edison Investment Research

Acquire in the aerospace and aviation markets

Having received proceeds of €85m from the sale of TXT Retail, after paying a special dividend we expect the company to retain funds of at least €20-30m for acquisitions to bolster the growth of the aerospace & aviation business. In addition, the company has treasury shares worth €13m that could be used for acquisitions. The company is primarily targeting profitable businesses with annual revenues in the range €5-20m and an international profile. They would ideally be well-established in the industry, and have a solid customer base and committed management team. Target companies would offer access to at least one of the following: a broader technology offering, increased geographical presence, new customers, or better penetration within existing accounts or domains.

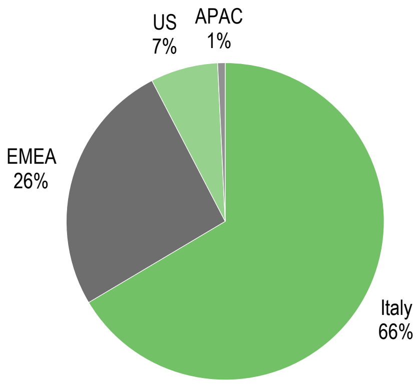
Management

TXT is run by a long-established team: the chairman is the original founder of the company and the group CEO, Marco Guida, joined TXT in 1994. The CFO, Paolo Matarazzo, joined the company in 2007. Several key managers of the business have been with the company for many years in Italy (with TXT Next) and Germany (with PACE).

TXT Next: Systems engineering specialist

TXT Next is now the main business of TXT. TXT Next provides specialised software solutions and services through two divisions: aerospace and aviation (A&A), and banking & finance (B&F). In 2016, TXT Next acquired PACE, a German aerospace software business. Exhibit 4 below shows how two-thirds of group revenues are generated in Italy, with a growing proportion of sales generated elsewhere in Europe and to a lesser extent, the US and Asia Pacific. In the nine months to September 2017, TXT Next generated 91% of revenues from services and 9% from software licenses and maintenance (FY16: services 90%, software 10%).

Exhibit 4: Group pro-forma FY16 revenue split by geography



Source: TXT e-solutions

Aerospace and Aviation

This business, founded 30 years ago, makes up the largest proportion of TXT Next, generating pro-forma revenues of €26m in FY16 (76% of TXT Next pro-forma revenues) and an EBITDA margin of 10.9%. The division provides a mix of software and specialised engineering services, providing support to customers' R&D, engineering and manufacturing operations. In FY16 revenues were generated from OEMs (68%), first tier suppliers (13%), airlines (7%) and automotive customers (8%). Until relatively recently, the business was mainly staffed out of Italy. Partly through a "follow-my-customer" strategy and partly as a concerted effort to expand internationally (organically and via the PACE acquisition), the division now has more than 330 consultants based in Italy, Germany, France, the UK, the Netherlands, Switzerland and the US. In FY16, the business generated 56% of revenues from Italy, 34% from other EMEA countries and 10% from the US and APAC. Exhibit 5 shows key customers and highlights the international nature of the customer base.

Exhibit 5: International customer base

OEMs	1st tier suppliers	Airlines & lessors	Automotive
Airbus	Air France Industries	AerCap	Brembo
ATR	Aviage Systems	Air Dolomiti	Magneti Marelli
Boeing	Avio Aero	Austrian Airlines	Pirelli
Comac	CAE	Brussels Airlines	TRW
Embraer	GE Aviation	Delta	Vodafone Automotive
Eurofighter Typhoon	Innovint	Etihad	
Fokker	KLM Engineering & Maintenance	Eurowings	
Leonardo	Leonardo	GE Capital Aviation Services	
Mitsubishi Aircraft Corporation	Liebherr	Icelandair	
Pilatus	Reiser	Lufthansa	
Sukhoi	Rolls Royce	Lufthansa Consulting	
	Safran	Netjets	
	Secondo Mona	Swiss	
	Superjet International		

Source: TXT e-solutions

PACE acquisition expanded the business

TXT Next already had a significant aerospace-focused business, providing IT, consulting and R&D services to mainly Italy-based business such as Leonardo. The acquisition of PACE added specialist aerospace software as well as a larger international customer base. Customers include more than 50 companies covering aircraft and engine manufacturing, airlines, civil and defence operators, and maintenance, repair and overhaul (MRO), including Airbus, Air France & KLM Engineering, Boeing, COMAC, Delta Airlines, Embraer, GE Aviation, Lufthansa, Rolls-Royce, Safran Group and Sukhoi. Until the acquisition, TXT Next had predominantly generated revenues from services – PACE adds higher-margin software revenues, which over time should drive higher recurring revenues.

From PACE's perspective, TXT Next has a large number of qualified consultants who are able to provide additional engineering software services to PACE's client base. The business continues to trade under the PACE brand, with the three founders continuing as managing directors, focused on expanding the value and range of services offered around their engineering software products.

TXT paid €7.7m for 79% of PACE (including contingent consideration). It also accrued a potential payment of €1.4m for the put/call option for the remaining 21% stake (owned by the three founders) exercisable from 1 January 2020 to 31 December 2021. On acquisition, it consolidated €2.3m of net cash within the PACE business; total consideration for the business, net of cash acquired, was €6.8m.

Specialist services enhanced by industry-specific software

Exhibit 6 shows the services and software the company offers across business processes.

Exhibit 6: Services and software by business area

	Product design & development		Production & customer engineering	Sales & procurement		Operations	
	Preliminary design	On-board software	Digital manufacturing	Product configuration	Sales & procurement	Training & simulation	Flight operations
	6%	36%	8%	13%	4%	22%	11%
OEMS & Tier 1 suppliers	■	◆	◆	■	■	◆	◆
Airlines					■		■
Automotive		◆				◆	

Source: TXT e-solutions. Key: ■ = services & exploitable software assets ◆ = fully packaged software & related services.

The original TXT Next business offers specialist engineering services, and has developed a variety of industry-specific software libraries and toolboxes and reference applications. Examples of reference applications include TXT FAST 4.0 (for digital manufacturing), TXT SIMCARE (for flight simulators), TXT IoT Manufacturing Operation Management (for internet of things) and TXT WEAVR (for augmented reality and virtual reality training solutions). With the PACE acquisition, TXT has added fully packaged software and related services (see Exhibit 7).

Exhibit 7: PACE software solutions

Solution	Functionality
Preliminary aircraft design	
Pacelab Suite	Platform that supplies functional & procedural infrastructure for early stage product design
Pacelab APD	Supports development of conventional and unconventional aircraft in the conceptual and preliminary design phases
Pacelab SysArc	Built on Pacelab APD, adds a functional layer for building, analysing and optimising system and sub-system architectures
Aircraft marketing & acquisition	
Pacelab Cabin	Aircraft and cabin configurator that supports aircraft manufacturers, seat & component suppliers, airlines and consultants with detailed cabin investigations and feasibility studies
Pacelab Mission Suite	Integrated software solution for route analysis, aircraft performance and economic investigations
Pacelab Route Network Analyser	Windows app which brings the route analysis capabilities of Pacelab Mission Suite to tablet computers and mobile phones
Flight operations	
Pacelab CI Ops	Enables flight crews to flexibly determine in flight the most cost-efficient trajectory whenever flight conditions have changed
Pacelab Flight Profile Optimiser (cloud version available)	Complements the functional scope of flight management systems with advanced flight profile optimisation capabilities

Source: TXT e-solutions

The division now has a customer base of more than 70 companies. Although most of the work is project based and therefore not recurring in nature, TXT has a very loyal customer base that provides repeat work. Of revenues generated from services, roughly three-quarters are from turnkey service engagements, while the remainder are contracted on a time and materials basis.

Growth strategy – organic and inorganic

The aerospace and aviation markets are characterised by global groups with large investment budgets – many groups have multiple subsidiaries that could each use TXT's software engineering services. The rapid pace of innovation combined with increasing regulation drives growth in R&D. In its 2020 strategic plan, Altran estimates that the global engineering and R&D services market was worth c €130bn in 2015, and is forecast to grow at a CAGR of 9-11% to 2020. Within that, it forecasts growth in Europe of 5-7%.

One obvious source of growth for TXT is to increase its share of wallet with the existing customer base, selling to multiple divisions within each customer. The business is also targeting new international customers. While not strictly fitting within the definition of aerospace and aviation, the division also supplies automotive manufacturers and sees further potential growth from this market.

In terms of its product range, the company is considering offering managed services – this would increase the level of recurring business. It is also looking to extend the capabilities and range of its software assets. In addition to achieving this through internal R&D, the company is looking to acquire niche software providers and is selectively targeting highly specialised mid-sized companies.

Banking & finance

The banking & finance business, which has been in operation for the last 15 years, provides software testing, verification and validation services to banks and insurance companies in Italy. Exhibit 8 shows the services offered across the software quality assurance lifecycle. Functional testing of software accounts for the majority of the division's services. Testing services are performed both on-site and off-site, using the company's Test Factory methodology.

Exhibit 8: Software quality assurance services

Source: TXT e-solutions

The division targets the top 50 Italian banking institutions; customers include Azimut, Banco BPM, Banca Mediolanum, Banco Popolare di Sondrio, Ergo Assicurazioni, Gruppo ICBPI, Gruppo Bancario Credito Valtellinese, ING Bank, Intesa SanPaolo, SIA. Webank.it, and Widiba.

The business has 128 consultants, all based in Italy. In FY16, it generated revenues of €8.1m (24% of TXT Next pro-forma revenues) and an EBITDA margin of 8%.

The company believes it can continue to grow this business organically. Management plans to strengthen the services offered through a combination of deepening domain knowledge, developing standardised "testing bricks" (reusable software IP), and developing its test methodology to master a wide range of market-leading tools from third-party providers (eg IBM, HPE, open source) and a wider range of banking domains/processes.

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

Competitive environment

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

On the services side, the division's competition is from customers' in-house R&D and IT departments, as well outsourced engineering services providers and system integrators. The A&A business sees competition from large European engineering services businesses such as Akka Technologies, Altran, Alten and Assystem in France (all listed on Euronext), ESG Group in Germany (private) as well as smaller local providers such as Critical Software (private, based in Portugal), Teoresi (private, based in Italy), and Philotech (private, based in Germany). Both the A&A and B&F businesses compete with the large offshore BPO providers such as HCL, Tech Mahindra and Tata, although TXT's specialist knowledge and on-shore capabilities are often preferred for mission critical work that requires not only technical expertise, but also in-depth industry knowledge and proximity to customers. The B&F business also competes with specialist outsourced testing providers such as SQS (AIM-listed). On the software side, PACE operates in the market for aircraft design and engineering processes, typically served by the large PLM[1] software vendors such as Dassault, PTC and Siemens. PACE offers niche solutions to address specific, critical tasks that complement and integrate with PLM software solutions.

TXT Sense

The company announced in May that it had created a new division called TXT Sense (sitting within TXT Next). This division is focused on exploiting the opportunity presented by augmented reality (AR) and virtual reality (VR) technology. The aerospace market has made use of AR and VR for

[1] PLM: product lifecycle management

years in flight simulation and ground crew training. TXT is keen to apply the knowledge it has built up in this area to other verticals. The division, with eight employees, is exploring opportunities to use the technology in other sectors including media & advertising and discrete manufacturing.

Sensitivities

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

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

Financials

Review of Q317 results

Exhibit 9: Quarterly results highlights

€m	Q316a	Q317a	% change
Revenues	8.1	8.1	0.7%
Licenses & maintenance	0.8	0.9	6.2%
Services	7.2	7.2	0.1%
Gross margin (%)	42.3%	40.9%	(1.4%)
EBITDA	0.9	0.7	(17.1%)
EBITDA margin (%)	11.2%	9.2%	(2.0%)
Normalised EBIT	0.8	0.7	(19.3%)
Normalised EBIT margin (%)	10.2%	8.2%	(2.0%)
Net income from continuing operations	0.6	0.4	(25.1%)
Net income from discontinued operations	1.1	0.2	(76.8%)
Reported net income	1.6	0.7	(58.9%)
Net cash	2.7	3.2	21.2%

Source: TXT e-solutions

TXT Next saw minimal y-o-y revenue growth in Q317. Software license sales were marginally higher than a year ago although were 20% higher sequentially, and service revenues were flat y-o-y. This is a seasonally quiet period for TXT as it covers the summer holiday period in Italy. Higher R&D and commercial costs were only partially offset by lower G&A costs resulting in a decline in EBITDA and EBIT margins y-o-y.

Revised forecasts post disposal of TXT Retail

We have revised our forecasts to reflect the disposal of TXT Retail. Exhibit 10 below shows the main changes to estimates. Now that the costs of being a public company are being fully borne by the remaining business, this weighs on profitability in Q417 and FY18. Margins should start to expand again from FY19. In our forecasts, we have not accounted for the special dividend – instead we have reduced our dividend assumption to reflect a similar pay-out ratio to prior to the disposal of

TXT Retail. In reality, we expect the company to announce a special dividend worth c €50m at the AGM in April 2018 – this would equate to a dividend of €4.3 per share.

Exhibit 10: Changes to forecasts

€m	FY17e old	FY17e new	change	y-o-y	FY18e old	FY18e new	change	y-o-y
Revenues	73.8	35.5	(52.0%)	7.2%	79.4	38.5	(51.5%)	8.6%
TXT Retail	37.8	0.0	(100.0%)	(100.0%)	40.4	0.0	(100.0%)	N/A
TXT Next	36.1	35.5	(1.7%)	7.2%	39.0	38.5	(1.2%)	8.6%
Gross margin	53.7%	42.8%	(10.9%)	0.1%	53.8%	41.0%	(12.9%)	(1.8%)
Gross profit	39.7	15.2	(61.8%)	7.6%	42.7	15.8	(63.1%)	3.9%
EBITDA	8.1	3.5	(56.8%)	(18.1%)	9.6	3.6	(61.8%)	4.6%
EBITDA margin	10.9%	9.8%	(1.1%)	(3.0%)	12.0%	9.5%	(2.6%)	(0.4%)
Normalised EBIT	7.3	3.1	(57.3%)	(20.8%)	8.8	3.3	(62.2%)	6.3%
Normalised EBIT margin	9.9%	8.8%	(1.1%)	(3.1%)	11.1%	8.6%	(2.5%)	(0.2%)
Normalised net income	5.4	2.3	(58.4%)	(28.9%)	6.4	2.5	(61.0%)	11.1%
Discontinued operations	0.0	69.1	N/A	N/A	0.0	0.0	N/A	N/A
Normalised EPS (€)	0.47	0.19	(58.4%)	(28.6%)	0.55	0.22	(61.0%)	11.2%
Reported basic EPS (€)	0.41	6.10	1386.8%	1183.2%	0.51	0.19	(62.2%)	(96.8%)
Net cash	6.9	86.9	1159.7%	1518.9%	9.7	87.2	795.2%	0.3%
Dividend (€)	0.32	0.15	(53.1%)	(50.0%)	0.33	0.16	(51.5%)	6.7%

Source: Edison Investment Research

Valuation

Multiples-based valuation

We have revised our peer group to reflect the focus of the remaining business. We have included European IT services and engineering services companies as well as software providers to a similar customer base. On an EV/Sales and EV/EBITDA basis, TXT trades at a discount to its peer group. Its EBITDA margins are currently below the peer group, although the company is targeting EBITDA margins of 12% in the medium term. With €85m in gross proceeds from the sale of TXT Retail in the bank, TXT is trading on inflated P/E multiples. We would expect the share price to fall once the special dividend is paid out, reducing price multiples to more normal levels. Until the remainder of the cash is put to use on value-accretive acquisitions, we would expect the stock to trade at a premium to peers on a P/E basis.

We have previously noted that TXT has been a beneficiary of the Italian PIR scheme. The January 2017 introduction of the PIR individual savings scheme in Italy, which allows mutual funds held for five years to earn returns tax free, has boosted investment in Italian small and mid-cap stocks.

Exhibit 11: Peer group financial and valuation metrics

Company	Share price	Market cap	Rev growth		EBIT margin		EBITDA margin		EV/Sales		EV/EBITDA		P/E	
		(m)	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
TXT	**€9.81**	**€114**	**7.2%**	**8.6%**	**8.8%**	**8.6%**	**9.8%**	**9.5%**	**0.8**	**0.7**	**7.8**	**7.5**	**50.7**	**45.6**
European engineering and IT services companies														
AKKA Technologies	€47.10	€956	17.3%	5.1%	6.2%	7.5%	8.5%	9.6%	0.9	0.7	10.7	9.0	19.3	15.0
Alten	€72.04	€2,437	11.9%	6.5%	9.2%	10.0%	10.3%	10.8%	1.2	1.2	12.1	10.8	18.7	16.4
Altran	€14.81	€2,604	8.1%	6.5%	10.0%	10.9%	11.3%	12.1%	1.2	1.1	10.6	9.4	16.8	14.4
Assystem	€31.25	€694	-47.7%	6.5%	7.9%	7.4%	8.0%	8.3%	1.5	1.3	19.3	17.4	17.1	15.9
AtoS	€126.10	€13,289	8.8%	2.9%	8.5%	9.2%	12.6%	13.3%	1.1	1.0	8.4	7.7	15.5	13.9
Cap Gemini	€100.20	€16,949	1.8%	3.2%	10.9%	11.6%	13.7%	14.1%	1.5	1.4	10.8	10.1	17.0	15.8
Devoteam	€74.77	€623	-3.8%	11.1%	9.7%	10.0%	10.2%	10.5%	1.1	1.0	10.6	9.3	23.1	19.6
ESI Group	€35.12	€211	2.8%	9.3%	8.7%	10.1%	11.9%	12.8%	1.7	1.3	14.5	12.3	30.9	23.1
Exprivia	€1.41	€73	12.2%	3.2%	6.9%	8.1%	10.1%	11.6%	0.7	0.5	7.2	6.0	17.6	11.8
Reply	€44.41	€1,652	13.5%	9.6%	12.8%	13.2%	14.1%	14.4%	1.8	1.7	12.9	11.6	26.3	22.9
SciSys	£1.32	£39	17.5%	2.7%	8.7%	9.1%	10.4%	10.9%	0.9	0.7	8.5	7.9	13.7	12.8
Sopra Steria	€148.65	€3,054	2.2%	4.6%	7.7%	8.3%	9.4%	10.0%	1.0	0.9	10.4	9.4	15.1	13.6
SQS	£5.15	£167	0.2%	4.3%	7.8%	8.2%	9.8%	10.1%	0.7	0.6	7.1	6.6	12.0	11.5
Average			**7.7%***	**5.8%**	**8.8%**	**9.5%**	**10.8%**	**11.4%**	**1.2**	**1.0**	**11.0**	**9.8**	**18.7**	**15.9**

Source: Edison Investment Research, Bloomberg (as at 14 November). Note: *Excludes Assystem.

Potential acquisitions – impact on financials and valuation

We have estimated the potential impact of using a proportion of the proceeds to acquire businesses with similar financial characteristics to engineering service providers such as Altran. Using an EV/Sales multiple of c 1.1x for CY18, proceeds of €30m could be used to buy CY18 revenues of c €27m. On a 10% EBIT margin with a 30% tax rate, this would equate to incremental EPS of €0.16 in FY18. Using a total normalised EPS of €0.38 and a P/E multiple of 15.9x (the peer group average) would result in a share price of €6.0. Add to that c €4.3 for the special dividend and the share price would be c €10.3, 5% above the current share price.

Reverse DCF

We have performed a reverse 10-year DCF to calculate what we believe the market is factoring into the current share price. Using a WACC of 9%, long-term growth of 2%, working capital/sales of 2% and capex/sales of 1.2% (the company does not capitalise development costs), a revenue CAGR of 4.2% for FY19-26 and average EBITDA margins of 9.9% over FY19-26 are required to reach the current share price. Based on market growth and the company's targets, this appears conservative.

Exhibit 12: Financial summary

€'000s	2012	2013	2014	2015	2016	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	46,499	52,560	54,410	61,540	33,060	35,456	38,506
Cost of sales	(22,351)	(24,854)	(26,455)	(29,189)	(18,954)	(20,283)	(22,736)
Gross profit	24,148	27,706	27,955	32,351	14,106	15,173	15,770
EBITDA	5,322	6,263	5,324	6,659	4,260	3,489	3,650
Operating Profit (before amort and except)	4,283	5,241	4,284	5,820	3,954	3,133	3,330
Amortisation of acquired intangibles	0	(285)	(285)	(285)	(264)	(352)	(352)
Exceptionals and other income	939	0	1,468	0	(557)	0	0
Other income	0	0	0	(740)	0	(69)	0
Operating Profit	5,222	4,956	5,467	4,795	3,133	2,712	2,978
Net Interest	(37)	(435)	(249)	(151)	48	(44)	150
Profit Before Tax (norm)	4,246	4,806	4,035	5,669	4,002	3,089	3,480
Profit Before Tax (FRS 3)	5,185	4,521	5,218	4,644	3,181	2,668	3,128
Tax	(188)	121	(1,046)	(762)	(661)	(720)	(876)
Profit After Tax (norm)	4,092	4,927	3,226	4,739	3,170	2,255	2,506
Profit After Tax (FRS 3)	4,997	4,642	4,172	3,882	2,520	1,948	2,252
Average Number of Shares Outstanding (m)	11.0	11.5	11.5	11.7	11.7	11.7	11.7
EPS - normalised (c)	37	43	28	41	27	19	22
EPS - normalised fully diluted (c)	34	41	28	40	27	19	22
EPS - (IFRS) (c)	45	40	36	33	48	610	19
Dividend per share (c)	18.2	22.7	22.7	25.0	30.0	15.0	16.0
Gross margin (%)	51.9	52.7	51.4	52.6	42.7	42.8	41.0
EBITDA Margin (%)	11.4	11.9	9.8	10.8	12.9	9.8	9.5
Operating Margin (before GW and except) (%)	9.2	10.0	7.9	9.5	12.0	8.8	8.6
BALANCE SHEET							
Fixed Assets	18,570	17,850	18,019	18,132	25,428	10,006	9,754
Intangible Assets	16,621	15,370	15,078	14,692	21,296	7,506	7,150
Tangible Assets	1,154	1,118	1,249	1,361	1,598	566	670
Other	795	1,362	1,692	2,079	2,534	1,934	1,934
Current Assets	36,769	34,914	34,892	38,946	37,085	106,286	107,812
Stocks	1,388	1,451	1,820	2,075	3,146	3,846	3,946
Debtors	19,562	18,642	20,768	27,791	26,369	13,600	14,769
Cash	15,819	14,821	12,304	9,080	7,570	88,840	89,097
Other	0	0	0	0	0	0	0
Current Liabilities	(20,651)	(17,864)	(17,451)	(18,349)	(21,051)	(9,843)	(10,613)
Creditors	(15,155)	(14,512)	(15,297)	(17,528)	(20,243)	(9,643)	(10,413)
Short term borrowings	(5,496)	(3,352)	(2,154)	(821)	(808)	(200)	(200)
Long Term Liabilities	(8,666)	(6,965)	(6,491)	(5,105)	(7,180)	(5,480)	(5,480)
Long term borrowings	(4,301)	(2,896)	(1,685)	0	(1,391)	(1,691)	(1,691)
Other long term liabilities	(4,365)	(4,069)	(4,806)	(5,105)	(5,789)	(3,789)	(3,789)
Net Assets	26,022	27,935	28,969	33,624	34,282	100,969	101,473
CASH FLOW							
Operating Cash Flow	2,760	7,630	5,404	2,412	10,676	5,558	3,150
Net Interest	(37)	(435)	(249)	(151)	105	(44)	150
Tax	64	(1,615)	(1,344)	(1,461)	(2,022)	(720)	(876)
Capex	(405)	(483)	(615)	(763)	(738)	(420)	(420)
Acquisitions/disposals	(8,450)	19	0	0	(5,403)	80,700	0
Financing	1,690	(755)	(597)	2,215	(828)	0	0
Dividends	0	(2,107)	(2,615)	(2,678)	(2,931)	(3,496)	(1,748)
Net Cash Flow	(4,378)	2,254	(16)	(426)	(1,141)	81,579	257
Opening net debt/(cash)	(10,266)	(6,023)	(8,575)	(8,465)	(8,259)	(5,371)	(86,949)
HP finance leases initiated	0	0	0	0	0	0	0
Other	135	298	(94)	220	(1,747)	0	0
Closing net debt/(cash)	(6,023)	(8,575)	(8,465)	(8,259)	(5,371)	(86,949)	(87,206)

Source: TXT e-solutions, Edison Investment Research

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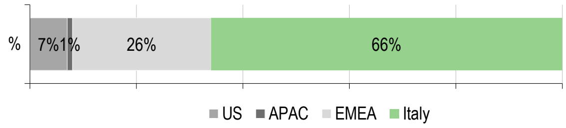
Revenue by geography



Management team

CEO: Marco Guida

Mr Guida joined TXT e-solutions from Pirelli Group in 1994. As director of international operations, he successfully led the transformation of TXT e-solutions from an Italian organisation to an international one. In 2006, he became the general manager of TXT e-solutions and was appointed CEO of TXT Group in 2009.

CFO: Paolo Matarazzo

Before joining TXT in 2007, Mr Matarazzo spent seven years as head of finance, administration and control in Europe for Eurand, a company listed on NASDAQ in 2007. Before that, he worked for the Recordati Group for seven years, with responsibility for treasury management. He spent three years as an analyst in London.

Chairman: Alvise Braga Illa

Mr Braga Illa led the optical communications group and the network systems at the Massachusetts Institute of Technology. He directed the R&D Labs at Italtel, founded Zeltron and managed the restructuring of Ducati Energia. He founded TXT Automation Systems, sold to ABB in 1997, and TXT e-solutions in 1989.

Principal shareholders	(%)
E-Business Consulting	29.7
Alvise Braga Illa	14.9
Treasury shares	10.0
Management	7.9
Kabouter Management	5.0
Allianz SE	2.3

Companies named in this report

AKKA Technologies, Altran, Alten, Assystem, Reply, SciSys