

Flatex

Financial services
23 June 2020

Waiting for the regulatory go-ahead

Flatex reported FY19 of earnings €14.9m (-15% y-o-y) and a ROE of 8.6%. Lower market volatility affected the results, as did the costs of expansion into the Dutch market before the decision to acquire 100% of DEGIRO in December 2019 for €60m cash plus €190m in shares. The EBITDA margin was 28.5%, down 16.8% y-o-y. The friendly acquisition of DEGIRO is transformational, with greater scale and breath of products. Management has identified €30m in annual synergies. The deal will make Flatex Europe's largest retail online broker, present in 18 countries, although it is still awaiting regulatory approval. Although the share price has almost doubled since the announcement of the DEGIRO acquisition, the shares trade at a discount to peers on both P/E and EV/EBIT despite consensus forecasts of above-average growth.

FY19: A mixed bag

Revenue was up 5.5% y-o-y, but the EBITDA margin of 28.5% was below >33.9% guidance. However, excluding one-off Dutch market entry costs it would have been 35%. Retail customers grew 27% y-o-y, ahead of expectations. Transaction volume declined by 1% as trading in lower-margin CFD and FX fell. However, trading in higher-margin products, such as ETP, is growing and financial (FIN) division revenue grew 5%. Financial debt was €81.5m (45% of equity) after paying €23.5m for an initial 9.4% DEGIRO stake. EBITDA was €37.6m and financial expenses only €3.1m. Adding the DEGIRO acquisition pro-forma results in debt of €118m, EBITDA of €51m and a debt to equity ratio of 56%, so debt levels would remain moderate.

DEGIRO merger transformational

The acquisition of DEGIRO, a Dutch pan-European online broker, would give Flatex greater scale and geographic presence, a proprietary trading engine and a broader product line. DEGIRO is a streamlined operation with a low-cost service centre in Sofia, Bulgaria. Based on FY19 pro-forma numbers, the combined entity would have 45% greater revenue and 34% more EBITDA and more than double the number of clients and transactions.

Valuation: Discount for premium growth

Flatex is trading on a P/E of 24.2x for FY20 and 17.6x for FY21 on consensus forecasts. Both its P/E and EV/EBIT ratios are at a discount to its B2B and B2C peer average despite consensus forecasting above-average growth. The acquisition's regulatory approval could be a short-term catalyst for the share price.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	125.1	42.4	0.98	0.0	42.8	N/A
12/19	132.0	37.6	0.77	0.0	54.5	N/A
12/20e	210.3	82.8	1.73	0.0	24.2	N/A
12/21e	277.2	117.0	2.39	0.0	17.6	N/A

Source: Flatex, Refinitiv

Price €41.95
Market cap €822m

Share price graph



Share details

Code	FTK
Listing	Deutsche Börse Scale
Shares in issue	19.6m

Business description

Flatex is an integrated online brokerage business. It covers two areas: technology and financial services, which includes a bank and a brokerage business.

Bull

- Merger with DEGIRO brings synergies (€30m identified by management) and greater geographic distribution, more technology and a broader product offering.
- Attractively valued against brokerage peer group in FY20.
- Favourable regulatory environment within Europe.

Bear

- The company does not pay a dividend as the focus is on investing for growth.
- Pressure to deliver on announced significant synergies with DEGIRO acquisition.
- Low/negative eurozone interest rates make it challenging to generate returns on client deposits.

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FY19 results

Flatex reported FY19 of earnings €14.9m, down 15% y-o-y, and revenue of €132m, up 5.5% y-o-y. Reported EBITDA was €37.6m, down 11% y-o-y. The EBITDA margin was 28.5%, which is below management guidance of over 34%. Management blamed the costs of the expansion into the Dutch market, before the decision to acquire DEGIRO in December. Management estimates the EBITDA margin would have otherwise been 35%. In its presentation on the merger with DEGIRO in December 2019, management used an estimated FY19 EBITDA figure of €40m.

Flatex purchased an initial 9.4% stake (for €23.5m cash) in DEGIRO in December 2019 as a first step in the purchase of 100% of the company. Therefore, operationally there is no real impact from the DEGIRO announcement on the FY19 income statement.

The FIN division grew 5.3% while the technology (TECH) division fell 8.8% y-o-y. Consolidation effects and other revenue led to the higher revenue growth numbers, so the underlying segments' growth is higher than the stand-alone figures.

Transaction volume fell 2% y-o-y, mainly due to reduced volume from lower margin contract for a difference (CFD, a form of derivative trading) and foreign exchange (FX) products. This FX and CFD volume decline is expected following the agreement in which Commerzbank took over Flatex's CFD order flow execution as market maker. We also note that since 2017, the Federal Financial Supervisory Authority and the European Financial Supervisory Authority has gradually restricted CFD and FX trading. Flatex's revenue growth is being delivered from higher-margin products, especially ETP, and it is encouraging to see that H219 total transaction volume grew 14% y-o-y despite the lower CFD/FX volume. We also note that market volatility (a key driver for revenue) was lower in FY19 than FY18.

Exhibit 1: Key performance indicators

Business volumes	FY16	FY17	FY18	FY19
Transactions executed (000s)	10,462	11,272	12,483	12,274
Number of retail customers (000s)	212	254	290	368
Transactions per customer per year	49.3	44.4	43.0	33.3
Customer assets under management (€m)	10,855	11,794	10,995	14,586
of which: securities account volume	9,512	10,910	10,000	13,600
of which: deposits account volume	1,343	884	995	986
Year-on-year (%)				
Transactions executed	3	8	11	(2)
Number of retail customers	20	20	14	27
Transactions per customer per year	(14)	(10)	(3)	(22)
Customer assets under management	88	9	(7)	33

Source: Flatex

The TECH division has been supporting the market entry of the online broker into the Netherlands. This included IT and expanding the production line. Basic modules were also created for other European markets. The company also highlighted progress in its cloud enterprise resource planning solutions and that its partnership with SAP was expanded to include a reselling component. This allows its core banking system (FTX:CBS) to be combined with SAP in a simpler, more integrated manner from a single source. The advanced stage of several contracts also helped boost results. The TECH division achieved a 45.2% EBITDA margin, which compares favourably to the management forecast of 'more than 35.3%'.

The number of retail customers grew an impressive 27% to 368,000; management had forecast more than 320,000. Besides organic growth in core markets, this also reflected the successful expansion in the Netherlands in FY19. Customer assets under management grew 33% to €14.6bn, helped by favourable financial markets.

Exhibit 2: Income summary with segments

€ 000s	FY17	FY18	FY19	FY19/18
FIN				
Revenues	89,113	107,140	112,767	5.3%
Raw materials and consumables used	(28,688)	(44,517)	(45,465)	2.1%
Personnel expenses	(15,353)	(17,274)	(21,294)	23.3%
Other administrative expenses	(25,206)	(17,001)	(24,798)	45.9%
EBITDA	19,866	28,348	21,209	-25.2%
EBITDA margin %	22.3%	26.5%	18.8%	
TECH				
Revenues	30,642	39,730	36,230	-8.8%
Raw materials and consumables used	(3,937)	(5,462)	(5,608)	2.7%
Personnel expenses	(2,702)	(9,470)	(8,018)	-15.3%
Other administrative expenses	(3,050)	(10,779)	(6,234)	-42.2%
EBITDA	20,952	14,018	16,370	16.8%
EBITDA margin %	68.4%	35.3%	45.2%	
Other/consolidation effects				
Revenues	(12,742)	(21,770)	(17,045)	-21.7%
Raw materials and consumables used	1,640	13,132	12,901	-1.8%
Personnel expenses	(5,088)	4,830	3,904	-19.2%
Other administrative expenses	7,445	3,808	241	-93.7%
EBITDA	(8,744)	0	0	
TOTAL				
Revenues	107,013	125,100	131,952	5.5%
Raw materials and consumables used	(30,985)	(36,847)	(38,172)	3.6%
Personnel expenses	(23,143)	(21,914)	(25,409)	15.9%
Other administrative expenses	(20,811)	(23,972)	(30,791)	28.4%
EBITDA	32,074	42,368	37,580	-11.3%
EBITDA margin %	30.0%	33.9%	28.5%	
Depreciation and amortisation	(5,590)	(8,180)	(12,829)	56.8%
Derecognition of financial assets*	0	(3,570)	0	
EBIT	26,484	30,618	24,751	-19.2%
Financial results	(1,288)	(2,179)	(3,123)	43.3%
EBT	25,196	28,439	21,628	-23.9%
Income tax expense	(8,179)	(10,965)	(6,720)	-38.7%
Tax rate	32.5%	38.6%	31.1%	
Earnings from continuing activities	17,017	17,473	14,908	-14.7%
Earnings from discontinued operations	(220)	0	0	
Consolidated net profit	16,797	17,473	14,908	-14.7%

Source: Flatex. Note: *There was a write-down adjustment of €3.57m retrospective write-down of financial assets adjustment on FY18 figures. This reduces the reported FY18 earnings from €21m to €17.5m and the EPS from €1.12 to €0.98.

Volatility drives record Q120

Financial market volatility has been very high this year since the COVID-19 pandemic began. The economic uncertainty caused by the countering measures to control the disease has affected markets and volatility is a good thing for brokers. In April 2020, Flatex announced that more than 17m transactions (+130% y-o-y) had been executed in Q120 for Flatex and DEGIRO on a pro forma basis. There were more than 170,000 new customers in Q120, +324% versus Q119. The company disclosed that the pre-tax profit in Q120 of Flatex alone was greater than it was for FY19 (€21.6m).

We would caution that these volumes are extraordinary and are likely to come down when the market turbulence subsides.

DEGIRO purchase is transformational

Flatex's DEGIRO purchase allows it greater scale, greater geographic presence, a proprietary trading engine and a broader product line. DEGIRO is a streamlined operation with a low-cost service centre in Sofia, Bulgaria and a wide presence across Europe.

The deal was announced on 13 December 2019 and is good for 100% of shares at a total price of €250m. The offer is €60m in cash and €190m in Flatex shares. The shares are priced at €25.33 each and 7.5m new shares will be issued. Flatex shares had been trading between €22 and €25 in the run-up to the announcement. The acquisition is fully supported by DEGIRO management and Flatex took a 9.4% initial stake paid in cash (€23.5m) in December 2019.

Approval by the regulatory authorities is yet to be finalised. The original expectation had been for a decision in Q220.

Flatex hired Lazard in mid-2019 to evaluate the strategic options of the business. At the time, it was explained to the market that the path taken could involve mergers, acquisitions, partnerships, new shareholders and even a possible sale of the company.

In its statements after the deal was announced, Flatex management stated it 'realised that size, scaling, customer orientation and internationality are key success factors. We want to actively participate in the consolidation given our financial strength and to continue being in the driver seat. For our stakeholders, we consider inorganic growth to be significantly value creating'.

Flatex's market share in its home market of Germany is already a dominant 50% with 25% in Austria. Although its expansion into the Netherlands was going well and Spain was lined up next, this acquisition allows a much quicker approach to scaling up aside from the other benefits from the acquisition.

Exhibit 3: 2019 pro-forma Flatex with DEGIRO combined

€m	Flatex	DEGIRO (est)	Combined	Mid-term ambition
Revenue	132	60	192	300
EBITDA	37.6	13.7	51	150
Net profit	15	10	25	
Equity	182	26	208	
Brokerage clients (000s)	368	470	838	
Transactions (m), B2C only	11.2	18.6	29.8	
EPS (€)				3.0

Source: Flatex

The acquisition allows Flatex to become the largest pan-European retail broker with a presence in 18 European counties and with the full value chain in-house.

The more than €30m annual synergies identified by the company are broken down as follows: flow-related (€15–20m); IT savings (€10–15m); single corporate structure (€3–5m); and greater scale, such as marketing and bargaining power (€3–5m).

Debt levels remain moderate after acquisition

Flatex's balance sheet remains healthy, with moderate year-end debt of €81.5m. This is equivalent to 45% of equity, similar to FY18 (42%) and considerably below 75% in FY17.

If the regulators approve the deal (which we believe is likely), there is €36.5m to be paid in cash for the DEGIRO acquisition (the rest will be in shares). The deal with DEGIRO is being carried out on a net debt-free basis. Adding €36.5m to the existing debt and divide by the pro-forma combined equity FY19 of Flatex with DEGIRO (€212m) is equivalent to a debt to equity ratio of 56%. The pro-forma combined FY19 EBITDA of €51m makes the pro-forma debt level of €118m look very comfortable indeed.

The cash flow shown is driven greatly by changes in customer cash deposits in Flatex's banking operations. These are customer cash balances and therefore not a significant indicator of available cash. We have shown the debt position to give a better idea of gearing. The company had a free liquidity position of €29.9m after the December payment for the 9.4% stake in DEGIRO.

Exhibit 4: Balance sheet and cash flow

Balance sheet (€000s)	FY16	FY17	FY18	FY19
Intangible assets	57,339	62,953	82,664	92,722
Other	21,550	34,420	49,829	86,978
Total non current assets	78,889	97,373	132,493	179,700
Financial assets at FVOCI	514,335	177,517	57,374	61,547
Financial assets at FVPL	1,234	1,006	893	214
Cash loans due to local authorities	401,171	237,165	18,900	14,056
Current loans due to customers*	122,472	175,415	213,675	362,552
Equity instruments FVOCI-EK			82,465	68,644
Equity instruments FVPL-EK			0	66,049
Other receivables due to banks	12,328	12,610	40,466	31,239
Cash	389,202	397,002	655,046	468,616
Other	13,905	8,962	22,857	13,345
Assets from discontinued operations	459	383	0	0
Total current assets	1,454,647	1,009,677	1,091,676	1,086,262
Total assets	1,533,995	1,107,433	1,224,169	1,265,962
Financial	2,875	16,040	9,874	3,727
Other	11,933	13,352	20,521	34,983
Total non-current liabilities	14,808	29,392	30,395	38,710
Liabilities to customers	1,339,845	885,112	955,489	950,777
Liabilities to banks	60,275	61,010	57,259	71,694
Other financial liabilities	3,813	7,463	2,219	6,131
Other	24,624	11,732	15,151	16,449
Total current liabilities	1,428,557	965,317	1,030,118	1,045,051
Total liabilities	1,443,365	994,709	1,060,513	1,083,761
Equity	90,630	112,724	163,656	182,202
Total financial liabilities	66,963	84,513	69,352	81,552
Cash flow		FY17	FY18	FY19
Cash flow operations - before banking		23,729	17,536	49,427
Cash flow from banking operations		-23,473	232,535	-206,673
Cash flow from operations		112	250,071	-157,246
Cash flow from investments		(12,587)	(27,756)	(33,189)
Cash flow from financing		20,273	32,160	4,005
Net cash flow		7,799	254,475	(186,430)
Cash and cash equivalent beg of year		389,202	397,002	655,046
Cash and cash equivalent end of year		397,002	655,046	468,616

Source: Flatex

Valuation

Flatex's share price has almost doubled since 13 December, with the market reacting very positively to the acquisition news. Furthermore, the market volatility has led to both Flatex and DEGIRO to post strong business volume figures in the first quarter of 2020 as aforementioned.

Flatex is now trading on forward P/E ratios of 24.2x (FY20e) and 17.6x (FY21e) based on consensus forecasts. FY20 is above the average for B2B peers (22.0x), but below that of the B2C (28.1x if we exclude loss-making outlier Crealogix). However, its 2021 P/E is noticeably lower than the averages for B2B (23.7x) and B2C (23.3x, ex Crealogix). Consensus is forecasting a 38% increase in Flatex's EPS in FY21, which is above average of its peers. The B2B average forecast EPS falls in FY21.

Consensus expects Flatex's EBIT margin to increase from 31.6% to 34.8% between FY20 and FY21 and only one of the peers (Sopra Steria) in Exhibit 5 has a lower FY21 EV/EBIT than Flatex's (12.2x).

So, besides the optimism regarding the DEGIRO acquisition, the market is also clearly positive about Flatex's business model and the growth outlook underpinned by its healthy balance sheet

and good competitive position. However, given the growth expectations, it is possible that some further positive re-rating of the shares may occur when (and if) the acquisition is approved the regulatory authorities.

Exhibit 5: Peer analytics

		Curr.	Shr price	Mtk cap	Rev grwth (y-o-y %)		EBIT margin (%)		P/E (x)		EV/EBIT (x)	
			(curr)	(€m)	2020e	2021e	2020e	2021e	2020e	2021e	2020e	2021e
FTKG.DE	Flatex	EUR	42.0	822	56.5	31.8	31.6	34.8	24.2	17.6	17.5	12.1
AVANZ.ST	Avanza	SEK	133	1,941	39.3	-5.0	51.2	43.9	26.6	32.3	84.8	104.4
CDBG.DE	Comdirect	EUR	14	1,928	12.2	-4.2	34.0	28.5	18.2	22.2	14.6	18.2
ETFC.O	Etrade	USD	48	9,581	-11.6	-5.6	35.5	34.5	17.5	19.5	53.0	57.9
FBK.MI	FinecoBank	EUR	12	7,396	11.9	-1.4	62.8	62.0	24.7	25.1	12.1	12.4
IBKR.K	Interactive brokers	USD	42	15,450	-7.5	-3.0	48.9	40.2	24.0	25.3	23.7	29.7
SQN.S	Swissquote	CHF	80	1,158	12.9	7.8	26.0	27.4	20.8	17.7	63.4	56.0
Avg. B2B*					9.5	-1.9	43.1	39.4	22.0	23.7	41.9	46.4
CLXN.S	Crealogix	CHF	94	123	-1.7	5.2	-4.9	-2.8	-341.8	113.3	-24.0	-40.0
FRST.L	First Derivatives	GBP	2,370	719	-2.9	6.0	12.9	13.1	37.7	31.3	24.3	22.5
GFTG.DE	GFT	EUR	10	271	-0.1	6.8	4.0	5.4	20.0	14.8	19.1	13.3
SOPR.PA	Sopra Steria	USD	109	2,252	-3.2	3.8	6.4	7.9	13.2	10.0	11.3	8.9
TEMN.S	Temenos	USD	146	10,094	-2.9	12.7	34.5	33.9	41.7	37.0	37.5	33.8
Avg. B2C*					-2.1	6.9	10.6	11.5	-45.9	41.3	13.6	7.7

Source: Refinitiv. * ex-Flatex Note: Priced at 22 June 2020.

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