EDISON

GB Group

Consistent strong performance

FY18 results update

Software & comp services

GBG delivered another excellent performance in FY18 with reported adjusted EPS up 37%. With over 75% of revenues now from the global product lines, a clear organic growth plan and a healthy acquisition pipeline, we retain our forecasts and believe the shares, which trade among identity access management and cyber security peers to be well supported at these levels.

Year end	Revenue (£m)	EBIT (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/17	87.5	17.0	16.5	9.9	2.4	52.8	0.5
03/18	119.7	26.3	25.8	13.5	2.7	38.6	0.5
03/19e	133.4	27.0	26.5	13.8	3.0	37.6	0.6
03/20e	147.7	30.0	29.6	15.2	3.3	34.1	0.6

3ote: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

FY18 results: Strong organic growth and PCA Predict impact

Revenues of £119.7m (+37% y-o-y, of which 17% was organic) and EBITA of £26.3m (+55%) were in line with April's trading update, with EBITA 12% above our forecast due to a higher margin – stripping out the impact from the one licence sale during H1, margins of 20% were in line with management's targeted rate and are expected to fall back to this level in FY19. Adjusting for the licence, underlying organic growth of 15% picked up slightly in H2 (12% in H1) as the synergy benefits of the PCA Predict acquisition start to present, along with some 'one-off' effects from a flurry of Bitcoin trading and first revenues being back-recognised from the GOV.UK Verify service. A final dividend of 2.65p (+13% y-o-y) has been proposed.

Faster-growing global products underpin forecasts

Growth was strongest in GBG's international product lines: fraud (31%), electronic identity verification (eIDV +37%) and location (+81%). These areas now account for over 75% of group sales, which we believe puts GBG in a strong position to continue to deliver our forecast double-digit organic revenue in FY19 and FY20. The group's efforts to integrate platforms and acquisitions over the last year will enable the launch of a common brand this year, a key part of the strategy to promote a more customer-oriented approach to selling. Although the growth comparative will be relatively difficult in H119, the year appears to have started well; 70% of GBG's revenues are recurring and deferred revenues as a share of our forecast for the year are ahead of last year. We increase EPS forecasts in FY19 and FY20 by c 2% to reflect a slightly lower tax charge.

Valuation: Premium captures growth opportunity

GBG's 23.1x FY19 EV/EBITDA and 37.6x P/E ratings are within the mix of other global companies in the identity access management and cyber security segments. While this is a considerable premium to the UK software sector, we believe it is supported by the good earnings quality and cash conversion, strong organic growth outlook and an active acquisition pipeline.

7 June 2018

Price	**520p**
Market cap	**£794m**

Net cash (£m) March 2018	13.5
Shares in issue	152.7m
Free float	98%
Code	GBG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	5.4	21.1	26.9
Rel (local)	2.9	13.0	23.6
52-week high/low		545p	330.75p

Business description

GB Group is a specialist in identity data intelligence. Its products and services enable its customers to better understand and verify their customers and employees, and are used across a range of fraud, risk management, compliance and customer on-boarding services. With headquarters in the UK, it operates across 24 countries and generates approximately one-third of revenues internationally.

Next events

H119 results	November 2018

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Edison profile page

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Results overview

Results headlines: Ahead as flagged at pre-close update

The revenue increase of 37% to £119.7m and adjusted EBITA of £26.3m, up 55%, had been pre-announced in April's trading update – ahead of our previous forecasts (£117.1m and £23.3m respectively) and a 12% beat in terms of adjusted operating profits. While operating margins (22%) were ahead of the group's targeted 20%, once the impact of the receipt of a one-off perpetual licence in H118 is backed out, margins were as expected at c 20%.

Net of £0.5m finance costs, adjusted PBT of £25.8m was similarly ahead. As in FY17, the group was granted R&D and patent box tax reliefs as well as the benefit of other timing differences, and the effective tax rate of the group at 11% was below our forecast rate, resulting in a reported adjusted diluted EPS of 15.3p (vs forecast of 11.8p).

In our calculation of adjusted EPS for FY18, we use a normalised tax rate of 20%, which implies an adjusted EPS of 13.5p (+37% y-o-y). Although our measure of EPS is conservative, we believe it gives a more meaningful picture of the group's underlying longer-term earnings pattern.

Reported PBT of £13.4m (up 33% y-o-y) captures a higher charge for amortisation of acquired intangibles of £7.9m, largely due to the acquisition of PCA Predict in May 2017, as well as associated exceptional costs relating to its acquisition, and other restructuring costs of £2.1m and a higher share-based payments charge of £2.4m (FY17: £10m), following the change of CEO last year.

Operating cash flow of £31.6m (FY16: £16.3m) equates to a 110% cash conversion. This is ahead of the group's trend rate of c 90%, with benefits seen following the PCA acquisition, which has a net positive working capital cycle, as well as a reduction in receivables days out of China, following the establishment of a wholly foreign-owned enterprise in the region last year. As a result, year-end net cash balance of £13.5m was well ahead of our forecast for net debt of £2.8m.

Exhibit 1: Summary FY18 results and forecasts (£m)

	FY17	FY18	y-o-y change	FY19e	FY20e
Revenues	**87.5**	**119.7**	**37%**	**133.4**	**147.7**
Gross profit	67.2	92.6	38%	100.1	111.0
Gross profit margin	76.8%	77.4%		75.1%	75.1%
EBITA	**17.0**	**26.3**	**55%**	**27.0**	**30.0**
EBITA margin	19.4%	22.0%		20.2%	20.3%
Amortisation of acquired intangibles	(4.0)	(7.9)	96%	(8.1)	(7.3)
Share based payments	(1.0)	(2.4)	139%	(2.5)	(2.8)
Exceptional items	(1.4)	(2.1)	52%	-	-
Reported operating profit	10.6	13.9	31%	16.4	19.9
Net financing costs	(0.5)	(0.5)	2%	(0.5)	(0.4)
Adjusted PBT	**16.5**	**25.8**	**56%**	**26.5**	**29.6**
Reported PBT	10.1	13.4	33%	15.9	19.5
Tax	0.7	(2.7)	-511%	(5.3)	(5.6)
PAT - adjusted	17.2	23.1	34%	21.6	23.9
PAT - reported	10.8	10.7	-1%	10.6	13.9
Adjusted diluted EPS (Edison definition) (p)	9.9	13.5	37%	13.8	15.2
Reported EPS (p)	8.2	7.1	-12%	6.9	9.1
Net cash/ (debt)	**5.2**	**13.5**	**158%**	**28.4**	**45.4**

Source: GBG (historicals), Edison Investment Research (forecasts)

Strong performance in focus areas: Fraud, eIDV and Loqate

Of the 37% revenue growth, 20% relates to the acquisition of PCA Predict in May 2017 and a full-year effect from ID Scan, acquired in June 2016. In total, 17% of growth was organic although, adjusting for the impact of a one-off £3.5m perpetual licence sale in H118 by ID Scan, the underlying organic revenue growth was 15%. The pick-up in underlying growth through the year (17% in H218 vs 12% in H118) is attributed to the benefits of integrating GBG data into the PCA platform (c 1pp), a flurry of ID verification requests associated with the interest in Bitcoin trading by one of GBG's newer clients (Coinbase) and c 1pp from the recognition of first revenues from the GOV.UK Verify platform. The strong underlying growth performance continues to be underpinned by the group's focus areas for global growth: fraud management (CAFS +31% organic growth), identity verification (eIDV +37% including a full year from ID Scan) and location intelligence products (+81% including this year's acquisition of PCA Predict, Loqate and Matchcode 360).

Exhibit 2: Divisional performance (£000s)

	2015	2016	2017	H118	2018	2019e	2020e
Fraud, risk and compliance	33,800	42,400	54,814	32,055	69,800	79,200	89,796
Location and customer intelligence	23,600	31,000	32,672	20,571	49,902	54,150	57,937
Total revenue	**57,283**	**73,401**	**87,468**	**52,626**	**119,702**	**133,350**	**147,733**
Revenue growth							
Fraud, risk and compliance	52%	25%	29%	35%	27%	13%	13%
Location and customer intelligence	21%	31%	5%	50%	53%	9%	7%
Total revenue growth	**37%**	**28%**	**19%**	**40%**	**37%**	**11%**	**11%**
Fraud, risk and compliance	6,600	10,300	12,923	7,693	16,000	17,776	20,154
Location and customer intelligence	4,800	4,000	4,758	3,442	11,511	10,830	11,587
Group costs	(610)	(872)	(675)	(707)	(1,200)	(1,606)	(1,779)
Total EBITA	**10,790**	**13,428**	**17,006**	**10,428**	**26,311**	**27,000**	**29,962**
FRC EBITDA margin	19.5%	24.3%	23.6%	24.0%	22.9%	22.4%	22.4%
LCI EBITDA margin	20.3%	12.9%	14.6%	16.7%	23.1%	20.0%	20.0%
Group	**18.8%**	**18.3%**	**19.4%**	**19.8%**	**22.0%***	**20.2%**	**20.3%**
Operating cash flow	11,684	13,397	16,305		31,620	27,375	30,219
Cash conversion	99%	91%	87%		110%	92%	92%

Source: GBG, Edison Investment Research. Note:* c 20% excluding the impact of a one-off licence.

GBG has made 11 acquisitions over the last seven years (including the recent small acquisition of Verifeyed, a digital anti-tampering software application) and has built leading positions in a number of products and markets. Investment over the last year has been stepped up to fully integrate these acquisitions, divisions and platforms in anticipation of the launch of a common brand, which should support cross sell opportunities moving forward; the recent appointment of a customer experience leadership role is a part of the efforts since Chris Clark joined last year to become more customer, rather than product, focused.

Further to this, next week management plan to launch its first full solution brand, GBG Loqate, which will pull together all the product lines in this area, providing it with one of the strongest offers on the market globally. The group now has a sales presence in 15 markets across the world and sees particular opportunity to expand PCA Predict from the UK to two of the world's largest markets – the US and Germany – where sales managers have been put in place and first contracts signed.

International growth, at over 50% y-o-y, continues to be strong with these revenues now accounting for 34% of total. GBG has had a strong representation in financial services and gaming for some time and continued to add global companies to its roster of clients in these areas (Nordstrom, KBC Ireland). During the year, it also added a number of e-tailers including ebay and Etsy in the US.

Momentum appears to be strong heading into the new financial year – deferred revenues at March 2018 were £28.3, +49% y-o-y, accounting for 21% of FY19 forecast revenues (vs 18% at the same point last year, adjusted for PCA Predict). Around 70% of revenues are recurring and, while the basis of comparison will be tough in the first half of the year in particular, over 76% of revenues are now derived from the faster-growing product areas. Some of the headwinds to growth from the less strategic Engage division appear to have eased (revenues, down 3% across the year were stable in H218). For now we leave operational FY19 and FY20 forecasts largely unchanged, but reduce our forecast tax charge slightly as GBG is likely to continue to benefit from a range of tax credits which results in a 2% increase to our FY19e and FY20e EPS forecasts to 13.8p and 15.2p respectively. We also upgrade our forecast year-end cash balance to £28.4m as a consequence of the higher starting point for the year. However, given the above and the 2% beat to FY18 revenues, there may be scope to nudge up our organic revenue forecast slightly as the year progresses.

Valuation reflects earnings quality and growth opportunity

GBG has delivered a consistently strong financial performance over the last three years (see Well positioned in the dynamic ID Intelligence market for more information on the group's historic performance). Double-digit organic revenue growth, in parallel with a widening gross margin as the group benefited from scale economies, coupled with acquisitions resulted in an EPS CAGR of 27% across the three years to FY18. Current trading remains strong and we expect the internationalisation of GBG's product set to support continued double-digit organic growth over the forecast period. While the scope for margin improvement is currently capped by the group's policy to reinvest an increasing share of revenues in new product and market development, this should nevertheless support our forecast for c 15% EPS CAGR to 2020.

The shares have performed strongly since the trading update in April and trade above the average software sector multiples. However, when compared to other companies in the identity access management sector and cyber security segments, which we believe share similar growth drivers, the 23.1x FY19 EV/EBITDA and 37.6x P/E ratings are within the mix (Exhibit 3).

Our reverse DCF, which we roll out one year following the results, implies the shares are already discounting low double-digit revenue growth over the medium term on stable margins (assuming an 8.4% WACC and 3% perpetuity growth after 10 years) as summarised in Exhibit 4. While already a fairly full rating, we believe the share price is supported at these levels based on the good earnings quality, strong cash conversion and the excellent growth outlook, which may be partly reflecting likely M&A activity, a key part of management's strategy to expand the group's product set and reach. The global market for identity data intelligence services remains fragmented, particularly internationally and in advanced authentication. Management has indicated that while valuations in the US are stretched for private companies in this area, it has c 40 prospects under review. With approximately £54m cash available to it via its £13.5m net cash balance and £40.7m undrawn facilities, bolt-on acquisitions could be absorbed without share dilution.

Furthermore, given the importance of ID intelligence in enabling the digital economy, and with General Data Protection Regulation initiatives in the spotlight, investors should consider the potential strategic value of quality companies to a widening potential pool of acquirers.

Exhibit 3: Peer summary

Segment	Sales growth (%)		EBITDA m'gin (%)		EBIT m'gin (%)	EV/ EBITDA (x)		EV/ EBIT (x)		P/E (x)	
	FY1	FY2	FY1	FY2	FY1	FY1	FY2	FY1	FY2	FY1	FY2
GBG	**11.4**	**10.8**	**22.3**	**22.1**	**20.2**	**23.1**	**20.9**	**25.4**	**22.9**	**37.6**	**34.1**
Average ID management	11.7	17.7	23.6	25.0	20.7	19.8	15.2	22.0	32.3	26.8	38.8
Average IAM	13.0	12.4	20.9	22.6	21.5	21.2	17.9	24.2	20.2	36.6	31.3
Average cyber security	17.7	15.2	24.0	22.7	19.1	33.1	28.2	56.8	34.3	61.4	45.0
Average UK software	22.0	13.2	22.6	25.1	19.3	13.9	12.2	17.3	15.4	26.0	21.8

Source: Bloomberg. Note: Priced 5 June 2018 (excludes outliers with multiples over 100x).

Exhibit 4: DCF sensitivity table

		EBITDA margin						
….revenue growth….		**18.0%**	**19.0%**	**20.0%**	**21.0%**	**22.0%**	**23.0%**	**24.0%**	**25.0%**
	4.0%	71	75	81	87	93	99	106	114
	6.0%	143	153	165	177	190	204	219	235
	8.0%	215	231	249	267	287	309	332	357
	10.0%	287	309	332	358	385	414	445	479
	12.0%	359	387	416	448	482	519	558	600
	13.0%	395	426	458	493	**531**	571	615	661
	14.0%	431	465	500	539	580	624	671	722
	15.0%	467	503	542	584	628	676	727	782
	16.0%	504	542	584	629	677	729	784	843

Source: Edison Investment Research. Note: FY18 EBITDA margin was 22%.

Exhibit 5: Financial summary

£'000s	2015	2016	2017	2018	2019e	2020e
March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	57,283	73,401	87,468	119,702	133,350	147,733
Cost of Sales	(16,448)	(17,606)	(20,302)	(27,092)	(33,212)	(36,722)
Gross Profit	40,835	55,795	67,166	92,610	100,138	111,011
EBITDA	11,844	14,772	18,734	28,741	29,675	32,719
Operating Profit (before amort. and except.)	10,790	13,428	17,006	26,311	27,000	29,962
Acquired intangible amortisation	(1,986)	(2,501)	(4,022)	(7,885)	(8,100)	(7,300)
Exceptionals	(1,629)	(94)	(1,410)	(2,143)	0	0
Share of associate	(10)	0	0	0	0	0
Share based payments	(971)	(1,245)	(994)	(2,375)	(2,500)	(2,750)
Operating Profit	6,194	9,588	10,580	13,908	16,400	19,912
Net Interest	(266)	(270)	(498)	(508)	(500)	(400)
Profit Before Tax (norm)	10,524	13,158	16,508	25,803	26,500	29,562
Profit Before Tax (FRS 3)	5,928	9,318	10,082	13,400	15,900	19,512
Tax	(1,127)	(178)	668	(2,746)	(5,300)	(5,617)
Profit After Tax (norm)	8,314	10,395	13,206	20,642	21,598	23,946
Profit After Tax (FRS 3)	4,801	9,140	10,750	10,654	10,600	13,896
Average Number of Shares Outstanding (m)	119.1	122.7	131.6	150.6	152.8	153.5
EPS - normalised (p)	7.0	8.5	10.0	13.7	14.1	15.6
EPS - normalised and fully diluted (p)	6.7	8.2	9.9	13.5	13.8	15.2
EPS - (IFRS) (p)	4.0	7.4	8.2	7.1	6.9	9.1
Dividend per share (p)	1.9	2.1	2.4	2.7	3.0	3.3
Gross Margin (%)	71.3	76.0	76.8	77.4	75.1	75.1
EBITDA Margin (%)	20.7	20.1	21.4	24.0	22.3	22.1
Operating Margin (before GW and except.) (%)	18.8	18.3	19.4	22.0	20.2	20.3
BALANCE SHEET						
Fixed Assets	51,238	59,364	105,653	170,284	162,160	154,853
Intangible Assets	45,296	54,113	98,753	161,372	152,292	144,012
Tangible Assets	2,829	2,234	2,856	4,700	5,656	6,629
Other fixed assets	3,113	3,017	4,044	4,212	4,212	4,212
Current Assets	33,186	36,189	48,187	60,722	76,535	93,552
Debtors	17,408	23,774	30,569	37,969	42,847	46,948
Cash	15,778	12,415	17,618	22,753	33,688	46,604
Other	0	0	0	0	0	0
Current Liabilities	(30,784)	(32,559)	(44,444)	(56,942)	(59,520)	(61,121)
Creditors	(24,305)	(30,927)	(36,436)	(56,100)	(58,678)	(60,279)
Contingent consideration	(5,733)	(1,050)	(7,122)	(45)	(45)	(45)
Short term borrowings	(746)	(582)	(886)	(797)	(797)	(797)
Long Term Liabilities	(7,506)	(6,593)	(15,940)	(16,711)	(12,711)	(8,711)
Long term borrowings	(3,643)	(3,160)	(11,499)	(8,451)	(4,451)	(451)
Contingent consideration	(895)	0	0	0	0	0
Other long term liabilities	(2,968)	(3,433)	(4,441)	(8,260)	(8,260)	(8,260)
Net Assets	46,134	56,401	93,456	157,353	166,463	178,573
CASH FLOW						
Operating Cash Flow	11,684	13,397	16,305	31,620	27,375	30,219
Net Interest	(266)	(282)	(498)	(545)	(500)	(400)
Tax	(337)	(248)	(2,193)	(3,247)	(5,300)	(5,617)
Capex	(2,011)	(1,762)	(2,227)	(2,018)	(2,650)	(2,750)
Acquisitions/disposals	(18,672)	(12,263)	(36,840)	(70,363)	0	0
Financing	10,954	790	24,755	56,668	0	0
Dividends	(1,955)	(2,277)	(2,775)	(3,582)	(3,990)	(4,536)
Net Cash Flow	(603)	(2,645)	(3,473)	8,533	14,935	16,916
Opening net debt/(cash)	(11,846)	(11,389)	(8,673)	(5,233)	(13,505)	(28,440)
HP finance leases initiated	0	0	0	0	0	0
Other	146	(71)	33	(261)	0	0
Closing net debt/(cash)	(11,389)	(8,673)	(5,233)	(13,505)	(28,440)	(45,356)

Source: GBG (historics), Edison Investment Research (forecasts)

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