Piteco

Interim results

Contract momentum

Software & comp services

Underlying momentum remains healthy, with 24 new contract wins in the eight months to 31 August, up from 21 in the previous corresponding period. LendingTools (LT), which was acquired in April, has been performing well and management is increasingly buoyant on its prospects. We have eased our Corporate Treasury revenue forecasts, due to the lack of an abnormally large contract this year that would require a higher level of professional services. We are maintaining our forecasts for LT despite the 10% decline in the dollar against the euro. Our FY18 and FY19 EPS move higher on lower tax assumptions. Given the attractive growth opportunities, strong cash generation and healthy balance sheet, we continue to believe the shares are attractive on c 14x our FY18e earnings.

Year end	Net sales revenue* (€m)	EBITDA** (€m)	EPS** (c)	DPS (c)	P/E (x)	Yield (%)
12/15	12.8	5.7	20.7	10.0	25.4	1.9
12/16	13.5	5.6	24.3	15.0	21.6	2.9
12/17e	17.1	7.1	30.6	17.5	17.2	3.3
12/18e	20.4	9.0	38.9	20.0	13.5	3.8

Note: *Excludes the capitalisation of development costs, change in work in progress and other revenues (largely expenses charged back to customers). **Normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Interim results: 24 new contracts in first eight months

H1 revenues rose by 13% to €7.4m, including 1% organic growth from Piteco's Corporate Treasury activities and €0.8m from LT, which contributed for an initial two-month period. Operating cash flow was €3.8m, or 51% of net sales, and the group finished the period with net debt of €6.6m, from €1.9m net cash as at end-December, after acquiring an initial 55% of LT in April, for c $12.7m. LT is the third largest player in the US correspondent banking software space, behind FedLine Advantage, which is owned by the Federal Reserve, and another system owned by the banks. Piteco acquired LT as a route into the lucrative US market, and Piteco plans to use LT to grow its core treasury software solutions in the US.

Forecasts: EPS boosted on lower tax assumptions

We have eased our net sales revenue forecasts by 5% in FY17, 2% in FY18 and 1% in FY19, while EBITDA retreats by 10% in FY17 and 1% in FY18 and rises by 3% in FY19 on disciplined cost control. We have increased our interest forecasts while cutting tax (to 15% of FY17 net income, rising gently thereafter). While EPS comes back by 4% in FY17, they rise by 11% in FY18 and by 16% in FY19. We forecast the group to end FY17 with net debt of €6.0m (previously €4.5m).

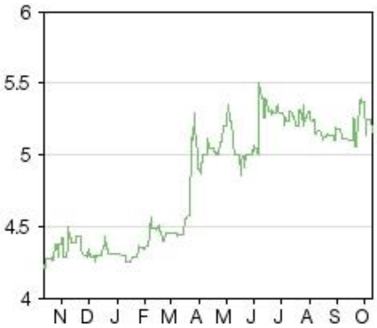
Valuation: DCF valuation moves up

The stock looks attractive, trading on c 17x our EPS in FY17e, falling to c 14x in FY18e and to c 12x in FY19e. Our DCF model suggests a valuation of 598c (previously 549c), which is 14% above the current price. The calculation uses conservative assumptions including a 5.4% CAGR in organic net sales revenue over 10 years, long-term operating margins of 40% to net sales and a WACC of 9%. It has also been adjusted for the dilution impact of the convertible bonds.

10 October 2017

Price	**€5.25**
Market cap	**€95m**
	US$1.18/€
Net debt (€m) at 30 June 2017	6.6
Shares in issue	18.1m
Free float	27.4%
Code	PITE
Primary exchange	AIM Italia
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.0	(1.3)	21.7
Rel (local)	(2.2)	(7.9)	(11.6)
52-week high/low		€5.5	€4.2

Business description

Piteco is Italy's leading company in designing, developing and implementing software for treasury, finance and financial planning management.

Next events

Final results	March/April 2018

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Edison profile page

Piteco is a research client of Edison Investment Research Limited

Interim results: Highlight was the US acquisition

H1 revenues rose by 13% to €7.4m, including 1% organic growth from Piteco's traditional Corporate Treasury activities and €0.8m from LT, which contributed for an initial two-month period. Software licence sales grew by 5% to €0.7m and hosted SaaS product more than doubled to €0.3m. The company has been developing a domestic distribution network for its SaaS product and also plans to develop an international distribution network for the SaaS product in due course. However, the group lacked any especially large contract wins – large deals typically involve more complex installations and higher levels of services revenues. Consequently, services revenue (implementation and customisation) dipped by 8% to €2.2m. However, Piteco has been in talks with a large client that it hopes to sign in late FY17, but more likely in FY18. If signed, this deal would provide a boost to the business in FY18. Maintenance fees increased by 1% to €3.4m.

The acquisition of LT was completed on 7 April, and LT generated c $0.3m of revenue during the period of ownership in April. This revenue was used to reduce the LT acquisition price from $13.0m to $12.7m, and the €0.8m reported revenue reflected business generated in May and June. However, LT operating costs were recognised for the entire period from 7 April. Hence, while LT's reported EBITDA was €0.2m for a 25% margin, the adjusted EBITDA was €0.5m on revenue of €1.1m for the full period since the acquisition completed, indicating an EBITDA margin of more than 40%. Management is very pleased with the LT acquisition; the new management team is working out well and LT's customers are happy with the deal. Management says LT's revenues and costs are exactly in line with its initial expectations. However, the dollar has slipped from $1.06/€ to $1.18/€ since the acquisition date, reducing the translation of LT's contributions to Piteco by 10%. As the international strategic focus shifted to the US in H1, the Mexican strategy has suffered for now.

Operating cash flow was €3.8m, or 51% of net sales, and the group finished the period with net debt of €6.6m, from €1.9m net cash as at end-December, after acquiring LT. LT also had a net cash position at the time of purchase, and the net acquisition cost was c €9m. A new €7m bank loan was signed with Iccrea Bank to finance the Juniper/LendingTools transaction, paying Euribor +190bp, and after the period end the company repaid an existing €3.5m loan. Piteco has lent the money to Juniper, at an interest rate of Euribor +250bp, providing Piteco with a small profit margin.

Piteco is making significant progress in its plan to move to the main market (MTA) on the Italian stock exchange and will probably list on MTA by next summer. In early June, Podini family interests sold 1,663,500 Piteco shares (c 9.18% of the share capital) to institutional investors, which increased the company's free float to 27.41%, satisfying the 25% MTA threshold.

Exhibit 1: Revenues by type

€	H116	H117	Change (%)
Maintenance fees	3,368,073	3,415,100	1.4
Software licence sales	668,397	704,142	5.3
Software as a service	138,301	277,471	100.6
Professional services	1,946,124	1,789,611	(8.0)
Customisation	415,606	386,647	(7.0)
Fees and royalties	10,529	9,409	(10.6)
Digital payment and clearing house	-	808,675	-
Total revenues	6,547,029	7,391,057	12.9

Source: Piteco accounts

Exhibit 2: Half-by-half analysis

€000s	2016			2017e			2018e
	H1	H2	FY	H1	H2e	FYe	FYe
Corporate treasury	6,547	6,930	13,477	6,582	7,301	13,883	14,994
LendingTools				809	2,386	3,195	5,396
Net sales revenue	6,547	6,930	13,477	7,391	9,687	17,078	20,390
Other income	164	497	661	192	497	689	858
Change in work in progress	(6)	(10)	(16)	8	(8)	0	0
Total revenue	6,705	7,418	14,122	7,591	10,176	17,767	21,248
Operating costs before depreciation	(4,243)	(4,273)	(8,516)	(5,056)	(5,587)	(10,643)	(12,279)
EBITDA	2,461	3,145	5,606	2,535	4,589	7,124	8,969
EBITDA margin	37.6%	45.4%	41.6%	34.3%	47.4%	41.7%	44.0%
Depreciation	(125)	(172)	(297)	(48)	(327)	(375)	(375)
Adjusted operating profit	2,337	2,972	5,309	2,487	4,262	6,749	8,594
Net financial income	(185)	(180)	(365)	(243)	(251)	(494)	(400)
Edison Profit Before Tax (norm)	2,152	2,793	4,945	2,244	4,011	6,255	8,194
Exceptional items & FX gains	96	10	106	(666)	0	(666)	0
Amortisation of ac'q intangibles	0	0	0	(424)	(446)	(870)	(870)
Profit before tax (FRS 3)	2,248	2,803	5,050	1,153	3,566	4,719	7,324
Income tax	(464)	(83)	(547)	(147)	(559)	(707)	(1,147)
Net income	1,784	2,719	4,503	1,006	3,006	4,012	6,177

Source: Piteco accounts (historics), Edison Investment Research (forecasts)

Acquisition of LendingTools

On 7 April, Piteco completed the acquisition of an initial 55% of LT for c $12.7m in cash. Piteco has an option to increase its stake by 2.5% in each of the next two years from the key managers for up to $1.5m, depending on the financial performance of the acquired business. Based in Wichita, Kansas, close to the centre of the US, LT is the third largest player in the US correspondent banking software space, behind FedLine Advantage, which is owned by the Federal Reserve, and another system owned by the banks. LT is profitable, strongly cash generative, with very high recurring revenues (90%), and has long-term contracts and low churn rates. LT operates on a SaaS basis, with 90% of revenue generated from contracted monthly billing, similar to a subscription service. More than $3bn of transactions from over 3,500 financial institutions are routed through LT's data centre each day. A high proportion of its customer base is in the US mid-west. In FY16, LT generated revenue of $5m and pre-tax profit of $1.75m, for a 35% margin.

Forecasts

We have made a number of changes to our forecasts. We have reduced our Corporate Treasury revenue forecasts by 4% to €13.9m in FY17 to reflect the lack of a large customer win in FY17 and a corresponding decline in professional services. Consequently, we are now forecasting a 3% growth in Corporate Treasury revenues in FY17. However, we forecast growth to accelerate as the group develops its SaaS and international strategies, and hence we forecast 8% growth in FY18 and FY19.

We have cut our FY17 LT revenue forecasts by 10%, reflecting the accounting period reducing from 2.7 months to two months and the lower average exchange rate. However, we note that €1.1m generated in a 2.7-month period translates to €4.9m on an annualised basis and our previous numbers were very conservative. Hence, we are maintaining our LT revenue forecasts for FY18 and FY19, which reflect 10% organic growth in line with our previous forecast, and this translates to an 11% underlying upgrade. We have conservatively maintained the Juniper/LT acquisition cost for now, though the initial price appears to be below our initial assumption of €10.4m and the future payments for an additional 5% are now subject to more favourable exchange rates.

Exhibit 3: Forecast changes

(€000s)	2017e Old	2017e New	Change (%)	2018e Old	2018e New	Change (%)	2019e Old	2019e New	Change (%)
Revenues									
Software	3,098	3,023	(2.4)	3,410	3,410	0.0	3,660	3,816	4.2
Services	3,973	3,883	(2.3)	4,328	4,328	0.0	4,644	4,823	3.9
Maintenance	7,413	6,977	(5.9)	7,742	7,256	(6.3)	8,120	7,554	(7.0)
LendingTools	3,557	3,195	(10.2)	5,396	5,396	(0.0)	5,936	5,936	(0.0)
Net sales revenue	18,041	17,078	(5.3)	20,876	20,390	(2.3)	22,361	22,129	(1.0)
Capitalisation of development costs	361	342	(5.3)	418	408	(2.3)	447	443	(1.0)
Other revenues	507	347	(31.5)	542	450	(17.0)	575	486	(15.5)
Turnover	18,909	17,767	(6.0)	21,836	21,248	(2.7)	23,383	23,058	(1.4)
Growth (%)	33.9	25.8		15.5	19.6		7.1	8.5	
Operating expenses before depn	(10,952)	(10,643)	(2.8)	(12,778)	(12,279)	(3.9)	(13,576)	(12,949)	(4.6)
Capitalisation of dev costs (net)	236	217	(8.2)	268	258	(3.6)	146	137	(6.5)
EBITDA	7,957	7,124	(10.5)	9,058	8,969	(1.0)	9,807	10,109	3.1
Depreciation	(130)	(250)	92.3	(207)	(225)	9.0	(219)	(215)	(1.8)
Amortisation of development costs	(125)	(125)	0.0	(150)	(150)	0.0	(301)	(306)	1.6
Depreciation & amortisation	(255)	(375)	47.1	(357)	(375)	5.2	(520)	(521)	0.2
Adjusted operating profit	7,702	6,749	(12.4)	8,701	8,594	(1.2)	9,287	9,587	3.2
Operating margin (%)	40.7	38.0		39.8	40.4		39.7	41.6	
Growth (%)	40.9	27.1		13.0	27.3		6.7	11.6	
Net interest	(294)	(494)	68.1	(250)	(400)	60.0	(150)	(250)	66.7
Profit before tax norm	7,408	6,255	(15.6)	8,451	8,194	(3.0)	9,137	9,337	2.2
Amortisation of acquired intangibles*	0	(870)		0	(870)		0	(870)	
Exceptional items (net of tax)	0	(666)		0	0		0	0	
Profit before tax	7,408	4,719	(36.3)	8,451	7,324	(13.3)	9,137	8,467	(7.3)
Taxation	(1,185)	(707)	(40.4)	(1,521)	(1,147)	(24.6)	(1,827)	(1,587)	(13.1)
Minority interest	(416)	0		(596)	0		(617)	0	
Net income	5,806	4,012	(30.9)	6,334	6,177	(2.5)	6,692	6,880	2.8
Statutory EPS (c)	32.0	22.1	(30.9)	34.9	34.1	(2.5)	36.9	38.0	2.8
Adjusted EPS (c)	32.0	30.6	(4.4)	34.9	38.9	11.3	36.9	42.8	15.8
P/E - Adjusted EPS (x)		**17.1**			**13.5**			**12.3**	

Source: Edison Investment Research. Note: *Relates to Juniper/LendingTools.

We have eased cost growth, which reflects strong cost control and favourable translation of the US cost-base. We have edged up our net interest forecasts, following the new loan. We have reduced our tax assumptions (in FY17 to 15% of net income, with the rate rising gently thereafter) to reflect the favourable corporate tax environment in Italy.

In all, our net sales revenue forecasts come back by 5% in FY17, 2% in FY18 and by 1% in FY19, while EBITDA retreats by 10% in FY17 and by 1% in FY18 but rises by 3% in FY19 on disciplined cost control. While EPS comes back by 4% in FY17, they rise by 11% in FY18 and by 16% in FY19. We forecast the group to end FY17 with net debt of €6.0m (previously €4.5m), which falls to €2.4m at end FY18 (€1.0m) and swings to €1.6m net cash (€2.5m) a year later.

Valuation: High margins, attractive risk profile

Piteco has built up an excellent track record of delivering steady revenue growth, healthy margins and strong cash generation, despite having had to cope with a very challenging economic backdrop. The group's turnover growth has outpaced Italian GDP in each of the eight years to 2016, and its turnover has expanded in aggregate by more than 70% over the period when Italian GDP has fallen by 7%. Piteco has a strong pipeline and growing brand awareness and is now seeking to accelerate growth through acquisition and international expansion. The investment profile is attractive, with a resilient maintenance book and LT SaaS revenues ensuring close to 60% recurring revenues, and with healthy growth prospects from the pipeline, cross-selling, a broadening end market (geographically and into smaller businesses) and via acquisitions.

Our DCF model (which assumes a conservative 5.4% pa growth in net sales revenue over 10 years, a long-term operating margin [against net sales revenues] target of 40%, a 20% tax rate, a WACC of 9% and terminal growth rate of 2%) values the stock at 598c, 14% above the current share price. In calculating this number, we have included the dilution impact from exercising the convertible bonds and reversed them from the adjusted net debt, which in aggregate reduces the valuation by c 6%.

Exhibit 4: Financial summary

€000s	2014	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Turnover	12,334	13,384	14,122	17,767	21,248	23,058
Net Sales Revenue	11,550	12,838	13,477	17,078	20,390	22,129
EBITDA	5,229	5,719	5,606	7,124	8,969	10,109
Adjusted Operating Profit	5,149	5,463	5,309	6,749	8,594	9,587
Amortisation of acquired intangibles	(623)	0	0	(870)	(870)	(870)
Exceptionals	17	(323)	106	(666)	0	0
Share based payments	0	0	0	0	0	0
Operating Profit	4,543	5,140	5,415	5,213	7,724	8,717
Net Interest	(1,011)	(585)	(365)	(494)	(400)	(250)
Profit Before Tax (norm)	4,139	4,878	4,945	6,255	8,194	9,337
Profit Before Tax (FRS 3)	3,532	4,555	5,050	4,719	7,324	8,467
Tax	(1,090)	(1,130)	(547)	(707)	(1,147)	(1,587)
Profit After Tax (norm)	3,049	3,748	4,398	5,548	7,047	7,750
Profit After Tax (FRS 3)	2,443	3,426	4,503	4,012	6,177	6,880
Average Number of Shares Outstanding (m)	0.0	18.1	18.1	18.1	18.1	18.1
EPS - normalised (c)	0.0	20.7	24.3	30.6	38.9	42.8
EPS - FRS 3 (c)	0.0	18.9	24.8	22.1	34.1	38.0
Dividend per share (c)	0.00	10.00	15.00	17.50	20.00	22.50
Gross Margin (%)	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA Margin (%)	42.4	42.7	39.7	40.1	42.2	43.8
Op Margin (before GW and except.) (%)	41.7	40.8	37.6	38.0	40.4	41.6
BALANCE SHEET						
Fixed Assets	29,303	30,055	30,090	39,701	39,027	38,255
Intangible assets and deferred tax	27,442	28,522	28,626	38,350	37,737	37,004
Tangible Assets	1,455	1,421	1,365	1,252	1,190	1,152
Investments	406	112	99	99	99	99
Current Assets	6,005	14,846	15,531	5,806	8,333	11,113
Stocks	0	0	0	0	0	0
Debtors	4,013	4,494	4,524	4,535	4,697	4,794
Cash	1,862	10,198	10,870	1,133	3,499	6,181
Current Liabilities	(4,994)	(5,408)	(5,023)	(5,984)	(7,065)	(7,691)
Creditors	(3,794)	(3,688)	(3,304)	(4,264)	(5,345)	(5,972)
Short term borrowings	(1,200)	(1,720)	(1,719)	(1,719)	(1,719)	(1,719)
Long Term Liabilities	(12,052)	(10,114)	(8,576)	(6,826)	(5,514)	(4,201)
Long term borrowings	(10,694)	(8,825)	(7,204)	(5,454)	(4,142)	(2,829)
Other long term liabilities	(1,359)	(1,289)	(1,372)	(1,372)	(1,372)	(1,372)
Net Assets	18,262	29,379	32,022	32,698	34,782	37,476
CASH FLOW						
Operating Cash Flow	5,739	5,056	5,525	6,629	9,173	10,262
Net Interest	(1,011)	(585)	(365)	(494)	(400)	(250)
Tax	(973)	(1,146)	(661)	(547)	(644)	(1,065)
Capex	(273)	(330)	(347)	(478)	(571)	(620)
Acquisitions/disposals	0	(972)	0	(10,377)	(708)	(708)
Financing	(2,265)	7,671	0	0	0	0
Dividends	0	0	(1,860)	(2,719)	(3,172)	(3,625)
Net Cash Flow	1,217	9,695	2,293	(7,987)	3,678	3,995
Opening net debt/(cash)	11,249	10,032	347	(1,946)	6,040	2,362
Other	()	(10)	0	0	0	0
Closing net debt/(cash)	10,032	347	(1,946)	6,040	2,362	(1,633)

Source: Piteco accounts (historics), Edison Investment Research (forecasts)