

## Vectron Systems

**IT hardware**
**13 September 2018**

### Shift in digital services strategy

Vectron has had a turbulent first half as it works to diversify its business into digital services. Several management changes have seen the company return to founder control. To develop its digital marketing services, the company has chosen to use an existing loyalty platform via a partnership with DeutschlandCard, revised its relationship with Coca-Cola and entered into a pilot project with the digital arm of Metro. Regulation is likely to reinvigorate POS system sales in FY19 with longer term growth dependent on the successful uptake of digital services.

### H118 results reflect waning influence of regulation

Vectron's softer interim results were indicative of the absence of regulatory tailwinds for the period. Revenues declined 28% to €13.9m, while personnel and other operating costs grew 5% as the business continues to invest in digital services, resulting in an EBITDA loss of €0.9m. While FY18 is likely to see year-on-year revenue decline, the business is now preparing itself for the next wave of regulation for cash registers, which will become effective in 2020. We expect consensus forecasts to trend down for FY18 to reflect the lull in purchasing before sales start to recover in FY19.

### Digital services shift from GetHappy to DeutschlandCard

The GetHappy partnership with Coca Cola has been rescinded, with a similar scheme being put in place with Germany's second largest customer loyalty provider, DeutschlandCard (DC). Vectron will thus benefit from the established nature of DC and will also incur lower set-up costs as a result. Furthermore, Vectron has announced secondary deals with both Coca-Cola and Metro. We understand that Vectron will sell aggregated sales data to these entities, though we note that commercial details for these deals (including DC) are limited at this stage.

### Valuation: Pricing in digital success

Despite the recent share price weakness, Vectron continues to trade at a premium to listed peers on a multiples basis. While this is indicative of lower levels of near-term profitability, we maintain our view that the shares are pricing in successful execution of the shift to diversify revenue streams away from the sale of POS systems. The opportunity is significant, but consensus does not expect material contributions from these schemes until 2020e.

#### Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	33.7	3.0	0.30	0.25	59.8	1.4
12/17	32.4	1.7	0.16	0.06	111.1	0.3
12/18e	30.5	0.1	0.10	0.06	172.6	0.3
12/19e	42.2	4.8	0.49	0.10	35.2	0.6

Source: Company data, Bloomberg as at 10 September 2017

**Price** €17.26

**Market cap** €114m

#### Share price graph



#### Share details

Code	V3S
Listing	Deutsche Börse Scale
Shares in issue	6.6m
Net debt as at 30 June 2018	€0.0m

#### Business description

Vectron Systems produces high-end, proprietary POS systems for the hospitality sector. Vectron is also diversifying into providing systems designed for online marketing services, which has been given impetus recently through partnerships with Coca-Cola and DeutschlandCard.

#### Bull

- Flexible, comprehensive POS systems.
- Strong position in DACH hospitality market.
- Partnership with DeutschlandCard.

#### Bear

- Dependent on the German economy.
- Management owns more than 50% of Vectron.
- Delayed commercial impact of Coca-Cola agreement.

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## Review of H118 results

### Exhibit 1: H118 results highlights

€m	H116	H117	H118	% y-o-y
<b>Revenues</b>	<b>15.33</b>	<b>19.31</b>	<b>13.89</b>	<b>-28.1%</b>
Changes in inventory of finished goods & WIP	2.11	0.20	(0.27)	-236.5%
Other income	0.18	0.31	0.20	-36.4%
Material costs	(9.12)	(8.49)	(6.11)	-28.1%
Personnel costs	(3.72)	(4.88)	(4.95)	1.5%
Other operating expenses	(3.24)	(3.32)	(3.63)	9.2%
<b>EBITDA</b>	<b>1.53</b>	<b>3.13</b>	<b>(0.87)</b>	<b>-127.8%</b>
Depreciation and amortisation	(0.27)	(0.25)	(0.22)	-12.5%
<b>Operating profit</b>	<b>1.26</b>	<b>2.88</b>	<b>(1.09)</b>	<b>-137.8%</b>
Interest expense	(0.22)	(0.02)	(0.03)	128.0%
<b>PBT</b>	<b>1.04</b>	<b>2.87</b>	<b>(1.12)</b>	<b>-139.2%</b>
Tax	(0.46)	(0.97)	0.35	-136.4%
<b>Net income</b>	<b>0.59</b>	<b>1.90</b>	<b>(0.77)</b>	<b>-140.6%</b>
Operating margin	8.2%	14.9%	-7.8%	N/A
EBITDA margin	10.0%	16.2%	-1.3%	N/A
Tax rate	43.8%	33.7%	N/A	N/A

Source: Vectron Systems

### Exhibit 2: Half-yearly divisional revenues

€m	Actuals (€m)				y-o-y % change			
	H117	H217	FY17	H118	H117	H217	FY17	H118
<b>POS systems</b>	<b>12.81</b>	<b>7.41</b>	<b>20.22</b>	<b>8.29</b>	<b>31.3%</b>	<b>-41.7%</b>	<b>-10.0%</b>	<b>-35.3%</b>
Germany	9.47	5.30	14.77	6.12	34.6%	-48.6%	-14.8%	-35.4%
Other EU	3.21	1.97	5.18	2.06	24.1%	-11.5%	7.7%	-35.7%
International	0.14	0.14	0.28	0.10	-4.2%	-22.1%	-14.2%	-27.0%
<b>Software</b>	<b>1.69</b>	<b>1.03</b>	<b>2.72</b>	<b>1.16</b>	<b>68.9%</b>	<b>-22.5%</b>	<b>16.8%</b>	<b>-31.4%</b>
Germany	1.16	0.68	1.84	0.77	73.8%	-32.4%	9.9%	-33.5%
Other EU	0.52	0.33	0.85	0.36	64.4%	9.8%	38.0%	-31.7%
International	0.01	0.02	0.03	0.04	-41.2%	-4.3%	-20.0%	260.0%
<b>Good for resale/service</b>	<b>4.81</b>	<b>4.64</b>	<b>9.44</b>	<b>4.43</b>	<b>5.3%</b>	<b>6.4%</b>	<b>5.8%</b>	<b>-7.8%</b>
Germany	3.48	3.64	7.12	3.44	8.7%	-0.2%	4.0%	-1.2%
Other EU	1.28	0.92	2.21	0.96	-2.0%	39.4%	11.9%	-24.9%
International	0.04	0.07	0.11	0.03	-19.6%	52.1%	15.2%	-26.8%
<b>Total revenues</b>	<b>19.31</b>	<b>13.07</b>	<b>32.38</b>	<b>13.88</b>	<b>26.0%</b>	<b>-28.9%</b>	<b>-4.0%</b>	<b>-28.1%</b>

Source: Vectron Systems

Against a strong comparative period in H117, which benefitted from regulatory tailwinds, Vectron reported revenues of €13.9m (28% y-o-y decline). While material costs fell in line with revenues, continued investment into new digital business models meant that personnel costs and other operating expenses increased slightly y-o-y to a combined €8.6m (H117: €8.2m). These changes underpinned a €4m negative swing to a €1.1m loss at the PBT level. €350k of tax rebates reduced net losses to €0.8m. Further to the €10m loan from DZ Bank in April, the company closed the period with a neutral net debt/cash position.

## Operational update

### Partnership with DeutschlandCard

Alongside the interim results, Vectron announced a new partnership with DeutschlandCard (DC); the second largest customer loyalty system in Germany. Vectron POS systems will be made compatible with the DC scheme, which will enable customers to collect and redeem loyalty points when visiting hospitality venues equipped with a Vectron cash register. Vectron is set to benefit from small commission charges on transactions which use the DC scheme, while DC itself can broaden the market penetration of the card into the hospitality and bakery sectors. The card programme already boasts over 20 million users and is active on 10,000+ POS terminals. We expect the

company to start a marketing push for the service from early next year, mobilising its reseller network to market the service to existing POS customers. Further functionality such as online table reservation, online deliveries and a restaurant finder are expected to be rolled out roughly six months after launch.

## GetHappy replaced, Coca Cola relationship maintained

Concurrently, the company announced that the initial partnership with Coca-Cola's GetHappy loyalty scheme will be discontinued. Although both parties were reportedly happy with the progress made to date on the initiative, they agreed that it would be significantly faster and more cost efficient to partner with an established customer loyalty platform (eg DC, Nectar, Payback). However, Vectron has also announced a new pilot scheme with Coca-Cola which will include c 5,000 restaurants, though details of the aims and scope of this project are limited. We understand that the c €1.3m of capitalised development costs for GetHappy will now be re-categorised under the DC partnership as the work completed to date will be applicable to the new venture.

## Piloting digital project with Metro

Further demonstration of the digital opportunity was provided by the announcement of a pilot scheme with HOSPITALITY.digital, the digital arm of Metro. Vectron will provide more than 100 restaurants with Duratec POS systems for no charge. In return, Vectron will have access to real-time aggregated purchasing data. Such information would be valuable to Metro (and Coca-Cola), and we would expect Vectron to monetise these sales data while being mindful of GDPR requirements.

## Management changes

We note the recent departure of the recently appointed CEO, Oliver Kaltner due to differences in opinion regarding Vectron's expansion strategy. Co-founder and supervisory board member Thomas Stümmeler has taken over the role of CEO.

## Forecasts and valuation

Since our [previous note](#) in May, near-term forecasts have compressed, while consensus for FY19e has improved (Exhibit 3 below). We estimate that these forecasts assume an uptick in POS system sales in FY19 in preparation for new regulations coming into force in FY20.

We note that not all analysts have updated forecasts post-H1 results – we would expect a downward trend in FY18 forecasts, as the consensus revenue forecast for FY18 currently implies a sequential and year-on-year increase in revenues, which in our view is unlikely. Consequently, we also note the continued divergence of forecasts; for example, the FY18e EBITDA figure comprises an estimate of losses of €0.7m and gains of €2.3m.

<b>Exhibit 3: Changes to consensus forecasts</b>				
	Old		New	
	FY18e	FY19e	FY18e	FY19e
Revenues	31.0	39.9	30.5	42.2
EBITDA	1.1	4.0	0.8	5.6
EBIT	0.5	3.3	0.5	4.9
PBT	0.4	3.2	0.1	4.8
EPS	0.03	0.32	0.10	0.49
DPS	0.06	0.09	0.06	0.10
Source: Edison Investment Research, Bloomberg				

**Exhibit 4: Recent share price performance**


Source: Bloomberg

### Peer valuation: Premium maintained

Despite the recent share price fall, Vectron continues to trade at a premium to peers across all valuation metrics. While the compressed near-term profitability is inevitably a significant contributing factor to this premium, we maintain our view that the share price is factoring in upside from the group's digital activities such as the recently launched DC partnership. The effects of these partnerships are yet to be reflected in near-term forecasts, with consensus expecting material contributions from 2020e onwards.

**Exhibit 5: Peer valuation multiples**

Company	Quoted	Share	Market	EV	EV/Sales (x)		EV/EBITDA (x)		P/E (x)		Div yield (%)		EBITDA margin (%)	
	ccy	price	cap (m)	(m)	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
<b>Vectron Systems</b>	EUR	17.26	114	114	3.7	2.7	142.5	20.5	172.6	35.2	0.3	0.6	2.7	13.2
Ingenico Group	EUR	59.18	3738	5491	2.0	1.9	10.4	9.4	12.7	11.3	2.5	2.9	19.6	20.3
NCR Corporation	USD	28.1	3318	6949	1.1	1.1	7.0	6.5	10.8	9.6			15.6	16.1
Verifone Systems	USD	23.0	2550	3273	1.8	1.7	10.5	10.5	15.7	13.3	0.0		17.3	16.6
Aures Technologies	EUR	38.6	154	151	1.4	1.1	10.2	8.4	16.7	14.1	1.2	1.3	13.5	12.8
Paypoint	GBp	920.0	628	582	4.9	4.6	9.5	8.8	14.7	13.9	6.4	6.5	51.5	52.7
Universe Group	GBp	5.1	12	10	0.5	0.4	2.8	2.4	7.2	6.3			17.1	18.1
Pax Global Technology	HKD	3.9	4291	2308	0.6	0.5	4.1	3.4	8.7	7.6	1.8	1.9	13.5	14.2
Square INC - A	USD	90.0	36926	36346	22.6	16.3	153.5	80.9	198.6	115.1	0.0	0.0	14.7	20.2
Just Eat	GBp	710.0	4837	4796	6.4	5.1	26.6	20.9	38.4	30.2	0.0	0.0	24.1	24.6
Grubhub	USD	141.9	12838	12479	12.7	10.0	46.9	35.9	74.3	60.0	0.0	0.0	27.2	27.8
Takeaway.com	EUR	65.3	2822	2755	11.7	8.9		105.0					-2.6	8.5
Eagle Eye Solutions Group	GBp	126.5	32	31	2.1	1.7							-13.6	3.0
<b>Average</b>					<b>5.7</b>	<b>4.4</b>	<b>28.1</b>	<b>26.6</b>	<b>39.8</b>	<b>28.1</b>	<b>1.5</b>	<b>1.8</b>	<b>16.5</b>	<b>19.6</b>
<b>Median</b>					<b>2.1</b>	<b>1.8</b>	<b>10.3</b>	<b>9.4</b>	<b>15.2</b>	<b>13.6</b>	<b>0.6</b>	<b>1.3</b>	<b>16.3</b>	<b>17.4</b>

Source: Bloomberg. Note: Prices as at 10 September 2018.

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