Learning Technologies Group

Interim results

Strong organic growth puts LTG ahead of target

Software & comp services

Learning Technologies Group (LTG) announced a strong set of H1 results, incorporating c 18% underlying organic growth. LEO, Rustici, Preloaded and gomo have been performing exceptionally well and the numbers were slightly ahead of management plans. Consequently, we have upgraded our forecasts, with profits getting an additional boost from the incorporation of LTG accounting policies at NetDimensions. Given the attractive growth drivers, the P/E of c 24x our FY18e EPS is not demanding and our DCF analysis indicates upside potential of 31% to 87%.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	19.9	3.9	0.76	0.15	68.5	0.3
12/16	28.3	6.4	1.18	0.21	43.9	0.4
12/17e	50.5	11.1	1.65	0.28	31.5	0.5
12/18e	58.0	15.5	2.17	0.38	24.0	0.7

Note: *PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H1 results: Underlying organic growth of c 18-19%

H1 organic growth was 33%, including 3-4% FX tailwind (46% of revenues are from outside the UK) and a c 11% one-off effect from the CSL contract. That leaves underlying growth at c 18-19%. The H1 operating margin dipped as planned, due to the initial inclusion of low-margin NetDimensions, but cost savings from the acquisition are on target and will begin coming through in H2. Recurring revenues were 37% of the total, and are expected to approach 50% in the full year. The group ended the period with net debt of £6.1m. There are also outstanding acquisition liabilities of c £9.3m, the majority of which are contingent on incremental revenue growth, which takes the adjusted net debt to £15.4m.

Forecasts: EPS edge up by 3% in FY18, 2% in FY19

We have edged up our revenue forecasts by 2% in FY17 and 1% in FY18 and FY19. EBITDA rises as LTG brings NetDimensions' accounting policy on internally generated software in line with LTG's accounting policy. We have also edged up our interest and tax forecasts. As a result, adjusted diluted EPS rises by 13% in FY17, 3% in FY18 and 2% in FY19. After making some adjustments to the cash flow, we now forecast the group to end FY17 with net debt of £6.9m (previously £8.0m).

Valuation: DCF analysis suggests 68-97p range

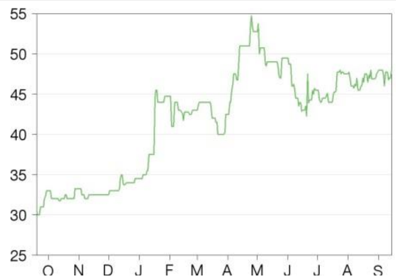
Given the strong industry growth rates and LTG's unique position in the e-learning space, we do not believe that the current P/E rating of c 24x in FY18e and 22x in FY19e is at all demanding. Our DCF model suggests a value of 68-97p if management can generate organic growth rates in the mid-teens and drive operating margins to 30% from 24.6% in FY16. Further acquisitions could also increase the company's scale and enhance earnings.

19 September 2017

Price	**52p**
Market cap	**£297m**

Net debt (£m) at 30 June 2017	6.1
Shares in issue	570m
Free float	56.8%
Code	LTG
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	4.4	9.4	51.2
Rel (local)	5.2	11.9	37.7
52-week high/low		54.8p	30.0p

Business description

Learning Technologies Group is a broad-based e-learning technology business, providing a range of software and services to both private enterprises and the public sector.

Next events

Trading update	January 2018
Final results	April 2018

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Learning Technologies GroupLearning Technologies Group is a research client of Edison Investment Research Limited

H1 results: Total organic revenue growth of 33%

H1 organic revenue growth was 33%, including 3-4% FX tailwind (46% of revenues are from outside the UK) and a c 11% one-off effect from the CSL contract. That leaves underlying growth at c 18-19%, which we understand is at record levels. LEO, Rustici, Preloaded and gomo have been performing exceptionally well and the numbers were slightly ahead of management plans. Over the last year, attention had been focused on delivering the CSL contract, but from early FY17 new business began to pick up pace and the order book remains at record levels. Management has implemented a “co-ordinated selling” strategy to help drive cross sales across the business units. gomo, which is an authoring tool, is an important part of this strategy, as it helps build customer relationships. While it can cost the group short-term revenues, ie, small content creation projects that LEO could handle, it helps introduce larger projects when customers do not have the capacity or technological capability to deliver these more complex projects on their own. gomo revenues grew by c 70% in H117. Rustici has also been growing at pace, and full earn-outs are expected to be paid for this business. While management was anticipating a decline in the legacy SCORM business as the new xAPI standard picks up pace, SCORM business has continued to grow. Preloaded has won several high-profile virtual reality projects and had also been growing at pace. Further, Eukleia has been growing well, and is expected to benefit from the introduction of MiFID II in 2018. As part of LTGs “co-ordinated selling” strategy, Eukleia can offer industrial customers assessments to cover the Modern Slavery Act 2015.

The H117 operating margin dipped to 19.2% from 23.0% in H116, due to the initial inclusion of low-margin NetDimensions, which contributed for three months. The restructuring at NetDimensions has been extensive with the unit’s annualised cost base on target to be reduced by $8m. These savings will begin coming through in H2 and will help bring margins back to normal levels. LTG has shifted its focus away from EBITDA and to EBIT (adjusted operating profit). Recurring revenues were 37% of the total, and are expected to approach 50% in the full year, since c 70% of NetDimensions’ revenue is recurring in nature. The company increased the interim dividend by 29% to 0.09p.

Back in April, management stressed that it was focused on the integration of NetDimensions and near-term attention was on organic growth. However, with NetDimensions now largely integrated, management is on the lookout for acquisitions, with a focus on domain specific expertise, eg pharmaceuticals, or add-on software tools.

Exhibit 1: Half-by-half analysis

£000s	H116	H216	FY16	H117	H217e	FY17e	FY18e
Total revenue	12,785	15,478	28,263	21,472	29,024	50,496	58,026
Opex before depn & amortisation	(9,916)	(11,471)	(21,387)	(17,527)	(21,732)	(39,259)	(42,508)
Capitalisation of development costs	378	418	796	667	1,479	2,146	2,466
Adjusted EBITDA	3,247	4,425	7,672	4,612	8,771	13,383	17,983
EBITDA margin	25.4%	28.6%	27.1%	21.5%	30.2%	26.5%	31.0%
Amortisation of development costs	(164)	(241)	(405)	(280)	(420)	(700)	(1,200)
Depreciation	(146)	(174)	(320)	(205)	(375)	(580)	(621)
Adjusted operating profit	2,937	4,010	6,947	4,127	7,976	12,103	16,163
Operating margin	23.0%	25.9%	24.6%	19.2%	27.5%	24.0%	27.9%
Associates	(102)	(103)	(205)	(80)	(320)	(400)	0
Net interest	(155)	(202)	(357)	(339)	(311)	(650)	(650)
Edison profit before tax (norm)	2,680	3,705	6,385	3,708	7,345	11,053	15,513
Amortisation of acquired intangibles	(1,536)	(1,664)	(3,200)	(3,042)	(2,958)	(6,000)	(6,000)
Share-based payments	(300)	(305)	(605)	(218)	(482)	(700)	(800)
Exceptional items	(1,779)	(1,994)	(3,773)	(2,346)	(1,854)	(4,200)	(3,000)
Profit before tax (FRS 3)	(935)	(258)	(1,193)	(1,898)	2,051	153	5,713

Source: Learning Technologies Group (historicals), Edison Investment Research (forecasts).

The company has introduced new information that reveals how revenue breaks down by nature. This is very helpful given that the group operates a range of business models. The content category represents the group's core content creation business, including LEO, Preloaded and Eukleia. Software licences is primarily Rustici's and NetDimensions' annual licences. Hosting and SaaS is gomo and NetDimensions' "Secure SaaS" business. Platform development is predominantly the customisation of the Moodle open-source platform for customers. Other non-e-learning is the face-to-face training business of Eukleia.

Exhibit 2: Revenue breakdown by nature

£000s	FY16		H116		H117		Change H117 over H116 (%)	
e-learning revenues	Recurring	Non-recurring	Recurring	Non-recurring	Recurring	Non-recurring	Recurring	Non-recurring
Content		14,118		6,109		9,935		63
Software licences	6,630	949	2,792	487	4,798	598	72	23
Hosting and SaaS	689	8	309	0	2,878	5	831	N/A
Support & maintenance		574		330	179	258		(22)
Consulting		853		440		472		7
Platform development		1,419		572		1,406		146
Other		1,147		856		322		(62)
Totals	**7,319**	**19,068**	**3,101**	**8,794**	**7,855**	**12,996**	**153**	**48**
Total e-learning	26,387		11,895		20,851		75	
Other non-e-learning	1,876		890		621		(30)	
Total group revenue	**28,263**		**12,785**		**21,472**		**68**	

Source: Learning Technologies Group

There was significant change to the balance sheet over the H1 period as the group acquired the enterprise LMS software provider NetDimensions for £53.6m in cash and funded the acquisition with a share placement. We note NetDimensions has a significant net cash position. There have also been additional acquisition payments, primarily for Rustici, which have been expensed through operating cash flow, as required by IFRS. There were estimated outstanding acquisition liabilities of £9.3m as at 30 June, which includes £1.5m "squeeze out" of NetDimensions minorities that was paid after the period end. The balance of these acquisition liabilities is contingent on incremental revenue growth in 2018 and 2019. In March 2017, LTG announced a new debt facility with Silicon Valley Bank, comprising a £10m term loan and a £10m revolving credit facility, both of which are available to LTG for five years. Hence, the group has financing available to make tuck in acquisitions with £11.5m cash on the balance sheet.

Exhibit 3: Adjusted net debt position

£000s	31/12/15	31/12/16	31/6/17
Cash & bank balances	(7,305)	(5,348)	(11,498)
Short-term borrowings	0	3,252	1,922
Long-term borrowings	0	10,582	15,663
Net debt (cash)	(7,305)	8,486	6,087
Outstanding acquisition liabilities	1,249	10,700	9,300
Adjusted net debt (cash)	(6,056)	19,186	15,387
Net assets	25,144	30,710	73,768
Adjusted net debt/equity	(24.1%)	62.5%	20.9%

Source: Learning Technologies Group

Forecast changes: Revenues and EPS edge up

We have edged up our revenue forecasts by 2% in FY17 and 1% in FY18 and FY19. Adjusted EBITDA rises by more, as LTG brings NetDimensions' accounting policy on internally generated software in line with LTG's accounting policy and this will result in significantly higher levels of capitalised development costs, with amortisation picking up from FY18. We eased associates' losses in FY17, as the H1 Watershed loss was lower than we had expected. We have also increased our interest and tax forecasts. As a result, adjusted diluted EPS rises by 13% in FY17, 3% in FY18 and 2% in FY19. After making some adjustments to the cash flow (tax, capex, M&A,

fund-raising and dividends), we now forecast the group to end FY17 with net debt of £6.9m (previously £8.0m).

Exhibit 4: Forecast changes

£000s	Old 2017e	New 2017e	Change (%)	Old 2018e	New 2018e	Change (%)	Old 2019e	New 2019e	Change (%)
Group revenues	49,546	50,496	2	57,651	58,026	1	59,010	59,470	1
Growth (%)	75.3	78.7		16.4	14.9		2.4	2.5	
Opex before depn & amortisation	(38,902)	(39,259)	1	(42,471)	(42,508)	0	(42,986)	(43,032)	0
Capitalisation of dev costs	1,474	2,146	46	1,715	2,466	44	1,756	2,527	44
Adjusted EBITDA	12,118	13,383	10	16,895	17,983	6	17,780	18,966	7
Amortisation of dev costs	(700)	(700)		(800)	(1,200)		(899)	(1,400)	
Depreciation	(580)	(580)		(621)	(621)		(664)	(664)	
Adjusted operating profit	10,838	12,103	12	15,474	16,163	4	16,217	16,902	4
Operating margin (%)	21.9	24.0		26.8	27.9		27.5	28.4	
Growth (%)	56.0	74.2		42.8	33.5		4.8	4.6	
Associates	(500)	(400)		0	0		500	500	
Net interest	(650)	(650)		(600)	(650)		(400)	(600)	
Profit before tax norm	9,688	11,053	14	14,874	15,513	4	16,317	16,802	3
Amortisation of acquired intangibles	(3,200)	(6,000)		(3,200)	(6,000)		(3,200)	(6,000)	
Share based payments	(1,200)	(700)		(800)	(800)		(900)	(900)	
Exceptional items	(4,200)	(4,200)		(3,000)	(3,000)		0	0	
Profit before tax (reported)	1,088	153	(86)	7,874	5,713	(27)	12,217	9,902	(19)
Taxation	(1,274)	(1,546)	21	(2,231)	(2,482)	11	(2,570)	(2,812)	9
Net income	(185)	(1,393)		5,643	3,231		9,647	7,090	
Statutory EPS (p)	(0.03)	(0.26)		0.99	0.57		1.68	1.23	
Adjusted diluted EPS (p)	1.46	1.65	13	2.10	2.17	3	2.27	2.31	2
P/E - Adjusted EPS (x)		**31.5**			**24.0**			**22.5**	

Source: Edison Investment Research

Exhibit 5: Financial summary

£000s	2014	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	14,920	19,905	28,263	50,496	58,026	59,470
EBITDA	2,225	4,338	7,672	13,383	17,983	18,966
Adjusted Operating Profit	1,965	3,908	6,947	12,103	16,163	16,902
Amortisation of acquired intangibles	(570)	(1,203)	(3,200)	(6,000)	(6,000)	(6,000)
Exceptionals	(621)	(665)	(3,773)	(4,200)	(3,000)	0
Operating Profit	774	2,040	(26)	1,903	7,163	10,902
Associates	(160)	(62)	(205)	(400)	0	500
Share based payments	(583)	(776)	(605)	(700)	(800)	(900)
Net Interest	(158)	12	(357)	(650)	(650)	(600)
Profit Before Tax (norm)	1,647	3,858	6,385	11,053	15,513	16,802
Profit Before Tax (Statutory)	(127)	1,214	(1,193)	153	5,713	9,902
Tax	(35)	(258)	(133)	(1,546)	(2,482)	(2,812)
Profit After Tax (norm)	1,612	3,034	5,385	9,507	13,031	13,990
Profit After Tax (Statutory)	(162)	956	(1,326)	(1,393)	3,231	7,090
Average Number of Shares Outstanding (m)	332.03	373.51	418.62	545.40	571.62	574.48
EPS - normalised (p)	0.49	0.81	1.29	1.74	2.28	2.44
EPS - normalised & fully diluted (p)	0.46	0.76	1.18	1.65	2.17	2.31
EPS - Statutory (p)	(0.05)	0.26	(0.32)	(0.26)	0.57	1.23
Dividend per share (p)	0.10	0.15	0.21	0.28	0.38	0.52
EBITDA Margin (%)	14.9	21.8	27.1	26.5	31.0	31.9
Op Margin (before GW and except.) (%)	13.2	19.6	24.6	24.0	27.9	28.4
BALANCE SHEET						
Fixed Assets	12,337	19,502	45,558	87,457	82,799	77,857
Intangible assets and deferred tax	11,982	18,959	41,667	83,239	78,505	73,632
Tangible Assets	339	543	708	1,035	1,111	1,041
Investments & other	16	0	3,183	3,183	3,183	3,183
Current Assets	9,263	13,913	14,214	27,896	37,179	45,454
Stocks	0	0	0	0	0	0
Debtors	4,905	6,608	8,866	17,717	19,236	20,176
Cash	4,358	7,305	5,348	10,179	17,943	25,278
Current Liabilities	(5,184)	(6,146)	(13,058)	(19,789)	(21,453)	(22,421)
Creditors	(5,184)	(6,146)	(9,806)	(16,537)	(18,201)	(19,169)
Short term borrowings	0	0	(3,252)	(3,252)	(3,252)	(3,252)
Long Term Liabilities	(2,007)	(2,125)	(16,004)	(19,204)	(19,204)	(19,204)
Long term borrowings	0	0	(10,582)	(13,782)	(13,782)	(13,782)
Other long term liabilities	(2,007)	(2,125)	(5,422)	(5,422)	(5,422)	(5,422)
Net Assets	14,409	25,144	30,710	76,360	79,321	81,686
CASH FLOW						
Operating Cash Flow	936	4,735	3,021	7,633	14,783	15,966
Net Interest	4	12	(274)	(650)	(650)	(600)
Tax	(32)	(483)	(645)	(1,200)	(1,382)	(2,327)
Capex	(321)	(542)	(1,218)	(2,853)	(3,162)	(3,122)
Acquisitions/disposals*	(4,586)	(7,779)	(14,583)	(46,739)	0	0
Financing	7,291	7,419	647	46,720	0	0
Dividends	(107)	(448)	(712)	(1,280)	(1,825)	(2,582)
Net Cash Flow	3,185	2,914	(13,764)	1,631	7,764	7,335
Opening net debt/(cash)	(1,170)	(4,358)	(7,305)	8,486	6,855	(909)
Other	3	33	(2,027)	(0)	0	(0)
Closing net debt/(cash)	(4,358)	(7,305)	8,486	6,855	(909)	(8,244)

Source: Learning Technologies Group (historicals), Edison Investment Research (forecasts). Note: *The outflow in FY17 represents the cost of acquiring NetDimensions less assumed net cash position on acquisition.

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