Brady

Revising forecasts

Transitioning continues

Software & comp services

We have revised our forecasts following the newsflow over the last few months. While management has completed its strategic review, the transitioning process is continuing. The group has switched from operating on a divisional basis to global functions. The development team has been unified, and development work has shifted from platforms to 'microservices', so that new products can be leveraged across the group. Further, Brady is evolving to a recurring revenue model. We have cut our FY17 forecasts to reflect the current transitioning but forecast revenue and margins to improve significantly thereafter. Given the long-term growth opportunities, notably in agriculture, natural gas and power, we believe the shares look attractive on 14x our cash-adjusted FY19 EPS.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	27.4	1.0	1.0	0.0	73.2	0.0
12/16	30.3	2.3	2.4	0.0	30.0	0.0
12/17e	29.0	(0.7)	(0.6)	0.0	N/A	0.0
12/18e	30.8	2.9	2.8	0.5	24.7	0.7

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

Investment case: E/CTRM is highly attractive space

While commodity markets remain challenging, the E/CTRM market remains a highly attractive software vertical and Brady, as the largest Europe-based E/CTRM player, is well positioned to benefit. Brady's solutions support a broad range of services to a wide range of commodity businesses including trading companies, financial institutions, producers, manufacturers and recyclers. Brady has more than 400 customers including many blue chip names. The global E/CTRM market is worth c $1.65bn, and is forecast to grow at c 6% CAGR to 2020 (Comtech). Brady's traditional strengths are in the metals and electricity verticals, and Brady seeks to leverage these strengths into agriculture and European power, respectively. Recurring revenues represented 62% of the total in FY16, which we forecast to remain at similar levels in FY17, but grow to 66% in FY18 and to 69% in FY19.

Forecasts: FY17 cut, FY18 and FY19 introduced

We have cut our FY17 revenue forecasts by 10%, while adjusted operating profit falls by £4.7m to a £0.7m loss. Noting the lack of contract wins, we expect FY17 to be more H2 weighted than normal. We forecast revenues to rise by 6% in FY18 and by 10% in FY19, as the benefits from the group reorganisation feed through, with operating margins lifting to 9.5% in FY18 and 14% in FY19. We forecast Brady's net cash position to slip to £5.7m as at end-FY17, rising to £8.0m a year later.

Valuation: Well positioned for commodities recovery

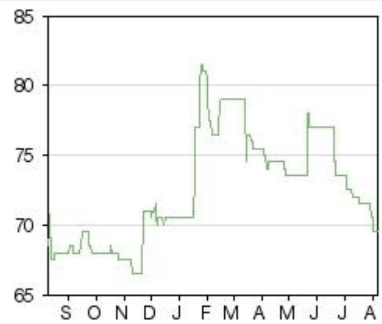
Brady trades on 24.7x our FY18e EPS falling to 15.6x in FY19e. Alternatively, it trades on 1.5x FY19e EV/sales and 9.4x EV/EBITDA. In our view, the group's strong balance sheet (FY16 £7.3m cash and no debt) and streamlined cost base position Brady well for a broader recovery in the commodity markets.

7 August 2017

Price	**69.5p**
Market cap	**£58m**

Net cash (£m) at 31 December 2016	7.3
Shares in issue	83.4m
Free float	87%
Code	BRY
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(4.1)	(5.4)	1.5
Rel (local)	(6.3)	(8.4)	(9.8)
52-week high/low		81.5p	66.5p

Business description

Brady is the largest Europe-based E/CTRM (Energy, Commodity Trading and Risk Management) player. It provides a range of transaction and risk management software applications, which help producers, consumers, financial institutions and trading companies manage their commodity transactions in a single, integrated solution.

Next events

Trading update	July 2017
Interim results	September 2017

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Edison profile page

Brady is a research client of Edison Investment Research Limited

Strategic review completed, restructuring continues

After Ian Jenks was appointed chairman in June 2016, he initiated a strategic review of the company and appointed external consultants to look at all aspects of the business. As a result of the review, Brady has switched from operating on a divisional basis to global functions, and this has involved a lot of management focus over recent months. The group will no longer report on a divisional basis. Two small offices in North America have been closed. The sales team has been trained to sell all the group's products globally, while the development team has been unified, with all global staff reporting to the group's chief technology officer (CTO). Brady outsources some coding to a company in Poland and it intends to make greater use of its Bangalore development centre, which was acquired with energycredit. New product development has shifted from platforms to web enabled components based on microservices (service-oriented architecture) so that any new products can be leveraged across the group. This is part of a long-term strategy to evolve the group's existing ten platforms to a single platform, utilising the functional components. The new platform is based on the Brady Web Framework which ensures consistent data service layers and enables close integration with third-party solutions. This enables the group to sell its products to customers that operate large in house systems or competing E/CTRM systems.

2016 senior management changes

Paul Fullagar stepped down as chairman over the 2016 summer after nine years and Ian Jenks was appointed to the role. In early September, it was announced that Gavin Lavelle had stepped down as CEO after nine years and Mr Jenks took on the interim position of executive chairman. In early October, Elizabeth Sipiere joined Brady as a non-executive director. In addition, Ms Sipiere took on the role of chief operating officer.

Forecast changes

We have cut our FY17 revenue forecasts by 10% to reflect the current transitioning of the business, while adjusted operating profit falls by £4.7m to a £0.7m loss. This reflects the declining focus on upfront licence revenue, a lower level of revenue overall, along with a small amount of restructuring costs. Nevertheless, the business remains underpinned by a high level of recurring (c £18m) and contracted (c £24m) revenues. We forecast revenues to rise by 6% in FY18 and by 10% in FY19, as the benefits from the group reorganisation feed through, with operating margins lifting to 9.5% in FY18 and 14% in FY19. We forecast the group's net cash position to slip to £5.7m as at the end-FY17 and recover to £8.0m a year later.

Exhibit 1: Forecast changes

Revenue (£'000s)	Old 2016e	Actual 2016	Change (%)	Old 2017e	New 2017e	Change (%)	New 2018e	New 2019e
Licence revenues	5,182	3,600	(31)	5,390	2,400	(55)	1,898	1,760
Recurring fees (software rental, hosting and support)	17,226	18,900	10	18,418	18,200	(1)	20,356	23,382
Services and development	8,119	7,800	(4)	8,363	8,400	0	8,568	8,739
Group revenue	30,527	30,269	(1)	32,170	29,000	(10)	30,822	33,881
Growth (%)	11.5	10.6		5.4	(4.2)		6.3	9.9
Cost of sales (before dev cost capn)	(11,298)	(11,823)	5	(11,485)	(11,921)	4	(11,780)	(11,991)
Capitalisation of dev'ment costs (net)	341	(43)	(113)	(62)	(260)	320	(87)	132
Gross profit	19,570	18,403	(6)	20,624	16,819	(18)	18,955	22,022
Gross margin (%)	64.1	60.8		64.1	58.0		61.5	65.0
Selling & administrative expenses	(16,136)	(16,062)	(0)	(16,620)	(17,490)	5	(16,035)	(17,282)
Adjusted operating profit	3,434	2,341	(32)	4,003	(671)	(117)	2,920	4,741
Operating profit margin (%)	11.2	7.7		12.4	(2.3)		9.5	14.0
Growth (%)	271.6	153.4		16.6	(128.6)		(535.5)	62.3
Net interest	50	3		60	20		30	60
Profit before tax (norm)	3,484	2,344	(33)	4,063	(651)	(116)	2,950	4,801
Amortisation of acquired intangibles	(1,640)	(1,718)		(1,640)	(1,750)		(1,750)	(1,750)
Share-based payments	(263)	(90)		(275)	(100)		(300)	(300)
Exceptional items	(251)	(2,037)		0	0		0	0
Profit before tax	1,331	(1,501)	(213)	2,148	(2,501)	(216)	900	2,751
Normal tax charge	(610)	(352)		(813)	117		(590)	(1,056)
Profit after tax	721	(1,853)	(357)	1,336	(2,383)	(278)	310	1,694
Adjusted EPS (p)	3.5	2.4	(31)	3.9	(0.6)	(116)	2.8	4.4
P/E – adjusted EPS (x)		**29.0**			**N/A**		**24.7**	**15.6**

Source: Brady, Edison Investment Research

Exhibit 2: Cash flow and reconciliation of EBITDA definitions

(£'000)	FY14	FY15	FY16	FY17e	FY18e	FY19e
Adjusted operating profit	5,019	924	2,341	(671)	2,920	4,741
Depreciation (incl s/w)	573	582	678	700	700	700
Adjusted EBITDA	5,592	1,506	3,019	29	3,620	5,441
Working capital	(695)	139	(721)	(870)	(154)	(169)
Amortisation of devt costs	928	1,187	1,598	1,843	1,770	1,718
Exceptional costs/misc	384	(469)	(1,159)	0	0	0
Operating cash flow	6,209	2,363	2,737	1,002	5,236	6,989
Net interest	58	31	3	20	30	60
Tax paid	(420)	(416)	(428)	(400)	(531)	(960)
Purchase fixed assets (incl s/w)	(618)	(624)	(612)	(638)	(678)	(745)
Capitalised development	(1,801)	(1,967)	(1,555)	(1,583)	(1,683)	(1,850)
Free cash flow	3,428	(613)	145	(1,599)	2,374	3,494
EBITDA (Edison definition)	5,592	1,506	3,019	29	3,620	5,441
Deduct: share based payments	(232)	(243)	(90)	(100)	(300)	(300)
Add back: amortisation cap devt	928	1,187	1,598	1,843	1,770	1,718
EBITDA (Brady definition)	6,288	2,450	4,527	1,772	5,090	6,858

Source: Brady, Edison Investment Research

Exhibit 3: Financial summary

£'000s	2014	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	31,015	27,374	30,269	29,000	30,822	33,881
Cost of Sales	(10,977)	(10,867)	(11,866)	(12,181)	(11,867)	(11,859)
Gross Profit	20,038	16,507	18,403	16,819	18,955	22,022
EBITDA	5,592	1,506	3,019	29	3,620	5,441
Adjusted Operating Profit	5,019	924	2,341	(671)	2,920	4,741
Amortisation of acquired intangibles	(1,613)	(1,640)	(1,718)	(1,750)	(1,750)	(1,750)
Exceptionals items	(2,143)	(469)	(1,159)	0	0	0
Share based payments	(232)	(243)	(90)	(100)	(300)	(300)
Operating Profit	1,031	(1,428)	(626)	(2,521)	870	2,691
Net Interest	58	31	3	20	30	60
Profit Before Tax (norm)	5,077	955	2,344	(651)	2,950	4,801
Profit Before Tax (FRS 3)	1,089	(1,397)	(623)	(2,501)	900	2,751
Tax	(630)	(329)	(1,230)	117	(590)	(1,056)
Profit After Tax (norm)	4,315	813	1,992	(533)	2,360	3,744
Profit After Tax (FRS 3)	459	(1,726)	(1,853)	(2,383)	310	1,694
Average Number of Shares Outstanding (m)	81.3	82.7	83.0	83.3	83.8	84.2
EPS – normalised (p)	5.3	1.0	2.4	(0.6)	2.8	4.4
EPS – FRS 3 (p)	0.6	(2.1)	(2.2)	(2.9)	0.4	2.0
Dividend per share (p)	1.85	0.00	0.00	0.00	0.50	1.00
Gross Margin (%)	64.6	60.3	60.8	58.0	61.5	65.0
EBITDA Margin (%)	18.0	5.5	10.0	0.1	11.7	16.1
Adjusted Operating Margin (%)	16.2	3.4	7.7	-2.3	9.5	14.0
BALANCE SHEET						
Fixed Assets	32,614	31,461	37,035	34,963	33,104	31,532
Intangible Assets	30,996	29,831	35,999	33,989	32,152	30,534
Tangible Assets	1,076	1,147	978	916	894	939
Deferred tax	542	483	58	58	58	58
Current Assets	16,948	13,633	14,640	12,670	15,418	19,143
Stocks	0	0	0	0	0	0
Debtors	7,368	7,039	7,297	6,991	7,430	8,168
Cash	9,580	6,594	7,343	5,679	7,987	10,975
Current Liabilities	(10,545)	(10,804)	(12,669)	(11,352)	(11,676)	(12,347)
Creditors	(10,545)	(10,804)	(12,669)	(11,352)	(11,676)	(12,347)
Short-term borrowings	0	0	0	0	0	0
Long-Term Liabilities	(4,651)	(4,814)	(5,670)	(5,670)	(5,670)	(5,670)
Long-term borrowings	0	0	0	0	0	0
Other long-term liabilities	(4,651)	(4,814)	(5,670)	(5,670)	(5,670)	(5,670)
Net Assets	34,366	29,476	33,336	30,611	31,176	32,657
CASH FLOW						
Operating Cash Flow	6,209	2,363	2,737	1,003	5,236	6,989
Net Interest	58	31	3	20	30	60
Tax	(420)	(416)	(428)	(400)	(531)	(960)
Capex	(2,419)	(2,591)	(2,167)	(2,221)	(2,361)	(2,595)
Acquisitions/disposals	0	(1,186)	(326)	(66)	(66)	(66)
Financing	338	469	47	0	0	0
Dividends	(1,378)	(1,524)	0	0	0	(440)
Net Cash Flow	2,388	(2,854)	(134)	(1,664)	2,308	2,988
Opening net debt/(cash)	(7,222)	(9,580)	(6,594)	(7,343)	(5,679)	(7,987)
Other	(30)	(132)	883	0	0	0
Closing net debt/(cash)	(9,580)	(6,594)	(7,343)	(5,679)	(7,987)	(10,975)

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

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