EDISON

SCISYS

AGM trading update

An "impressive start" to 2018

Software & comp services

SCISYS has released an upbeat AGM trading update, noting that progress has been made across all its four divisions. The order book has reached £100m, up from £91.3m at end-FY17, boosted in particular by the renewal of M&B's BBC support contract. Cash flow was strong, with net debt declining by £4m over the first five months of the year, in what is typically a subdued period for cash generation. We have increased our FY18 operating cash flow forecast, while conservatively maintaining our other forecasts. Management's goal to achieve £60m in revenues and double-digit margins within three to five years looks increasingly conservative, and we believe the stock looks attractive on c 12.6x our FY19e EPS.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	45.7	3.0	9.2	1.96	17.5	1.2
12/17	57.2	3.8	10.0	2.16	16.0	1.3
12/18e	53.0	4.4	12.0	2.38	13.3	1.5
12/19e	57.0	5.0	12.7	2.62	12.6	1.6

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. IFRS 15 is applied from 1 January 2018.

AGM update: Underpinned by impressive pipeline

The company says it has made an "impressive start" to 2018, with growth being achieved both through winning new customers and expanding business in established ones. FY18 is expected to be more evenly balanced than FY17.

Early end to ANNOVA ring-fencing

There is an early termination of the ring-fencing of ANNOVA, which relates to the acquisition earnout, at a cost of €0.7m. Clearly the vendors saw more value in a swift integration of ANNOVA with SCISYS M&B to take full advantage of synergies.

Brexit contingency plans

The company stands to lose significant revenues from its work on Galileo and EGNOS if Brexit proceeds without specific amendments. If this happens, we expect SCICYS to redomicile in an EU country at a cost in the region of c £0.5m.

Forecasts: Moving up FY18 cash generation

We have added the €0.7m final payment for the acquisition of ANNOVA and increased FY18 operating cash flow by £0.9m, and hence we now forecast the group to end FY18 with net debt of £3.0m (previously £3.3m).

Valuation: Profits maintained for now

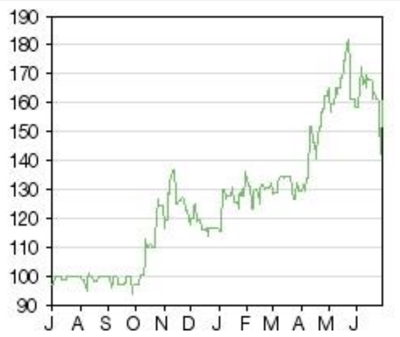
The stock trades on c 13.3x our earnings in FY18e, falling to c 12.6x in FY19e. Alternatively, the stock trades on c 0.89x our FY19e sales and c 7.7x EBITDA, which we believe is attractive if SCISYS can maintain the momentum. Our DCF model – which is based on our forecasts and organic CAGR of 3% over 10 years, a weighted average cost of capital of 10% and an 11.5% long-term margin target – values the stock at 178p, 11% above the current level. This is 12% above our previous level, reflecting adjustment to the base and increased cash flow.

29 June 2018

Price	**160.5p**
Market cap	**£47m**

Net debt (£m) at 31 May 2018	1.9
Shares in issue	29.5m
Free float (%)	63.7
Code	SSY
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(0.6)	23.5	65.5
Rel (local)	1.0	14.5	59.6
52-week high/low		182.0p	93.5p

Business description

SCISYS provides a range of professional services in support of the planning, development and use of computer systems in the space, media/broadcast and defence sectors, as well as to other public and private sector enterprises.

Next events

Interim results	20 September 2018

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Edison profile page

SCISYS is a research client of Edison Investment Research Limited

Trading update: Record order book and strong pipeline

SCISYS says it has made an "impressive start" to 2018, delivering on contracts that were part of the opening order book as well as winning notable new contracts. Growth has been achieved both through acquiring new customers and expanding business in established ones. The order book has reached £100m, up from £91.3m at end-FY17 and the company also states that it has an "impressive pipeline" of new business. The order book was boosted by the renewal of M&B's BBC support contract, which we understand exceeds £10m. The £100m order book is much longer term than it used to be, including M&B's BBC support revenues for the dira! running to 2025 and ANNOVA's significant BBC contract, which runs to 2027. FY18 is expected to be more evenly balanced than FY17, when operating profit represented c 27% in H1 and 73% in H2.

In April, the Space division announced a €3.9m order with Airbus Defence & Space to develop the ground control infrastructure for the EGNOS satellite-navigation augmentation system. In addition, Space has extended its footprint in the EU's Galileo satellite navigation programme. SCISYS says it has not experienced resistance from awarding authorities on EU space programmes where it has been bidding.

The Media & Broadcast (M&B) division reported in February that it had secured an enhanced service contract for the BBC until at least 2025 and has subsequently added six new German broadcasters to its customer base for roll-out of its weConnect gateway functionality to exchange media content within the ARD group of public broadcasters. ANNOVA Systems, acquired in December 2016, has signed contracts with German Hessischer Rundfunk and French L'Equipe 24, which are both new customers.

The Enterprise Solutions & Defence (ESD) division has extended its support agreements with Vodafone to 2020 and Capgemini to 2021, for the 111 non-emergency NHS number and the Environment Agency applications, respectively. In addition, ESD continues to expand its activities providing on-site consultancy teams to key customers in both the commercial and defence/security arenas, increasing the number of staff deployed by 95% in the last 12 months. This has resulted in extending the time & materials revenues and provided a better balance with fixed-price revenue.

ANNOVA early end to ring-fencing

SCISYS has agreed to the early termination of the ring-fence arrangement established for ANNOVA's acquisition, which could have run to 31 December 2019. SCISYS will pay the vendors a fixed sum of €0.7m and repay a subordinated vendor loan of €2.5m six months early, which will save c £60k in interest. SCISYS had been anticipating that no further acquisition payments were likely under the terms of the earnout, so clearly the vendors saw more value in accelerating the integration of ANNOVA with M&B than in holding on for additional earnout payments.

Brexit contingency plans

In the 2017 annual report, SCISYS said it was exploring a wide range of Brexit contingency plans. The board is determined to protect the group's participation in EU-funded programmes such as Galileo (c €6m revenues in each of the last two years) and EGNOS (a €3.9m contract was won in April). Under existing rules, services to these entities must be provided by entities that have parent companies domiciled in the EU. While the Brexit negotiations continue, with UK politicians pushing for continued involvement with Galileo, there is the possibility that Brexit will take place without a favourable resolution. In these circumstances, we understand that SCICYS would likely redomicile in an EU country. We estimate that this would cost the company in the region of c £0.5m, while it would remain listed on AIM as a foreign company and should be able to maintain its UK tax status. There has also been media speculation that the UK could start its own global navigation satellite system if it is shut out from Galileo; if this occurred it could create new work for SCISYS.

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Exhibit 1: Financial summary

£'000s	2015	2016	2017	2018e	2019e	2020e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	36,106	45,744	57,164	53,012	57,041	58,774
Cost of Sales	0	0	0	0	0	0
Gross Profit	36,106	45,744	57,164	53,012	57,041	58,774
EBITDA	1,548	3,995	5,619	6,097	6,627	6,922
Adjusted operating profit	818	3,214	4,520	4,983	5,472	5,761
Amort'n of acq'd intangibles	0	0	(1,982)	(1,250)	(1,200)	(1,150)
Exceptionals	0	(458)	2,075	0	0	0
Share based payments	(11)	14	0	(45)	(50)	(55)
Operating Profit	807	2,770	4,613	3,688	4,222	4,556
Net Interest	(196)	(185)	(710)	(567)	(450)	(400)
Associates	3	17	39	0	0	0
Profit Before Tax (norm)	625	3,046	3,849	4,416	5,022	5,361
Profit Before Tax (FRS 3)	614	2,602	3,942	3,121	3,772	4,156
Tax	(241)	(380)	(593)	(874)	(1,243)	(1,340)
Profit After Tax (norm)	384	2,666	3,256	3,542	3,779	4,021
Profit After Tax (FRS 3)	373	2,222	3,349	2,247	2,529	2,816
Average Number of Shares Outstanding (m)	29.0	29.0	29.2	29.4	29.7	30.0
EPS - normalised (p)	1.3	9.2	10.0	12.0	12.7	13.4
EPS - FRS 3 (p)	1.3	7.6	11.5	7.6	8.5	9.4
Dividend per share (p)	1.78	1.96	2.16	2.38	2.62	2.88
Gross Margin (%)	100.0	100.0	100.0	100.0	100.0	100.0
EBITDA Margin (%)	4.3	8.7	9.8	11.5	11.6	11.8
Operating Margin (%)	2.3	7.0	7.9	9.4	9.6	9.8
BALANCE SHEET						
Fixed Assets	16,553	31,955	30,465	29,162	27,948	26,812
Intangible Assets	7,831	22,441	21,086	19,836	18,636	17,486
Tangible Assets	8,635	9,057	9,261	9,208	9,194	9,208
Deferred tax asset & associates	87	457	118	118	118	118
Current Assets	17,839	27,895	33,333	31,268	34,301	35,434
Stocks	211	261	321	298	320	330
Debtors	12,299	19,621	24,541	22,758	24,486	25,229
Cash	4,352	6,915	8,021	7,763	9,045	9,425
Current Liabilities	(12,003)	(18,763)	(23,481)	(22,034)	(23,274)	(23,494)
Creditors	(8,699)	(14,959)	(21,191)	(19,994)	(21,484)	(21,954)
Short term borrowings	(3,304)	(3,804)	(2,290)	(2,040)	(1,790)	(1,540)
Long Term Liabilities	(2,333)	(18,374)	(14,603)	(11,690)	(10,479)	(8,268)
Long term borrowings	(2,007)	(13,355)	(11,667)	(8,754)	(7,543)	(5,332)
Other long term liabilities	(326)	(5,019)	(2,936)	(2,936)	(2,936)	(2,936)
Net Assets	20,056	22,713	25,714	26,706	28,495	30,484
CASH FLOW						
Operating Cash Flow	1,570	3,442	10,369	6,732	6,342	6,628
Net Interest	(196)	(185)	(710)	(567)	(450)	(400)
Tax	(583)	(1,250)	147	(930)	(1,283)	(1,405)
Capex	(619)	(663)	(1,255)	(1,060)	(1,141)	(1,175)
Acquisitions/disposals	(889)	(7,521)	82	(617)	0	0
Financing	(14)	15	(131)	0	0	0
Dividends	(340)	(671)	(586)	(652)	(725)	(806)
Net Cash Flow	(1,071)	(6,833)	7,916	2,905	2,743	2,841
Opening net debt/(cash)	(328)	959	10,244	5,936	3,031	288
Other including foreign exchange	(216)	(2,452)	(3,608)	0	0	0
Closing net debt/(cash)	959	10,244	5,936	3,031	288	(2,553)

Source: SCISYS, Edison Investment Research. Note: IFRS15 is applied from 1 January 2018.

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