

# Esker

H120 results

Robust H1; continuing to invest for growth

Esker reported revenue growth of 8% for H120, despite COVID-19 disruption. The company continued to invest in headcount during H1; while this resulted in a decline in operating profit year-on-year, Esker achieved a respectable operating margin of 11.4%. We have trimmed our revenue forecasts for FY20 and FY21 but this is outweighed by the positive effect of lower tax rates in both years. Esker's cloud delivery model has proven resilient during the pandemic and the company expects a resumption in 15%+ revenue growth rates from FY21 as the pipeline of new business converts and volumes transacted on Esker's platform return to more normal levels.

Year end	Revenue (€m)	PBT* (€m)	Diluted EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/18	86.9	12.2	1.65	0.41	84.2	0.3
12/19	104.2	13.6	1.79	0.33	77.5	0.2
12/20e	113.9	14.1	1.76	0.35	78.8	0.3
12/21e	131.8	18.0	2.21	0.40	62.7	0.3

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

## Robust performance in H120

While it was more difficult to sign new business and volumes processed by the platform declined in Q2, Esker reported 8% revenue growth for H120. Despite lower demand in H1, the company continued with its investment plans. Higher growth in headcount costs outweighed revenue growth resulting in a 14% decline in operating profit (margin 11.4% versus 14.4% in H119). The first-time application of patent box rules to software in France resulted in lower tax rates and a 4% decline in reported diluted EPS. Net cash at the end of H120 was €22.9m, up 9% from the end of 2019.

## Expecting growth to accelerate in FY21

Management trimmed its guidance for FY20 constant currency revenue growth from double-digit to 9% but in FY21 anticipates that revenue growth will return to rates seen in recent years. In FY20, it expects to maintain operating profitability at a similar level to FY19. We have trimmed our revenue forecasts and reduced our tax rate assumptions for FY20/21, resulting in normalised EPS upgrades of 1.5% for FY20 and 6.5% for FY21.

## Valuation: Reflects high recurring revenues

The stock has gained 50% year-to-date and is trading 22% higher than its pre-COVID-19 peak. The stock trades at a premium to DPA software and French software peers but at a discount to US SaaS peers. Esker has re-rated over the last year, with its P/E multiple moving more towards the US SaaS peer group. We believe that this is due to the value placed on businesses with high levels of recurring revenue, providing visibility through a period of economic uncertainty. Esker has the added advantage of a strong balance sheet that does not require additional funding to support growth. Successful execution of Esker's partner strategy could be a trigger for earnings and share price upside.

### Software & comp services

15 September 2020

**Price** €138.6

**Market cap** €787m

\$1.19/€

Net cash (€m) at end H120 22.9

Shares in issue 5.7m

Free float 68%

Code ALESK

Primary exchange Euronext Growth Paris

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (3.9) 16.7 73.3

Rel (local) (5.5) 11.3 93.4

52-week high/low €153.00 €76.70

### Business description

Esker provides end-to-end document automation solutions, offering on-demand and on-premise delivery models. In FY19, the business generated 57% of revenues from Europe, 38% from the US and the remainder from Asia and Australia.

### Next events

Q3 revenue update 13 October

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## Investment summary

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### Company description: Document automation specialist

Esker is a document process automation (DPA) software developer, specialising in moving business processes from paper-based to digital. Its software is used to automate the purchase-to-pay and order-to-cash cycles. The company principally operates a software-as-a-service (SaaS) delivery model and the majority of revenues are generated from customers using its on-demand solutions. Esker's revenues are well spread geographically, with 57% from Europe, 38% from North America and the remainder from Australia and Asia. In recent years, the company has made small bolt-on acquisitions and we believe it would consider further acquisitions if they added technology expertise or geographic presence at a reasonable price. The company generates organic growth from a combination of winning new customers globally and deepening existing relationships. To accelerate the pace at which it can sign up and on-board customers, it is developing a network of partners to undertake implementation work and resell Esker software.

### Financials: Maintaining margins despite COVID-19

Esker expects to generate constant currency revenue growth of c 9% for FY20 before reverting to previous growth rates of 15%+ in FY21. It aims to maintain profitability at a similar rate to FY19 despite the disruption caused by COVID-19. We have slightly reduced our revenue forecasts to reflect the longer duration of the pandemic than originally expected. A cut in tax rates due to the first-time application of patent box rules to software in France means that overall, our EPS forecasts increase by 1.5% in FY20 and 6.5% in FY21. Net cash remains strong (€22.9m at the end of H120) and we forecast it will grow to €33.0m by the end of FY21.

### Valuation: Reflects SaaS business model

The stock is up 50% year-to-date and on a P/E basis continues to trade at a premium to both a group of listed global DPA software companies and to French-listed small-cap software companies, in our view justified by revenue growth and operating margins at the upper end of both groups. Compared to US SaaS companies, which have a similar business model to Esker, the company trades at a material discount to average EV/sales and P/E multiples. We note that on average US peers are growing faster than Esker, although they are generating lower operating margins. The typical growth path for US SaaS companies involves investing heavily in sales and marketing to gain market share as fast as possible, with little focus on achieving profitability in the short term. Esker's model sits somewhere between low-growth, high-profitability on-premise software businesses and US SaaS companies' high growth operating model, aiming for a happy medium of double-digit revenue growth while achieving mid-teen operating margins. Esker has the added advantage of a strong balance sheet that does not require additional funding to support growth.

### Sensitivities: Currency, on-demand transition, competition

Our forecasts and the Esker share price are sensitive to the following factors. **Currency:** Esker is exposed to the US\$/€ exchange rate. **Competition:** Esker competes with well-established, well-funded software companies and will need to maintain its technology to continue this. **Success of channel partner strategy:** revenue growth and headcount needs will depend on the rate at which partners are able to resell and/or implement Esker software. **Rate of decline of on-premise licensing and legacy business:** these businesses are very profitable maintenance revenue generators. The rate at which these businesses decline will affect growth and profitability. **Reliance on datacentre providers:** Esker leases datacentre capacity for its on-demand products. Changes in the availability and pricing of capacity will have an impact on Esker's profitability.

## **Company description: Automating business processes**

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Esker is a DPA software developer, specialising in moving business processes from paper-based to digital. The company's SaaS delivery model generates high levels of recurring revenue and has proven robust during the COVID-19 pandemic.

### **Background**

Esker was founded in 1985 by Jean-Michel Bérard, the current CEO. Management was originally focused on software consulting and developed its first host access product in 1989. The company listed on the Nouveau Marché in 1997. From 1998 to 2000 the company made a series of acquisitions in the US host access and fax server markets. Esker launched the DeliveryWare platform in 2000, Mail on Demand in 2003, Esker on Demand (an automated on-demand mail and fax service) in 2004 and FlyDoc in 2006. The current SaaS products for accounts payable and accounts receivable were launched in 2009. The company's listing was transferred from Euronext C to Euronext Alternext in 2010 (since renamed Euronext Growth). The company made bolt-on acquisitions: TermSync and CalvaEDI in 2015 and e-integration in 2017. The company has operations in 13 countries and its revenues are well spread geographically, with 57% from Europe, 38% from North America, and the remainder from Australia and Asia.

### **Growth strategy: Broaden functionality, add partners**

Esker's DPA SaaS software supports order-to-cash and purchase-to-pay business processes. The company is working to broaden the functionality of its product suite and ultimately join up the processes to create a business collaboration network. It is also exploring the opportunities that such a network could open up in the supply chain finance market. As well as increasing headcount to support organic growth, management would consider acquiring complementary businesses. Excluding acquisitions, growth in recent years has come from a combination of adding new customers and existing customers adding new processes and/or pushing higher volumes through Esker's platform. To accelerate growth, the company is building a network of partners to undertake implementation work and resell Esker software.

### **Well established management team headed up by founder**

As described above, the company's CEO, Jean-Michel Bérard, founded the company in 1985. Emmanuel Olivier joined the company in 1999, was originally the CFO and became COO in 2003. He previously worked at Ernst & Young in France and the US for seven years. The CEO's brother, Jean-Jacques Bérard, is the EVP of R&D, having joined Esker in 1995. Other members of the management board include Eric Bussy (global director of marketing and product management), Steve Smith (COO, Americas), Eric Thomas (VP business development) and Anne Grand-Clément (global director of professional services and technical support).

### **DPA software**

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Esker has developed a unified cloud platform to automate order-to-cash and purchase-to-pay cash cycles. Its DPA software operates in five areas: procurement, accounts payable, accounts receivable, sales order processing and document delivery. These can be combined to fulfil the cash cycles as per Exhibit 1: order-to-cash to fulfil customer orders and collect payment; and purchase-to-pay to source, order and pay for goods and services.

**Exhibit 1: Esker's positioning**


Source: Esker

Features of the software include:

- multi-tenant cloud platform;
- single solution with common interface to access all functionality;
- mobile capabilities;
- enterprise resource planning (ERP) integrations;
- artificial intelligence (AI) functionality; and
- ongoing development via agile methodology.

## Automating invoice and order delivery and receipt

Esker's DPA software operates in the following way. For **receipt** of documents (eg sales orders, supplier invoices), the software converts paper documentation into digital format and populates standard templates with the data from the digital document. The software can also extract data from other sources such as emails, email attachments and faxes. Esker has used machine learning for many years to train the software: if there is any doubt over the accuracy of the data, the user compares the original document to the digitised version and corrects it as necessary helping the software to learn. The standardised data can then be fed into the customer's ERP system and processed and viewed by the relevant people throughout the organisation before being archived automatically. For **sending** documents, the software generates orders or invoices in the format required and if paper documents or fax services are required, Esker's document delivery service can be used. The software provides a dashboard showing relevant key performance indicators (KPIs) and data analytics to support performance monitoring.

The software has certified integrations with the main ERP vendors, including SAP (including S/4HANA), Cegid, Oracle's E-Business Suite, JD Edwards EnterpriseOne, Microsoft Dynamics NAV, Sage, Infor and NetSuite. Earlier this year, Esker announced that it had partnered with Cegid to provide its supplier invoice processing software for Cegid's XRP Flex solution.

Esker's mobile solution, **Esker Anywhere**, can be used for procurement, accounts payable and sales order processing.

The business helps buyers and suppliers to **collaborate** by providing a portal for each process that they can both access, with features such as invoice status and chat. More recently, using AI it has developed a shared database of document recognition models for orders and invoices in pdf format. The longer-term goal is to connect these portals together to create a networking platform that would allow customers and suppliers to interact securely and could be used for direct

exchange of purchase orders and invoices, payment of invoices, early payment discounting, dispute resolution and data clarification.

### Enhancing cash and credit management processes for accounts receivable

The software offers self-service online payment options such as credit cards, ACH, SEPA and direct debit, or can be integrated with the customer's preferred payment processor. The software also manages cash allocation automatically. The company recently integrated its order-to-cash software with Stripe Connect to offer the convenience of a single payment provider globally.

In June, Esker launched a credit management solution that allows companies to automate new customer on-boarding and secure their credit approval process. The solution includes customisable credit application templates, workflow rules and a customisable dashboard to monitor application status and tasks. Periodic credit reviews can be automated and a customer repository includes all customer-related documents, credit and business information to make informed decisions. Esker has partnered with Dun & Bradstreet globally, CreditRiskMonitor in North America and Ellisphere in Europe to provide access to external credit data.

### Document delivery the final step in the process

Document delivery services enable customers to send business documents via cloud fax or mail centres directly from their desktop or enterprise applications. Esker services on-demand document delivery through its fax servers located in France, the US and Australia and mail production centres located in France, Belgium, the UK, the US, Australia, Spain and Singapore.

### Demand drivers: Efficiency, cash management, regulation

The software improves productivity by accelerating the cash conversion cycle, reducing errors, enabling faster processing, improving process visibility and improving customer service. It has the added benefit of reducing paper and paper-related costs.

The software also meets government legislation around e-invoicing. In Europe, the EU has mandated that paper and digital invoices should be treated equally and lays out ways that documents can be authenticated. EU member states have been subject to the 2014/55/EU directive since April 2019: this specifies that businesses selling to government entities must use e-invoicing that is based on specified interoperability standards. This should increase demand for e-invoicing solutions. In Latin America, e-invoicing is government-mandated to ensure tax compliance and collection.

### SaaS-based software driving growth

**Exhibit 2: DPA product range**

Product	Details
Esker on Demand	On demand DPA platform for outsourcing and automating the enterprise process linked to the circulation of documents (invoicing, reminders, sales administration). Supports the following processes: accounts payable, accounts receivable, procurement, sales orders.
CalvaEDI	Designed for transport decision-makers, manufacturers, freight forwarders, logistic services and haulers to automatically exchange shipping orders in real time in the EDI (electronic data interchange) format.
Esker EDI Services	Enables industrial companies to exchange different business documents (orders, order confirmations, delivery slips, payment notices, inventory reports, consignment notes, etc) in EDI format with their partners.
TermSync	Cloud-based service for managing the accounts receivable collection process for customer invoices issued by Esker on Demand or a third-party solution.
FlyDoc	Online fax and mail delivery service; targeted at SMEs and individuals. Only in France and the US.
Source: Esker	

The table above details Esker's product range for DPA, all of which are SaaS-based. Esker on Demand is the main product; this multi-tenant solution was originally developed by Esker in 2004,

ahead of many other software companies' entries into the SaaS market. It started to gain traction from 2009 as customers were attracted by the lack of upfront investment and the usage-based payment mechanism. The company has more than 6,000 SaaS customers and 600,000 SaaS users.

Esker upgrades Esker on Demand every 15 days. The software is hosted out of six data centres: two leased by Esker (France, US) and four Microsoft Azure facilities (Australia, Canada, the Netherlands and Singapore).

Esker's longest-standing product, DeliveryWare, is an on-premise solution. The company discontinued new sales of this product in September 2019; we would expect related maintenance revenues to slowly decline. In FY19, DeliveryWare-related revenues made up 6% of group revenue.

## Product development

The table below shows the development of the platform in terms of functionality.

Exhibit 3: Product development roadmap							
Media types		Document types		Processes		People	
EDI	✓	Purchase orders	✓	Order processing	✓	Portals	✓
Fax	✓	Customer invoices	✓	Accounts receivable	✓	Collaboration	○
Email	✓	Supplier invoices	✓	Accounts payable	✓	Mobile app	✓
Mail	✓			Purchasing	✓	Business network	○
SMS	✓					Factoring	○

Source: Esker, Edison Investment Research. Key: ✓ = available; ○ = under development/partially available.

We understand that the company's main priorities for product development include:

- **Employing artificial intelligence to increase automation.** Esker has used **machine learning** for many years to improve the accuracy of its software in automating invoice processing. It also incorporates **robotic process automation** into its software in selected areas, for example to automate invoice submission to a customer's accounts payable portal or to retrieve sales orders from portals and input them into a customer's ERP system. It is applying **deep learning**, which requires access to a very high volume of documents, to a number of use cases. For example, it is using deep learning to classify and route documents received in an email inbox ('triage'). The software needs to be able not only to figure out which department a document is intended for, but also to reject documents that are spam. The goal is to achieve accuracy on a par with a human; this then frees up the software user to focus their attention on exceptions rather than routine email sorting. Other AI-based enhancements to the platform include auto-splitting of batch invoices, semantic recognition of purchase orders and anomaly detection. The company is developing new enhancements in the area of fraud detection, semantic recognition of other documents and non-OCR<sup>1</sup> recognition of documents.
- **Extending the functionality of the P2P solution:** Esker is increasingly adding functionality to its purchase-to-pay offering, through a combination of in-house development and technology partnerships, and is focusing its efforts on the functionality demanded by customers. One area of demand is catalogue management: Esker already offers 'punch out' functionality, which allows purchasing customers to access online suppliers such as Dell and Amazon Business from within the Esker e-procurement application and place orders with those suppliers. The company continues to add features in this area. In June, Esker added supplier management functionality. A self-service portal allows suppliers to provide all required account information and documentation and keep it up-to-date. The software verifies the accuracy of supplier information and uses third-party data to monitor supplier risk. Contract management functionality is also being developed so that invoices and purchase orders can be linked to the related contract.

<sup>1</sup> Optical Character Recognition



- **Supply chain finance:** as an interesting add-on to its existing software business, Esker has evaluated the supply chain financing market to assess the best way to participate. Several invoice networks are active in this space, for example Taulia and Tungsten, offering invoice factoring, reverse factoring and/or dynamic discounting. Rather than offering finance itself (not a core skill of the company), Esker has entered the market via a partnership in Singapore. If this proves popular, Esker would look to extend this type of offering in other countries.

### **Partnering to access niche technology**

As well as in-house product development and acquisitions of companies with relevant technology, Esker partners with other companies to provide access to technology that augments its products. One example is Rimilia, a UK-based company with a SaaS-based product that provides automatic matching of cash receipts to invoices for Esker's order-to-cash solution. Last year, Esker made a 40% investment in the initial seed finance round for a US start-up called B/2BNOW, which has since changed its name to Highview. Highview provides EDI solutions for SAP S/4HANA Cloud ERP systems. Steve Smith, COO of Esker US, joined the board of Highview.

### **Sales strategy: Mainly direct, adding channel partners**

Esker has a direct sales presence in Europe (France, Germany, Italy, Spain and the UK), the US and Asia-Pacific (Australia, Hong Kong, Malaysia and Singapore). Esker has sales representatives in Miami (to target South America, in particular Argentina, Brazil and Colombia), Brussels (to target European-headquartered US companies) and Montreal. Esker also sells its software to several companies on a white-label basis.

### **Land and expand strategy**

The salesforce tends to target those responsible for business processes; in most cases this will be the finance department, although sometimes it is customer services. The company also works with the customer's IT department, but this is mainly to work on integrating the software rather than to sell to. As the implementation process takes time and can be disruptive, most customers tend to select Esker for one process initially. Esker may then benefit from growth within that process eg more departments, more geographies. Some customers go on to use Esker for additional processes. Last year, the company created a customer experience team to strengthen the relationship with customers and to minimise churn.

### **Signing up channel partners**

Excluding the effect of COVID-19 on demand, the main gating factor for Esker's growth is the availability of consultants. To accelerate the pace at which it can sign up and on-board new customers, Esker is developing a network of channel partners. These partners are providing consulting and implementation services, and in some cases are reselling Esker's technology.

Key partners include:

- **Fuji Xerox:** Esker announced an agreement with Fuji Xerox<sup>2</sup> in early 2019 whereby Fuji Xerox would initially market Esker's accounts payable automation solution as part of its offering to optimise accounts payable management processes in Japan, with a view to extending this to Australia, Hong Kong and Singapore. Both parties were already working together in New Zealand with customers in the construction, retail, business and education sectors using Esker's accounts payable solution. The agreement also included the provision of consulting, implementation and support services by Fuji Xerox, potentially accelerating Esker's penetration of this region without Esker incurring substantial sales and consulting costs. In March 2020,

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<sup>2</sup> Fuji Xerox is owned by FUJIFILM Holdings Corporation; its direct salesforce covers Japan and the Asia-Pacific region including China.

Esfer announced that the partnership was being extended to include the accounts receivable solution.

- **KPMG Netherlands:** In 2019, the company signed a reseller agreement with KPMG Netherlands. KPMG will market Esfer's cloud-based accounts payable solution as part of its RPA and Finance Transformation offering.
- **Cegid:** As mentioned earlier, Esfer's software is distributed by Cegid via its XRP Flex Marketplace.

The company noted in its H120 results that it has signed several deals in Japan via the Fuji Xerox partnership. While these are small in terms of revenue, they provide Esfer with the opportunity to learn and adapt product to suit customers in the Japanese market.

### Joint venture with Quadient targets SMEs

Esfer sold its software on a white-label basis through Quadient (previously called Neopost) in France for several years and in 2015 entered into a joint venture (JV) with Quadient to expand the scope of this agreement. The JV (owned 70% Quadient, 30% Esfer) is focused on selling Esfer's software, marketed as Neotouch, to SMEs in France, the US and the UK (Esfer's direct salesforce tends not to target the SME market) and to date has c 3,500 end customers. Neotouch is a hybrid mail solution, converting internet mail into physical form for transfer to postal services. In FY19, Esfer reported a €0.5m contribution from its share in the JV, and the JV generated 10.2% of group sales.

### Competitive positioning: Esfer competes by process

Esfer competes against a different group of companies for each business process and by geography. As well as specialist DPA software companies, the company also sees competition from business process outsourcers such as Accenture and Xerox.

Most of the companies that Esfer competes with operate in either the order-to-cash or purchase-to-pay markets. Esfer has the advantage that its software can be used across all processes, reducing the number of software suppliers a company deals with and simplifying the implementation process. More than 6,000 companies globally use Esfer software, including BMW, GE Healthcare, Heineken, Microsoft, Novartis, Samsung and Siemens. Esfer has more than a decade's experience in SaaS delivery and has achieved various SaaS certifications such as SSAE18, ISAE3402 and ISO27001, providing a level of confidence regarding business continuity and data security.

**Accounts payable** is the most competitive area; when Esfer wins business it tends to be for customers that have decided to move from manual to automated processing, rather than winning business from an existing supplier (although this occasionally happens). **Accounts receivable** has historically been Esfer's strongest area; the customer owns the process so the document format is set in-house and therefore data recognition is more straightforward. Due to European legislation around electronic signatures, demand for automated accounts receivable processing is growing, as companies move from paper to digital invoices. Esfer sometimes replaces mail houses in this market. The most complex market from a technical perspective is **sales order processing**. This is because end-customers send orders to Esfer's customers in many different non-standard formats such as faxes, emails or within email attachments. This market has the fewest suppliers and Esfer has a very high win rate. The newest area for Esfer is **purchasing** (launched in 2014), which contributes less than 1% of revenues. This is a sub-set of the procurement software market, which is dominated by cloud provider Coupa. Esfer's purchasing solution covers the procurement process from purchase requisition to invoice payment authorisation, but over time we expect the company to extend the functionality of the solution to encompass the earlier part of the procurement process. Esfer typically sells this solution to existing accounts payable customers to support the full purchase-to-payment cycle.



**Exhibit 4: Competitive environment – DPA software suppliers**

Company	Accounts receivable	Sales order processing	Accounts payable	Purchasing
Esker	x	x	x	x
Basware	x		x	x
bill.com	x			
Billtrust	x			
Conexiom		x		
Coupa				x
Determine				x
HighRadius	x			
ITESOFT			x	
iValua				x
Kofax*			x	
OmPrompt		x		
OpenText		x	x	
SAP (Ariba)				x
Sidetrade	X			
Tradeshift	X		x	
Tungsten (OB10)	x			
Yooz			x	

Source: Esker, Edison Investment Research. Note: \*Includes ReadSoft.

Exhibit 4 shows the most common competitors for each process. Competition tends to be country specific; for example, Billtrust for accounts receivable in the US, ITESOFT for accounts payable in France. Global competitors include Basware, Kofax, OpenText and SAP.

Document delivery has a different group of mail-focused competitors, including j2 Global, Docapost, and Maileva (both subsidiaries of Le Groupe La Poste) and OpenText.

### Supplier/buyer networks present an opportunity for Esker

Many customers use Esker's software to enable them to join supplier networks such as Ariba or OB10. These networks usually require e-invoicing and Esker's software enables them to produce invoices according to the requirements of the networks. In other cases, such as Taulia, the networks rely on invoices that are approved for payment to provide supply chain financing. As Esker's software provides dashboards to show this type of information, the company is able to introduce customers with the necessary volume of approved invoices to the networks.

## Legacy Products (4% of FY19 revenues)

Esker's Legacy Products division includes fax servers and host access products. While the legacy business continues to be supported, the company is not actively seeking new business or developing new products.

- **Fax servers** were developed to send the fax directly via a word processing programme, or to receive a fax and send it directly to the recipient's inbox. Esker Fax works on Microsoft operating systems and is compatible with electronic messaging systems including IBM Lotus Notes, Microsoft Exchange and SMTP. VSI-Fax is designed for UNIX and Linux operating systems.
- **Host access** supplies terminal emulator software that enables users to access mainframes from PCs. Tun PLUS supports access to SCO Linux, Linux, IBM AIX, HP-UX, IBM 390 and IBM AS/400 servers, and SmarTerm supports access to Digital (Vax Open VMS), Data General and IBM servers. Esker mainly generates maintenance revenues from this business, although occasionally it wins new business as the number of host access suppliers reduces.

## Sensitivities

Our forecasts and the Esker share price will be sensitive to the following factors:

- **Currency:** while Esker has some natural hedging, the R&D and central function teams are based in France, resulting in exposure to the US dollar-euro exchange rate. If the US dollar weakens against the euro from the current level, it would have a negative effect on revenues and profitability.
- **Competition:** Esker competes with well-established, well-funded software companies and will need to maintain its technology to compete.
- **Success of channel partner strategy:** the rate at which the company is able to sign up channel partners, the pace at which those partners are able to resell Esker solutions and the ability of partners to successfully implement Esker solutions for clients will influence revenue growth and headcount requirements.
- **Rate of decline of legacy businesses:** the host access and fax server businesses and DeliveryWare are very profitable maintenance-revenue generators. The rate at which these businesses decline will have an impact on profitability, although as these businesses make up a decreasing proportion of revenues (8% in H120 compared to 11% in H119), the effect is reducing.
- **Reliance on datacentre providers:** Esker leases datacentre capacity for its on-demand products. Changes in the availability and pricing of capacity will influence profitability.

## Financials

### Revenues: SaaS business is the driver

**Exhibit 5: Revenues by business line and by type**

€m	FY17	FY18	Growth	FY19	Growth	FY20e	Growth	FY21e	Growth
SaaS-related DPA revenues	64.4	75.8	17.6%	93.7	23.7%	106.0	13.1%	124.9	17.8%
License-based DPA revenues	8.1	7.8	(3.3%)	6.6	(16.1%)	5.6	(14.6%)	4.9	(12.0%)
Legacy products	3.6	3.3	(9.1%)	3.9	19.9%	2.3	(41.4%)	2.0	(13.0%)
<b>Total</b>	<b>76.1</b>	<b>86.9</b>	<b>14.2%</b>	<b>104.2</b>	<b>19.9%</b>	<b>113.9</b>	<b>9.3%</b>	<b>131.8</b>	<b>15.7%</b>
SaaS	51.4	60.5	17.7%	75.5	24.8%	86.5	14.5%	103.8	20.0%
Consulting	14.4	16.6	15.7%	18.9	13.7%	19.3	2.0%	21.2	10.0%
Upgrades & maintenance	8.0	7.4	(8.3%)	6.9	(6.1%)	6.5	(6.0%)	5.6	(13.5%)
New licenses	1.6	1.9	15.4%	2.4	28.7%	1.5	(40.0%)	1.1	(27.5%)
Fax card sales/hardware	0.6	0.5	(22.3%)	0.4	(11.9%)	0.2	(50.0%)	0.2	(20.0%)
<b>Total</b>	<b>76.1</b>	<b>86.9</b>		<b>104.2</b>		<b>113.9</b>		<b>131.8</b>	

Source: Esker, Edison Investment Research

Esker reports revenues in two ways:

- split by business line: DPA (split out as SaaS and licence-based) and Legacy Products, on a quarterly basis; and
- split by type of revenue: SaaS, maintenance fees, licence sales, hardware and consulting, on a half-yearly basis.

SaaS revenues are generated on a per-transaction basis from all SaaS DPA products customers. Licence and maintenance fees are generated from DeliveryWare on-premise licence sales and the fax server and host access businesses (although as DeliveryWare has been discontinued there will no longer be any licence sales from this product). Hardware sales are generated by the fax server business. Consulting revenues are generated from on-premise and on-demand DPA business. Older DPA subscription sales were structured on a traffic-only basis, with consulting revenues charged for the initial integration of the software. For the last few years, Esker has sold on a hybrid

subscription model that guarantees minimum monthly revenues plus transaction-based revenues, reducing Esker's dependence on the speed at which a customer implements the software. On-demand contracts are typically signed for a minimum of 12 months, and most commonly are for three years. See Exhibit 5 for historical and forecast divisional performance.

SaaS-related revenues (which include SaaS and consulting revenues) have shown significant growth in recent years. On a like-for-like, constant currency basis, these grew 21% in FY17, 20% in FY18, 21% in FY19 and 11% in H120 (SaaS +9%, consulting +15%). Licence-based DPA revenues (licences, consulting and maintenance revenues) declined 23% in FY17, 1% in FY18, 18% in FY19 and 15% in H120, now making up only 5% of revenues.

### High level of recurring revenue provides good visibility

In H120, recurring revenues<sup>3</sup> made up 80% of the total, versus 78% in FY18 and 79% in FY19. Esker has a strong record of retaining customers – management estimates that churn is less than 1% per year. As each new customer comes on board, this adds another layer of recurring revenues. In H120, Esker won orders worth €12m (+3% y-o-y); this is the amount of revenue the company is contracted to earn over the (usually) three-year life of the contract, and does not include variable per document fees, which can make up the same amount again over the three years. This was a strong performance considering the difficulties in signing new business during Q2.

### Review of H120 results: A robust performance

<b>Exhibit 6: Half year results highlights</b>			
€m	H119	H120	y-o-y
Revenues	50.1	54.2	8.2%
EBITDA	10.9	10.2	-6.4%
EBITDA margin	21.7%	18.8%	-2.9%
Reported operating profit	7.2	6.2	-14.0%
Operating margin	14.4%	11.4%	-3.0%
Reported net income	5.5	5.4	-0.5%
Basic EPS (€)	1.02	0.96	-5.9%
Diluted EPS (€)	1.00	0.96	-4.0%
Net cash	15.0	22.9	52.7%
Source: Esker			

Esker generated 8.2% y-o-y revenue growth for H120 (7% constant currency), despite COVID-19 disruption. On a quarterly basis, Q120 was 16% higher on a constant currency basis whereas Q220 revenues were flat. Consulting revenues were robust in the period (+15%) as a backlog of projects meant that consultants were fully utilised as they were able to undertake implementation projects from home. SaaS revenues were 9% higher year-on-year; while the US and Asia-Pacific were more robust and benefited from new customers coming onboard, Europe was hit harder by lockdowns in Q2. We note that SaaS revenues are made up of monthly subscription fees, which continued unaffected by COVID-19, and volume-based fees, which declined c 24% in April and May, as companies processed fewer invoices during lockdown.

The company slightly slowed the pace of hiring during H1, but still grew headcount 6% h-o-h and 14% y-o-y. This resulted in staff costs increasing 20% y-o-y. Other operating costs (excluding depreciation and amortisation) fell 6% y-o-y, as travel and marketing costs fell significantly in Q2 and a higher level of development costs were capitalised (although the percentage of R&D costs capitalised remained flat at 63%). Overall, this resulted in a 14% decline in reported operating profit and a 3pp decline in the operating margin year-on-year.

Until March, the JV with Quadient (see above) was on a growth path, but as it involves physical mail, COVID-19 disruption (particularly in France) drove a decline in business for the JV of c 35% in

<sup>3</sup> SaaS plus maintenance revenues.

H120. The contribution to Esker of €174k in H120 therefore declined from the €251k in H119 and €272k in H219.

France recently updated its tax rules to allow software companies to take advantage of its patent box regime. This reduces the tax rate on profits from copyrighted software resulting from R&D in France from 31% to 10%. This resulted in a one-off tax credit of €852k for FY19 (reported as exceptional income in H120) and reduced the effective tax rate from 31% to 27% in H120.

## Strong cash position

In H1, the company generated operating cash flow of €9.5m. As well as paying the prior-year dividend of €1.9m, the company paid down €1.5m of debt and took advantage of a government-guaranteed loan of €11.5m (one-year maturity, 0.5% rate).

The company invests in tangible fixed assets for its mail centres and offices and capitalises development costs. In H1, Esker capitalised €4.0m of development costs and amortised €2.6m and spent €1.2m on tangible assets. We expect a gradual increase in both capitalisation and amortisation in FY20 and FY21 reflecting the growing R&D headcount.

Gross cash was €33.8m at period end (excluding a further €5.7m recorded in fixed assets), providing ample funds for acquisitions and investment. The company ended H120 with a net cash position of €22.9m, up from €21.0m at the end of FY19. We forecast that net cash will increase to €26.0m by the end of FY20 and €33.0m by the end of FY21.

## Changes to forecasts

We have slightly reduced our revenue forecasts reflecting company guidance for FY20 for constant currency revenue growth of c 9%. Management expects growth to return to more normal rates in FY21. We have reflected the new tax rates of 27% (down from 31%) for FY20 and FY21. Overall, this results in a 1.5% increase in our FY20 normalised diluted EPS forecast and a 6.5% increase in FY21.

<b>Exhibit 7: Changes to forecasts</b>								
€m	FY20e old	FY20e new	Change	y-o-y	FY21e old	FY21e new	change	y-o-y
Revenues	114.8	113.9	(0.7%)	9.3%	132.9	131.8	(0.8%)	15.7%
EBITDA	22.0	22.2	1.2%	10.9%	25.9	26.2	1.3%	17.8%
EBITDA margin	19.2%	19.5%	0.4%	0.3%	19.5%	19.9%	0.4%	0.4%
Normalised EBIT	14.0	14.0	(0.4%)	8.8%	17.2	17.3	0.7%	24.1%
Normalised EBIT margin	12.2%	12.3%	0.0%	(0.1%)	12.9%	13.2%	0.2%	0.9%
Reported EBIT	13.7	13.5	(1.0%)	9.6%	16.9	16.9	0.3%	24.9%
Reported EBIT margin	11.9%	11.9%	(0.0%)	0.0%	12.7%	12.8%	0.1%	0.9%
Normalised PBT	14.7	14.1	(4.1%)	3.6%	17.9	18.0	0.7%	27.8%
Normalised net income	10.2	10.3	1.5%	2.0%	12.4	13.2	6.5%	27.8%
Normalised dil. EPS (€)	1.73	1.76	1.5%	(1.7%)	2.07	2.21	6.5%	25.6%
Reported basic EPS (€)	1.75	1.88	7.0%	4.4%	2.10	2.23	6.1%	19.0%
Reported diluted EPS (€)	1.69	1.81	7.0%	5.3%	2.03	2.16	6.1%	19.1%
Net cash	26.8	26.0	(3.1%)	23.7%	33.5	33.0	(1.3%)	27.1%
DPS (€)	0.35	0.35	0.0%	6.1%	0.40	0.40	0.0%	14.3%
Source: Edison Investment Research								

## Currency impact

With 37% of revenues from the US but a lower proportion of the cost base in US dollars, the company is exposed to changes in the dollar-euro exchange rate. In our cost calculations, we use a rate of \$1.125/€ for FY20 and FY21. Any weakening of the dollar could have a material negative impact on our forecasts.

## Valuation

The stock has gained 50% year-to-date and is trading 22% higher than its pre-COVID-19 peak. We have compared Esker's valuation to a group of listed global DPA software companies and to French-listed small-cap software companies (Exhibit 8). We have also included aggregate data for a group of more than 40 US SaaS software companies. We note that most companies in the first two peer groups are not predominantly SaaS companies, whereas Esker has been operating a SaaS business model for more than a decade.

US SaaS companies on average are growing faster than Esker, although they are generating operating margins below the level of Esker. The typical growth path for US SaaS companies involves investing heavily in sales and marketing to gain market share as fast as possible, with little focus on achieving profitability in the short term. Esker's model sits somewhere between low-growth, high-profitability on-premise software businesses and US SaaS companies' high-growth operating model, aiming for a happy medium of double-digit revenue growth while achieving mid-teen operating margins.

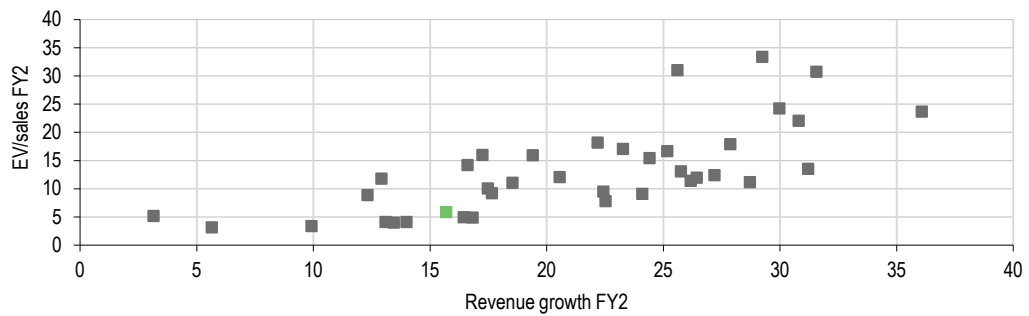
Esker has re-rated over the last year, with its P/E multiple moving more towards the US SaaS peer group. We believe that this is due to the value placed on businesses with high levels of recurring revenue, providing visibility through a period of economic uncertainty. Esker has the added advantage of a strong balance sheet that does not require additional funding to support growth.

**Exhibit 8: Peer financial and valuation metrics**

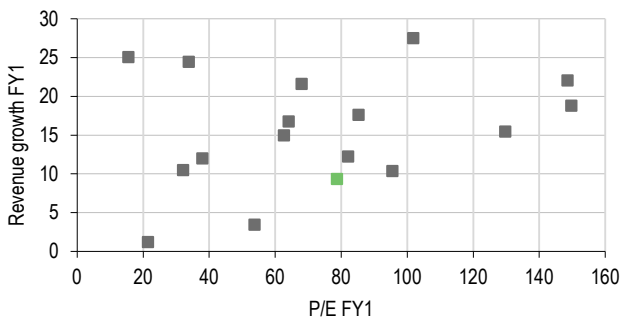
Company	Share price	Market cap (m)	Revenue growth		EBIT margin		EBITDA margin		EV/sales		P/E	
			CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
<b>Esker</b>	€138.6	€787	9.3%	15.7%	12.3%	13.2%	19.5%	19.9%	6.7	5.8	78.8	62.7
<b>Software companies with DPA software offerings</b>												
Basware	€36.95	€532	2.0%	9.7%	1.7%	4.9%	12.1%	14.2%	3.8	3.5	N/A	N/A
Bottomline	\$42.64	\$1,905	6.6%	12.5%	15.6%	16.6%	21.8%	22.3%	4.0	3.5	34.2	28.3
Coupa	\$260.48	\$17,934	27.9%	25.9%	6.9%	8.7%	13.0%	15.7%	36.2	28.8	596.2	442.2
ITESoft	€2.92	€18	-8.5%	6.9%	-4.6%	0.9%	1.4%	6.9%	1.0	0.9	N/A	17.2
OpenText	\$56.95	\$15,483	2.6%	2.5%	34.0%	34.5%	37.6%	38.4%	4.5	4.4	14.6	13.8
Proactis	£0.34	£32	-9.1%	11.2%	6.5%	7.5%	24.0%	23.4%	1.6	1.5	18.6	12.9
Tungsten Corp	£0.37	£47	3.8%	8.1%	1.3%	4.4%	12.0%	14.5%	1.4	1.3	93.6	26.8
<b>Average</b>			<b>3.6%</b>	<b>11.0%</b>	<b>8.8%</b>	<b>11.1%</b>	<b>17.4%</b>	<b>19.3%</b>	<b>7.5</b>	<b>6.3</b>	<b>29.8*</b>	<b>19.8*</b>
<b>Median</b>			<b>2.6%</b>	<b>9.7%</b>	<b>6.5%</b>	<b>7.5%</b>	<b>13.0%</b>	<b>15.7%</b>	<b>3.8</b>	<b>3.5</b>	<b>18.6</b>	<b>17.2</b>
<b>French small-cap software companies</b>												
Axway Software	€19.45	€412	-0.9%	4.7%	8.0%	10.5%	10.8%	13.1%	1.5	1.5	25.5	18.5
Claranova	€6.58	€259	53.8%	12.6%	1.8%	5.0%	3.3%	5.8%	0.6	0.6	84.8	25.8
ESI Group	€40.00	€238	42.5%	5.1%	5.1%	6.8%	11.7%	11.3%	2.0	1.9	48.8	39.3
Lectra	€21.05	€674	-20.5%	12.7%	7.5%	11.3%	11.2%	14.6%	2.6	2.3	53.3	26.1
Linedata Service	€26.00	€172	-5.1%	1.8%	15.2%	13.6%	26.4%	26.8%	1.6	1.6	11.3	10.0
Sidetrade	€88.00	€124	12.9%	21.4%	6.6%	6.8%	10.0%	10.2%	4.1	3.4	N/A	N/A
<b>Average</b>			<b>13.8%</b>	<b>9.7%</b>	<b>7.4%</b>	<b>9.0%</b>	<b>12.2%</b>	<b>13.6%</b>	<b>2.1</b>	<b>1.9</b>	<b>44.7</b>	<b>23.9</b>
<b>Median</b>			<b>6.0%</b>	<b>8.9%</b>	<b>7.0%</b>	<b>8.7%</b>	<b>11.0%</b>	<b>12.2%</b>	<b>1.8</b>	<b>1.7</b>	<b>48.8</b>	<b>25.8</b>
<b>US SaaS software companies</b>												
<b>Average</b>			<b>27.2%</b>	<b>22.9%</b>	<b>3.3%</b>	<b>9.7%</b>	<b>9.2%</b>	<b>14.9%</b>	<b>15.6</b>	<b>12.6</b>	<b>327.8</b>	<b>164.6</b>
<b>Median</b>			<b>23.2%</b>	<b>22.4%</b>	<b>7.2%</b>	<b>9.5%</b>	<b>11.7%</b>	<b>13.8%</b>	<b>14.6</b>	<b>11.6</b>	<b>66.8</b>	<b>71.0</b>

Source: Edison Investment Research, Refinitiv (as at 10 September)

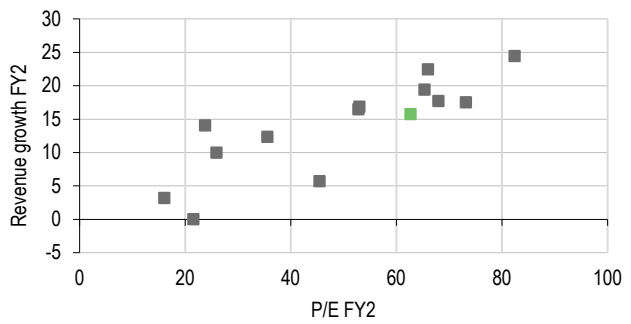
In Exhibit 9 we show how Esker (marked in green) compares to a selection of US SaaS peers when considering next year revenue growth versus next year EV/sales multiple. Exhibits 10 and 11 show how the peer group is trading on a P/E basis compared to revenue forecasts this year and next (we have excluded any companies trading on a P/E above 150 for either year). In Exhibit 12, we compare average revenue growth and average EBIT margins over the next two years.

**Exhibit 9: Next year revenue growth and EV/sales: US peers versus Esker**


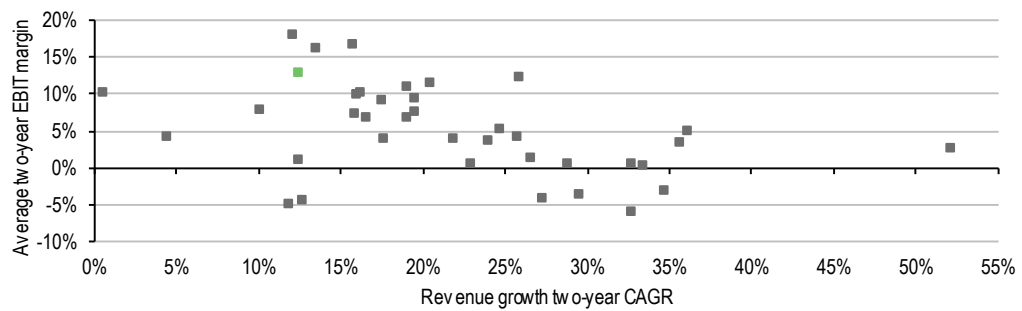
Source: Edison Investment Research, Refinitiv

**Exhibit 10: Revenue growth (%) and P/E – current year forecasts: US peers versus Esker**


Source: Edison Investment Research, Refinitiv

**Exhibit 11: Revenue growth (%) and P/E – next year forecasts: US peers versus Esker**


Source: Edison Investment Research, Refinitiv

**Exhibit 12: Two-year revenue growth and EBIT margins: US peers versus Esker**


Source: Edison Investment Research, Refinitiv



**Exhibit 13: Financial summary**

	€'000s	2016	2017	2018	2019	2020e	2021e
Year end 31 December		French GAAP	French GAAP	French GAAP	French GAAP	French GAAP	French GAAP
<b>PROFIT &amp; LOSS</b>							
Revenue		65,990	76,064	86,871	104,188	113,915	131,813
EBITDA		14,871	16,399	18,279	20,054	22,247	26,216
Operating Profit (before amort and except)		9,934	10,547	11,955	12,843	13,972	17,341
Amortisation of acquired intangibles		(200)	(300)	(344)	(425)	(425)	(425)
Exceptionals and other income		(474)	(456)	(88)	(62)	852	0
Other income		0	0	0	0	0	0
Operating Profit		9,260	9,791	11,523	12,356	14,399	16,916
Net Interest		(108)	(110)	(57)	268	(200)	100
Profit Before Tax (norm)		9,949	10,669	12,215	13,634	14,120	18,041
Profit Before Tax (FRS 3)		9,275	9,913	11,783	13,147	14,547	17,616
Tax		(2,950)	(3,148)	(2,940)	(3,402)	(3,928)	(4,756)
Profit After Tax (norm)		6,785	7,281	9,168	10,106	10,308	13,170
Profit After Tax (FRS 3)		6,325	6,765	8,843	9,745	10,619	12,860
Ave. Number of Shares Outstanding (m)		5.3	5.3	5.4	5.4	5.7	5.8
EPS - normalised (c)		128	138	170	186	182	229
EPS - normalised fully diluted (c)		122	132	165	179	176	221
EPS - (GAAP) (c)		120	128	164	180	188	223
Dividend per share (c)		30	32	41	33	35	40
Gross margin (%)		N/A	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)		22.5	21.6	21.0	19.2	19.5	19.9
Operating Margin (before GW & except) (%)		15.1	13.9	13.8	12.3	12.3	13.2
<b>BALANCE SHEET</b>							
Fixed Assets		28,324	37,912	39,635	47,201	49,849	52,649
Intangible Assets		22,381	26,673	28,096	29,323	31,723	34,223
Tangible Assets		5,158	7,115	7,050	10,434	10,334	10,034
Other		785	4,124	4,489	7,444	7,792	8,392
Current Assets		42,024	42,823	49,016	52,022	68,763	65,881
Stocks		101	176	147	185	185	185
Debtors		19,523	21,253	25,551	30,015	32,770	36,835
Cash		21,338	20,632	22,794	21,357	35,343	28,396
Other		1,062	762	524	465	465	465
Current Liabilities		(28,299)	(26,206)	(30,072)	(34,300)	(47,516)	(39,174)
Creditors		(28,299)	(26,206)	(30,072)	(34,300)	(36,016)	(39,174)
Short term borrowings		0	0	0	0	(11,500)	0
Long Term Liabilities		(7,657)	(14,909)	(10,810)	(8,276)	(5,776)	(3,276)
Long term borrowings		(7,657)	(13,716)	(9,318)	(6,516)	(4,016)	(1,516)
Other long term liabilities		0	(1,193)	(1,492)	(1,760)	(1,760)	(1,760)
Net Assets		34,392	39,620	47,769	56,647	65,320	76,081
<b>CASH FLOW</b>							
Operating Cash Flow		15,944	17,311	18,366	20,290	21,208	25,308
Net Interest		(127)	(75)	63	352	(200)	100
Tax		(1,456)	(2,053)	(2,795)	(3,329)	(3,076)	(4,756)
Capex		(7,021)	(9,304)	(7,789)	(10,995)	(11,000)	(11,500)
Acquisitions/disposals		(935)	(7,551)	(225)	(486)	0	0
Financing		467	(345)	785	1,449	0	0
Dividends		(1,550)	(1,633)	(1,756)	(2,237)	(1,946)	(2,099)
Net Cash Flow		5,322	(3,650)	6,649	5,044	4,987	7,053
Opening net debt/(cash)		(8,978)	(13,681)	(10,016)	(16,576)	(21,018)	(26,004)
HP finance leases initiated		(645)	0	0	0	0	0
Other		26	(15)	(90)	(602)	0	(0)
Closing net debt/(cash)		(13,681)	(10,016)	(16,576)	(21,018)	(26,004)	(33,057)

Source: Esker, Edison Investment Research

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**Revenue by geography (FY19)**

**Management team**
**President of the board and CEO: Jean-Michel Bérard**

Mr Bérard received his computer engineering degree in 1984 from the Lyon Institut National des Sciences Appliquées and shortly after co-founded Esker. He is responsible for defining and executing Esker's business plan. He also represents Esker to potential partners, the European technological community, IT analysts and the trade press.

**COO: Emmanuel Olivier**

Mr Olivier leads Esker's operations worldwide, covering sales, marketing and consulting activities. He also supervises Esker's finances and is in charge of financial communication and IR. He joined Esker in 1999 as CFO and was promoted to COO in 2003. He previously worked as an audit manager for Ernst & Young for seven years, including two years in the US. He has an MBA from SKEMA Business School, Nice Sophia Antipolis, France, and earned a CPA qualification from the state of Pennsylvania, US.

**Principal shareholders**

	(%)
Jean-Michel Bérard	6.8
Thomas Wolfe	4.7
Credit Agricole Group	3.3
Premier Miton	3.0
Treasury shares	2.6
Montanaro Group	2.2
Grandeur Peak Global Advisors LLP	2.1
Wasatch Advisors Inc	1.9

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