EDISON **Scale research report - Update**

Beta Systems

Technology

31 January 2019

Underlying positive trends

While FY18 numbers dipped as management expected, revenue and EBITDA were in the top half of guidance. The results reflected weaker software licence renewals, which reduced revenues and slashed margins. FY18 cash generation was strong, with operating cash flow up nearly 60% at €8.3m and the maintenance book continued to grow with the help of acquisitions. In our view, the shares are attractive, noting the potential sub 6x FY20 EV/EBITDA ratio, given the strong cash generation and high level of recurring revenues (we estimate 80%+ in FY18).

FY18 results: Ahead of guidance

Revenue slipped 8% to €45.9m (comfortably ahead of €41–43m guidance), while EBITDA nearly halved to €5.5m (€5.3m; mid-point of guidance). The result included €3m revenues and a €0.6m EBITDA loss from acquisitions. Net cash fell to €35.6m (including €30.1m on deposit) from €44.1m, due to the impact of a €11.5m share buyback and two acquisitions. A dividend of €0.23 per share is proposed.

Guidance: EBITDA margins expected to recover

FY19 management guidance is for revenues of €46.5–49.5m, which implies c 5% growth at the mid-point, and for EBITDA margins of c 15%. For FY20, the guidance is for moderate revenue and EBITDA growth, with an EBITDA margin of 15–20%.

M&A will continue to feature

The group has made four acquisitions in the last four years (HORIZONT in FY15, LYNET and AUCONET in FY18 and Categis in FY19) and it continues to seek acquisitions to bulk up its divisions and diversify revenue streams. Beta Systems has a €35.6m war chest to help it to pursue its acquisition strategy.

Valuation: Modest valuation after adjusting for cash

After stripping out net cash of €35.6m, the group enterprise value is c €52m. Based on the mid-point of management's FY19 EBITDA guidance, this implies an EV/EBITDA ratio of a modest 7.1x. Based on the longer-term guidance, EV/EBITDA could feasibly fall below 6x in FY20 (eg, 5% revenue growth and 17.5% margins implies 5.9x EV/EBITDA). In our view, these valuations are very modest for a software business that has the potential to deliver 20%+ EBITDA margins and writes off all its R&D expenditure (c 20% of sales) in the year incurred. Additionally, the group's main division, DCI, could benefit from the disruptions caused by the acquisitions of its two major competitors, BMC and CA, in 2018.

Historical financials

Year end	Revenue (€m)	EBITDA (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
09/16	46.4	7.0	5.7	0.99	0	18.5	N/A
09/17	49.8	10.8	9.3	1.51	0.41	12.1	2.2
09/18	45.9	5.5	4.3	0.76	0.23	24.1	1.3

Source: Company accounts

Price €18.30

Market cap €88m

Share price graph

Share details

Code	BSS
Listing	Deutsche Börse Scale
Shares in issue	4.8m
Last reported net cash as at December 2018, including €30.1m on deposit	€35.6m

Business description

Beta Systems provides data centre intelligence (DCI) solutions that enable efficient and secure bulk processing of data and identity access management (IAM) solutions. The company's headquarters are in Berlin and has sales and support offices in 18 markets globally. Approximately 70% of sales are derived in the DACH region.

Bull

- Market leader in mainframe environments and DCI in Europe.
- FY19 and FY20 should be more typical renewal years in DCI.
- Strong balance sheet.

Bear

- Mature mainframe market backdrop.
- Subscale IAM business.
- FY18 affected by down-cycle in licence renewals.

Analyst

Richard Jeans +44 203 077 5700

tech@edisongroup.com

Edison profile page

FY18 results: In the top half of guidance

FY18 revenue slipped by 8% to €45.9m (comfortably ahead of €41–43m guidance), while EBITDA nearly halved to €5.5m (€5.3m mid-point of guidance). Excluding acquisitions, revenues were €42.9m and EBITDA was €6.1m. Hence, excluding acquisitions, revenue and EBITDA were also above the mid-points of the guidance ranges. The revenue decline related to the renewal cycle, which saw a peak in FY17, and hence there was a 36% decline in licence revenues in FY18. Nevertheless, both the group's divisions experienced significantly higher volumes of new orders in FY18 and in spite of the fluctuating revenues and EBITDA, net cash from operating activities improved in the fourth consecutive year.

The group has two continuing divisions: data centre intelligence (DCI, solutions for data centre automation) and identity access management (IAM, solutions for central user and access management). A third division, digitalisation (DIG), has been established via the acquisition of LYNET during the year.

The bulk of group software is sold on a rental basis and Beta recognises rental revenues on a similar basis to a traditional licence (eg c 60% of total revenues of a three-year rental contract are recognised in the first year, with c 20% in each of year two and three). This adds volatility to revenues and brings revenues forward compared with a cash flow model. This revenue recognition policy is in line with IFRS15. Due to a renewal cycle, licence revenues jumped in FY17 but fell back in FY18. However, maintenance revenues continued to increase for the fourth consecutive year, rising 3%, boosted by the acquisitions. New business in both IAM and DCI also developed well.

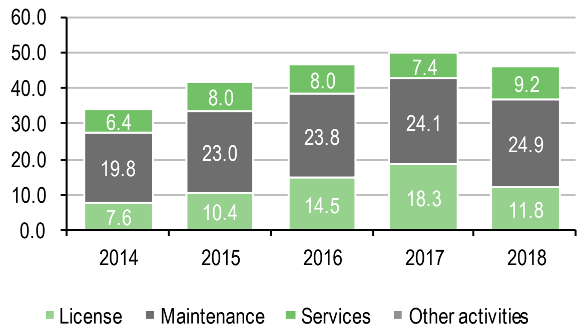
The predominant rental model means that c 80%+ of group revenues are recurring (licences and maintenance) while much of services revenues have a recurring feature, which would take the recurring revenues to more than 90% of the total.

Exhibit 1: Financial summary

€m	2013	2014	2015	2016	2017	2018
Year-end 30 September	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
Income statement						
Revenue	37.7	33.8	41.6	46.4	49.8	45.9
Revenue growth	-9%	-10%	23%	12%	7%	-8%
Gross margin	91%	91%	94%	94%	96%	95%
EBITDA	2.3	-1.3	3.53	6.95	10.8	5.5
EBITDA margin	6.1%	-3.8%	8.5%	15.0%	21.7%	12.0%
Total opex	-36.5	-36	-42.1	-41	-40.8	-42.1
EBIT	1.2	-2.2	-0.5	5.3	9	3.8
EBIT margin	3.2%	-6.5%	-1.2%	11.4%	18.1%	8.3%
Profit before tax (as reported)	1.5	-1.9	-0.3	5.7	9.3	4.3
Net income (as reported)	0.4	-2.2	2.8	5.2	8	4
EPS (as reported) (€)	0.08	-0.51	0.71	0.99	1.51	0.76
Dividend per share (€)	0	0	0	0	0.41	0.23
Balance sheet						
Total non-current assets	1.9	2.7	14.4	14	11.5	16.1
Total current assets	50.3	46.4	48.6	54.1	60.9	51.4
Total assets	52.1	49.1	63	68.1	72.4	67.4
Total current liabilities	-15.5	-15	-25.9	-18.7	-15.5	-18
Total non-current liabilities	-2.9	-2.8	-2.9	-3.9	-2.8	-3
Total liabilities	-18.3	-17.7	-28.7	-22.5	-18.2	-21
Total equity	33.8	31.4	34.2	45.6	54.2	46.4
Cash flow statement						
Net cash from operating activities	4.2	3.3	4.5	5	5.3	8.3
Net cash from investing activities	0.9	0	-6.1	-17.9	0.1	-10.4
Net cash from financing activities	-0.6	-0.4	7.2	-0.7	-0.1	-11.5
Net cash flow	4.4	-7.7	5.5	-13.5	5.3	-13.6
Cash	29.5	21.8	27.4	13.8	19.1	5.5
Cash on deposit	0	0	7.5	25	25	30.1
Net cash and equivalent	29.5	21.8	34.9	38.8	44.1	35.6

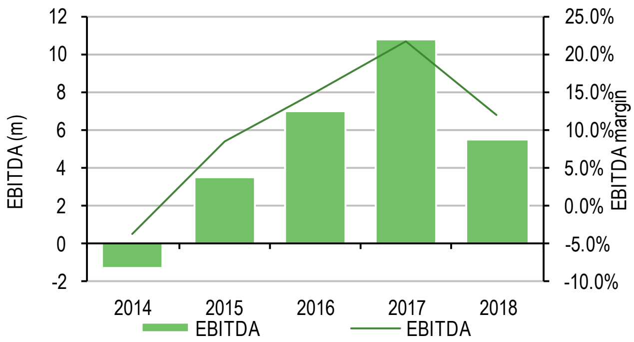
Source: Company accounts

Exhibit 2: Revenues by classification (€m)



Source: Beta Systems, Edison Investment Research

Exhibit 3: EBITDA and EBITDA margin profile



Source: Beta Systems, Edison Investment Research

The group spent €9.9m on R&D in FY18 (22% of sales), up from €9.1m in FY17 (18% of sales), which was expensed as incurred. The group had 127 employees working in R&D at the period end, representing 39% of the group's 322 total.

Net cash fell to €35.6m (including €30.1m on deposit) from €44.1m, due to the impact of a €11.5m share buyback and two acquisitions. The 23c dividend that has been proposed will cost c €1.1m, compared with 41c last year (€2.2m cost).

Divisional review and acquisitions

Revenues from the DCI division fell by 13% to €32.6m while IAM fell 10% to €11.4m. The addition of the new DIG division through the acquisition of LYNET, helped to moderate the group decline to 8%. Licence sales fell in both the continuing divisions due to the renewal cycle, which overshadowed a rise in new business in both divisions. Maintenance revenue increased, mainly due to acquisitions and services revenue jumped due to strong business in the DCI segment and the acquisition of LYNET - c 60% of LYNETs revenues are services. Other activities mainly comprise third-party hardware and software solutions in connection to LYNET products.

The group made two acquisitions in the period – LYNET and AUCONET.

Beta acquired LYNET, effective from 1 January 2018, for €2m. LYNET is an IT services, website design and e-commerce business that has operated for 22 years. LYNET has a broadly diversified customer base in northern Germany comprised of more than 450 small and medium-sized enterprises as well as public and social institutions. In FY18, LYNET contributed €1.9m revenues and EBITDA of €0.5m for the nine-month period. LYNET is being managed as an independent company within the group and comprises the group's new DIG division.

Beta acquired the assets of the then AUCONET and the then AUCONET Technologies with effect from 31 January 2018 and 1 February 2018 respectively. The combined purchase price was €3m. AUCONET has been developing and selling IT operations management (IOM) software for more than 10 years, which complements Beta Systems' DCI product portfolio. In FY18, AUCONET contributed €1.1m revenues and an EBITDA loss of €1.1m for the eight-month period. AUCONET is budgeting for a small positive EBITDA in the FY18/19.

After the period-end, Beta acquired Categis for a nominal €1 with a further €125k payment expected in 2020. Categis is a small IT business based in Bad Brückenau, Bavaria, focused on medium-sized companies in the DACH region. Categis operates in two locations in India, via its Bangalore subsidiary, Categis Software. The primary objective of the acquisition is to access developer resources in India, in light of the challenging IT shortage of skilled workers in Germany.

Exhibit 4: Revenue breakdown (€m)

	2017			2018				Change		
	DCI	IAM	Total	DCI	IAM	DIG	Total	DCI	IAM	Total
Licence	16.3	2	18.3	10.0	1.7	0.0	11.8	(39%)	(13%)	(36%)
Maintenance	18.6	5.6	24.1	19.4	5.4	0.1	24.9	5%	(4%)	3%
Services	2.4	4.9	7.4	3.2	4.3	1.2	8.6	32%	(13%)	16%
Other sales	0	0	0	0.0	0.0	0.6	0.6	N/A	N/A	N/A
Total	**37.3**	**12.6**	**49.8**	**32.6**	**11.4**	**1.9**	**45.9**	**(13%)**	**(10%)**	**(8%)**

Source: Beta Systems

Balance sheet and cash flow

Despite the profit decline, cash generation was strong with operating cash flow rising by c 57% to €8.3m. This was due to a big swing in working capital, which predominantly relates to the upfront revenue recognition policy. The company repurchased 0.5m of its shares in July 2018 at €23 per share, which resulted in a cash outflow of €11.5m whereas the acquisitions of LYNET and AUCONET cost €5.1m. Consequently, net cash fell to €35.6m from €44.1m a year earlier. The group has no debt. The latest net cash number includes €30.1m on deposit (with a c six-month notice to draw) as part of its arrangement with its largest shareholder, Deutsche Balaton. Hence the group has ample finances available to support ongoing portfolio development and modernisation as well as acquisitions.

Management guidance

Licences tend to be renewed on a three- to five-year cycle and FY17 benefited from a high number of large value clients renewing. However, this does not affect cash flows as the bulk of revenues are on a recurring rental basis.

FY19 management guidance is for revenues of €46.5–49.5m, which implies c 5% growth at the mid-point, and for EBITDA of €6.3–8.3m, ie with margins of c 15%. The EBIT guidance is €4.5–6.5m; we note the difference between EBITDA and EBIT is most explained by amortisation of acquired intangibles. For FY20, the guidance is for moderate revenue and EBITDA growth. Management has a long-term goal to achieve an EBITDA margin of 15–20%.

Exhibit 5: Management's FY19e and FY20e guidance

€m	FY14	FY15	FY16	FY17	FY18	FY19e	FY20e
Revenues	33.8	41.6	46.4	49.8	45.9	46.5-49.5	moderate increase
Licences	7.6	10.4	14.5	18.3	11.8	11.5-12.5	
Maintenance	19.8	23	23.8	24.1	24.9	26-27	
Other	6.4	8.1	8	7.4	9.3	9-10	
EBITDA	-1.3	3.5	6.9	10.8	5.5	6.3-8.3	moderate increase
EBITDA margin	N/A	8%	15%	22%	12%	15%	
Liquidity	21.8	27.4	39	44.1	35.6		

Source: Company accounts

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas,
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia