Esker

H118 results

Combining growth with profitability

Software & comp services

Esker's H118 results confirmed strong revenue growth and profitability on a group basis, and 20% growth in SaaS-related revenues. The company's strategy of investing in the business to support future growth while maintaining mid-teens operating margins remains on track. Strong order intake and a high level of recurring revenues provide good support for our revenue growth forecasts.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/16	66.0	9.9	1.22	0.30	54.4	0.5
12/17	76.1	10.7	1.32	0.32	50.4	0.5
12/18e	85.4	13.5	1.68	0.36	39.4	0.5
12/19e	97.1	15.9	1.95	0.39	34.0	0.6

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

H1 results confirm progress in line with targets

Esker achieved 12.2% y-o-y revenue growth in H118 (+17% constant currency); SaaS-based DPA revenues grew 15.7% y-o-y (+20% constant currency). Operating profit increased 12.4% y-o-y to achieve a margin of 15.7%, despite a 13% increase in headcount over the year. Net cash at the end of H118 was €11.2m, up from €10.0m at the end of FY17. Orders received in H118 were 52% higher y-o-y; combined with the high level of recurring revenues (79%), this provides good visibility for future revenue growth. We have made minimal changes to our forecasts.

Targeting 20% growth in SaaS-related revenues

The company's target operating model is to grow group revenues by at least 10% pa while maintaining operating margins around the 15% level – any upside is reinvested in headcount to fuel further growth. SaaS-related revenues are growing in the region of 20% pa, partially offset by declining licence-based and legacy sales. As these revenue streams diminish in importance, the faster-growth SaaS business should have more influence over the group growth rate.

Valuation: Reflects SaaS business model

On a P/E basis, Esker continues to trade at a premium to global DPA software peers and French small-cap software peers. As SaaS-related revenues make up 87% of group revenues, we believe it is more relevant to consider US SaaS software companies: Esker trades at a discount on all valuation metrics. We view Esker's operating model as sitting somewhere between low-growth, high-profitability on-premise software businesses and US SaaS companies' high-growth, high-investment operating model, aiming for a happy medium of double-digit revenue growth while achieving mid-teen operating margins. In our view, high levels of recurring revenue, a strong balance sheet and a focus on investing to maintain growth warrant a premium valuation.

28 September 2018

Price	**€66.4**
Market cap	**€354m**
	$1.17:€1
Net cash (€m) at end H118	11.2
Shares in issue	5.3m
Free float	81%
Code	ALESK
Primary exchange	Euronext Growth Paris
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	11.3	10.8	36.5
Rel (local)	10.5	6.9	30.2
52-week high/low		€67.0	€48.3

Business description

Esker provides end-to-end document automation solutions, offering on-demand and on-premise delivery models. The business generates c 55% of revenues from Europe, c 40% from the US and the remainder from Asia and Australia.

Next events

Q3 revenue update	16 October

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Edison profile page

Esker is a research client of Edison Investment Research Limited

Investment summary

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 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 55% from Europe, 39% 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 on-boards customers, it is developing a network of partners to undertake implementation work.

Financials: Double-digit top-line growth, 15% operating margins

The company is targeting double-digit organic revenue growth (we forecast 12.2% for FY18 and 13.7% for FY19) and investment in headcount such that operating margins are maintained in the region of 15%. H118 results confirmed the company was on track to achieve this for FY18, with 17% constant currency revenue growth and operating margins of 15.7%. We have made minimal changes to our estimates and forecast net cash to increase to €22.6m by the end of FY19.

Valuation: Reflects SaaS business model

The stock has gained 37% over the last year 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. We note that most companies in both peer groups are not predominantly SaaS companies, whereas Esker has been operating a SaaS business model for more than a decade. Esker trades at a material discount to US SaaS companies on all valuation metrics; we note that on average they 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 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 will be 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. **Pace of adoption of SaaS solutions:** as more customers move to on-demand software, Esker will see a decline in on-premise licence sales in favour of subscription-based revenues. **Rate of decline of legacy business:** the legacy businesses are very profitable maintenance-revenue generators. The rate at which these businesses decline will have an impact on 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

Esker is a DPA software developer, specialising in moving business processes from paper-based to digital. The company made the transition to the SaaS delivery model earlier than many peers, and now the majority of revenues are generated from customers using its on-demand solutions.

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. Esker's revenues are well spread geographically, with 55% from Europe, 39% from North America, and the remainder from Australia and Asia.

Growth strategy: Broaden functionality, increase collaboration

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 in consulting and R&D 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.

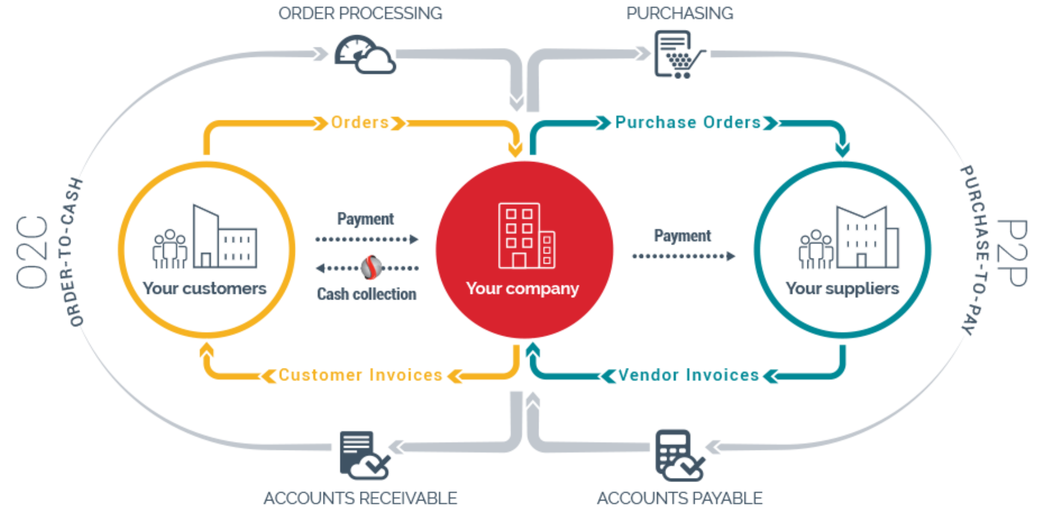
Well established management team headed up by founder

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 (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

Esker develops and sells DPA software operating in five areas: procurement, accounts payable, accounts receivable, sales order processing and document delivery. These can be combined to fulfil two basic cash cycles as per Exhibit 2: order-to-cash to fulfil customer orders and collect payment; and purchase-to-pay to order and pay for goods and services.

Exhibit 1: Esker's positioning



Source: Esker

Automating invoice and order delivery and receipt

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; this helps to train the software. 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 has certified integrations with the main ERP vendors, including SAP, Cegid, Oracle's E-Business Suite, JD Edwards EnterpriseOne, and Microsoft Dynamics NAV.

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 and is environmentally friendly.

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 are obliged to implement the 2014/55/EU directive by November 2018: 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	Hosted service, charged for monthly on basis of volumes. Also charge service revenues.
DeliveryWare platform	On-premise software plus maintenance and services.
FlyDoc	Simpler version of Esker on Demand, charged for in the same way; targeted at SMEs and individuals. Represents an electronic post office (automates fax sending/receipt, mail sending, archiving). Only in France and the US.

Source: Esker

Esker on Demand is Esker's main product. This multi-tenant, SaaS solution was originally developed by Esker in 2004, ahead of many other software companies' entry 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. Esker's longest-standing product is DeliveryWare, an on-premise solution. Typically, new business is for Esker on Demand, although some customers prefer to use the on-premise solution for security reasons. The company has more than 5,000 SaaS customers and 600,000 SaaS users.

Esker upgrades the Esker on Demand software every 15 days. Every three years, Esker takes the previous SaaS upgrades and incorporates them into one large upgrade of the DeliveryWare software. The software is hosted out of four data centres: two leased by Esker (France, US) and two Microsoft Azure facilities (Netherlands, Singapore).

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		Finance	
EDI	✓	Purchase orders	✓	Order processing	✓	Portals	✓	Payment	✓
Fax	✓	Customer invoices	✓	Accounts receivable	✓	Collaboration	O	Dynamic discounting	O
Email	✓	Supplier invoices	✓	Accounts payable	✓	Mobile app	✓	Reverse factoring	O
Mail	✓			Purchasing	✓	Business network	O	Factoring	O
SMS	✓								

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

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

- **Reducing complexity**: Esker continues to try to improve the software's ease of use. While this reduces the scope for implementation revenues, it leads to a shorter sales and integration cycle. This should make the product more attractive to customers and accelerate the start of traffic generation. It also makes it easier for channel partners to implement and resell the technology.
- **Extending the functionality of the P2P solution**: Esker is looking to add functionality to its purchase-to-pay offering, through a combination of in-house development and technology partnerships, and will focus its efforts on the functionality demanded by customers. It recently announced catalogue 'punch out' functionality. This 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. Contract management functionality is being added so that invoices and purchase orders can be linked to the related contract.
- **Collaboration:** the company's medium-term plan is to provide a business collaboration network and it is progressively adding functionality to achieve this. Currently, Esker provides a portal for each process and is encouraging the use of its portals by buyers and suppliers through providing functionality such as invoice status and chat. 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. The network should enable full visibility of invoice status (ie it should be possible for both supplier and buyer to see that an invoice has been approved for payment), at which point it should be possible to provide supply chain financing to either party.

- **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 decided to enter the market via partnerships. Last November, Esker launched a supply chain finance initiative in Singapore in partnership with Jing King Tech Group (JK Tech). JK Tech is a provider of payment solutions, transaction security and services to the banking industry. The joint venture will connect Esker's e-invoicing platform to a group of banking partners, including UOB, Singapore's second largest bank. Esker and JK Tech will market NEMO, a cloud-based supply chain finance solution to banking and financing partners in China and South East Asia. Having visibility into approved invoices gives finance providers a more efficient way of assessing the credit-worthiness of customers seeking finance. If this proves popular, Esker would look to extend this type of offering in other countries.

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 customers' accounts payable portals. It is applying **deep learning**, which requires access to a very high volume of documents, to a limited number of use cases. For example, it is applying deep learning to the classification of documents received in an email inbox. The software needs to be able not only to figure out which department a document is intended for, but also needs to be able to reject documents that are spam. The goal is to achieve an accuracy on a par with a human – this would then free up the software user to focus their attention on exceptions rather than routine email sorting.

As well as in-house product development and acquisitions of companies with relevant technology, Esker has started partnering to provide access to technology that augments its products. It recently partnered with Rimilia, a UK-based company with an SaaS-based product that provides automatic matching of cash receipts to invoices, for Esker's order-to-cash solution.

Sales strategy: Mainly direct with boost from JV

Esker has a direct sales presence in Europe (France, Germany, Italy, Spain and the UK), the US and Asia-Pacific (Australia, Malaysia and Singapore). The company recently opened an office in Hong Kong to support the Asia-Pacific market. 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. Both South America and Canada are serviced out of the US and Belgium out of France, although it is likely that staff will be hired in the relevant countries as the business grows. 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 then go on to use Esker for additional processes.

Adding external sources for consulting and implementation

To accelerate the pace at which it can sign up new customers, Esker is starting to build a network of channel partners. The company signed a partnership with Optima ECM Consulting in the US in January and with systems integrator Viveris in France in June. Ideally, these partners will start as implementation partners, but could end up as resellers. Management emphasised that the process of building out the network will take time, as even once partners are identified and signed up, their staff will need to be trained in the use of the software.

Joint venture with Neopost targets SMEs

Esker sold its software on a white-label basis through Neopost in France for several years and in 2015 entered into a joint venture (JV) with Neopost to expand the scope of this agreement. The JV (owned 70% Neopost/30% Esker) is focused on selling Esker’s software, marketed as Neotouch, to SMEs in France and the US, and is planning to launch in the UK by year-end. This is a market that Esker’s direct salesforce tends not to target. In FY17, Esker reported a €232k contribution from its share in the joint venture, and the joint venture generated c 6% of group sales.

Competitive positioning: Esker competes by process

Esker 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.

Esker 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 5,000 companies globally use Esker software, including BASF, GE Healthcare, Heineken, LVMH, Nvidia, Rockwell Automation, Samsung and Siemens. Esker has more than a decade’s experience in SaaS delivery and has achieved various SaaS certifications such as SSAE16, ISAE3402 and ISO27001, providing a level of confidence regarding business continuity and data security.

Accounts payable is the most competitive area – when Esker 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 Esker’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. Esker 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 Esker’s customers in many different non-standard formats such as faxes, emails, or within email attachments. This market has the fewest suppliers and Esker has a very high win rate. The newest area for Esker 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. Esker’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. Esker typically sells this solution to existing accounts payable customers to support the full purchase-to-payment cycle.

Exhibit 5 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.

Exhibit 4: Competitive environment – DPA software suppliers

Company	Accounts receivable	Sales order processing	Accounts payable	Purchasing
Esker	**x**	**X**	**x**	**x**
Basware	x		x	
Billtrust	x			
Conexiom		X		
Coupa				x
Determine				x
HighRadius	x			
ITESOFT			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.

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, Esker is able to introduce customers with the necessary volume of approved invoices to the networks.

Legacy Products (5% of FY17 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 chasing 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 Windows 2000/2003/XP 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$/€ 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.
- **Pace of adoption of SaaS solutions:** as customers move to on-demand software, Esker is seeing a decline in on-premise licences (which are recognised when the contract is signed) in favour of subscription-based revenues (which are recognised over the life of the contract). The pace at which customers make this move will influence revenue growth and profitability. The influence of on-premise licensing is reducing: in FY15 it made up 19% of revenues but had declined to 9% by H118.
- **Rate of decline of legacy businesses:** both the host access and fax server businesses 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 (only 4% in H118), 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: On-demand business is the driver

Exhibit 5: Revenues by business line and by type

€m	FY15	FY16	Growth	FY17	Growth	FY18e	Growth	FY19e	Growth
SaaS-related DPA revenues	41.8	50.9	22%	64.4	27%	75.0	17%	88.6	18%
License-based DPA revenues	11.1	10.7	-4%	8.1	-24%	7.0	-13%	5.6	-20%
Legacy products	5.5	4.4	-20%	3.6	-18%	3.3	-8%	2.9	-12%
Total	**58.4**	**66.0**	**13%**	**76.1**	**15%**	**85.4**	**12%**	**97.1**	**14%**
Traffic	36.6	43.4	18%	51.4	19%	60.4	17%	72.1	19%
Upgrades & maintenance	9.3	8.6	-7%	8.0	-7%	7.4	-8%	6.3	-15%
Services	8.7	10.6	22%	14.4	35%	15.9	11%	17.5	10%
New licenses	2.8	2.6	-8%	1.6	-37%	1.2	-25%	0.8	-35%
Fax card sales/hardware	0.9	0.7	-21%	0.6	-17%	0.5	-20%	0.4	-15%
Total	**58.5**	**66.0**		**76.1**		**85.4**		**97.1**	

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: traffic, maintenance fees, licence sales, hardware and services, on an annual basis. Traffic revenues are generated on a per-transaction basis from Esker on Demand and FlyDoc customers. Licence and maintenance fees are generated from DeliveryWare on-premise licence sales and the fax server and host access businesses. Hardware sales are generated by the fax server business. Service revenues are generated from on-premise and on-demand DPA business. Older DPA subscription sales were structured on a traffic-only basis, with service 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.

Targeting 20% growth in SaaS-related revenues

SaaS-related revenues (which include traffic and services revenues) have shown significant growth in recent years. On a like-for-like, constant currency basis, these grew 20% in FY16, 21% in FY17 and a further 20% in H118. At the same time, licence-based DPA revenues (licences, services and maintenance revenues) declined 3% in FY16, 23% in FY17 and gained 1% in H118, now making up only 9% of revenues. The company is targeting 20% growth for SaaS-related revenues and we expect a continuing decline in licence-based revenues, which will have a diminishing impact on overall revenues.

High level of recurring revenue provides good visibility

In H118, recurring revenues[1] made up 79% of the total, versus 78% in FY17 and 79% in FY16. 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 H118, the company won orders worth €8.2m (+52% 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 traffic fees, which can make up the same amount again over the three years.

Review of H118 results

Esker reported 12.2% y-o-y growth in revenues in H118 (17% on a constant currency basis). As previously highlighted, the company increased headcount in consulting and R&D, resulting in effectively flat operating margins on a year-on-year basis, with a 12.4% increase in operating profit. A shift from a small net financial expense to net financial income, as well as a higher contribution from the JV with Neopost (H118: €151k, H117: €67k) resulted in a 16.6% increase at the net income level.

Exhibit 6: Half-year results highlights

€m	H118	H117	YoY
Revenues	42.4	37.8	12.2%
EBITDA	9.8	8.8	11.8%
EBITDA margin	23.2%	23.3%	-0.10%
Reported operating profit	6.6	5.9	12.4%
Operating margin	15.7%	15.6%	0.03%
Reported net income	4.9	4.2	16.6%
Basic EPS (€)	0.91	0.80	14.1%
Diluted EPS (€)	0.85	0.75	13.3%
Net cash	11.2	6.3	75.9%

Source: Esker

Changes to forecasts

We have made minimal changes to our forecasts. We reflect H118 costs and slightly increase our capex assumptions for both years. We have also increased our FY19 revenue forecast to reflect strong SaaS-based revenue growth, which results in a 1.1% increase in normalised EPS.

[1] Traffic plus maintenance revenues.

Exhibit 7: Changes to estimates

€m	FY18e old	FY18e new	change	y-o-y	FY19e old	FY19e new	change	y-o-y
Revenues	85.4	85.4	0.0%	12.2%	95.5	97.1	1.7%	13.7%
EBITDA	19.6	19.6	0.2%	19.5%	22.1	22.5	1.7%	14.8%
EBITDA margin	22.9%	23.0%	0.1%	1.4%	23.2%	23.2%	0.0%	0.2%
Normalised EBIT	13.2	13.2	0.3%	25.1%	15.4	15.6	1.1%	18.2%
Normalised EBIT margin	15.4%	15.5%	0.1%	1.6%	16.2%	16.1%	-0.1%	0.6%
Reported EBIT	12.9	12.9	0.3%	31.7%	15.1	15.3	1.2%	18.6%
Reported EBIT margin	15.1%	15.1%	0.1%	2.2%	15.8%	15.8%	-0.1%	0.7%
Normalised PBT	13.5	13.5	0.3%	26.8%	15.8	15.9	1.1%	17.8%
Normalised net income	9.7	9.7	0.3%	33.8%	11.3	11.5	1.1%	17.8%
Normalised dil. EPS (€)	1.68	1.68	0.3%	28.0%	1.93	1.95	1.1%	15.8%
Reported basic EPS (€)	1.76	1.77	0.3%	38.4%	2.03	2.05	1.1%	16.0%
Net cash	16.0	15.5	-3.1%	54.5%	23.4	22.6	-3.5%	46.0%
DPS (€)	0.36	0.36	0.0%	12.5%	0.39	0.39	0.0%	8.3%

Source: Edison Investment Research

Currency impact

With 39% of revenues in the US but a lower proportion of the cost base in US dollars, the company is exposed to changes in the $/€ exchange rate. In our cost calculations, we use a rate of 1.20 for FY18 and 1.17 for FY19. Any further weakening of the dollar could have a material negative impact on our FY18 forecasts (as dollar-based revenues outweigh costs).

Strong cash position

The company ended H118 with a net cash position of €11.2m, up from €10.0m at the end of FY17. As well as paying the prior-year dividend, the company paid down €2.2m of debt. Gross cash was €22.7m at period end (including €3m recorded in fixed assets), providing ample funds for acquisitions. We forecast that net cash will increase to €15.5m by the end of FY18 and €22.6m by the end of FY19.

No change to capex trend

The company invests in tangible fixed assets for its mail centres and offices (c €2m a year) and capitalises development costs (€5.2m in FY17). In H118 it capitalised €3.0m of development costs and amortised €2.0m. We expect a gradual increase in both capitalisation and amortisation in FY18 and FY19 reflecting the growing R&D headcount.

Valuation

We have compared Esker's valuation to a group of listed global DPA software companies and to French-listed small-cap software companies (Exhibit 9). The stock gained 25% over the last year and continues to trade at a premium to both peer group averages on a P/E basis, in our view justified by revenue growth and operating margins at the upper end of both groups.

We note that most companies in both peer groups are not predominantly SaaS companies, whereas Esker has been operating a SaaS business model for more than a decade. The US SaaS companies in Exhibit 10 on average are growing faster than Esker, although 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 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	Rev growth		EBIT margin		EBITDA margin		EV/Sales		P/E	
		m	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
Esker	**€66.40**	**€353.8**	**12.2%**	**13.7%**	**15.5%**	**16.1%**	**23.0%**	**23.2%**	**4.0**	**3.5**	**39.4**	**34.0**
Software companies with DPA software offerings												
Basware	€ 34.50	€ 496.9	-5.0%	8.5%	-2.2%	-2.5%	10.5%	4.4%	3.6	3.3	N/A	N/A
Bottomline	$71.38	$3,029.5	8.5%	10.2%	19.1%	19.8%	24.4%	24.8%	7.1	6.5	49.2	42.8
Coupa	$79.49	$4,580.0	31.0%	24.3%	-0.8%	0.1%	2.1%	4.5%	17.6	14.2	N/A	1445.3
ITESoft	€ 3.80	€ 23.3	1.2%	0.8%	N/A	N/A	14.6%	14.4%	1.0	1.0	8.6	8.4
OpenText	$37.98	$10,168	3.4%	3.6%	34.2%	35.5%	37.1%	38.1%	4.2	4.0	13.9	12.7
Average			**7.8%**	**9.5%**	**12.6%**	**13.2%**	**17.7%**	**17.2%**	**6.7**	**5.8**	**23.9***	**21.3***
Median			**3.4%**	**8.5%**	**9.1%**	**9.9%**	**14.6%**	**14.4%**	**4.2**	**4.0**	**8.6***	**12.7***
French small-cap software companies												
Axway Software	€ 16.76	€ 356	-3.5%	1.5%	7.8%	7.9%	10.4%	10.1%	1.2	1.2	19.6	18.0
Claranova	€ 1.09	€ 429	46.9%	25.6%	7.6%	12.0%	8.2%	12.1%	1.5	1.2	36.3	16.8
ESI Group	€ 35.75	€ 215	5.7%	8.0%	5.3%	9.2%	8.6%	11.7%	1.7	1.6	53.5	26.1
Harvest	€ 81.00	€ 114	10.1%	10.7%	17.5%	19.1%	19.9%	22.0%	3.8	3.5	26.5	24.7
Lectra	€ 22.35	€ 711	3.9%	6.4%	13.7%	13.4%	16.6%	16.9%	2.2	2.0	24.2	22.3
Linedata Service	€ 38.15	€ 278	-3.4%	1.0%	16.6%	16.5%	27.6%	29.7%	2.1	2.0	14.2	13.9
Sidetrade	€ 63.00	€ 88	14.8%	17.7%	8.9%	12.0%	12.2%	15.3%	3.3	2.8	44.4	28.5
Average			**10.6%**	**10.1%**	**11.1%**	**12.9%**	**14.8%**	**16.8%**	**2.3**	**2.1**	**31.2**	**21.5**
Median			**5.7%**	**8.0%**	**8.9%**	**12.0%**	**12.2%**	**15.3%**	**2.1**	**2.0**	**26.5**	**22.3**

Source: Edison Investment Research, Bloomberg. Note: Priced at 26 September. *Excludes Basware and Coupa.

Exhibit 9: SaaS software company financial and valuation metrics

Name	Market cap (m)	EV in reporting currency (m)	Sales Growth CY (%)	Sales Growth NY (%)	EBITDA margin CY (%)	EBITDA margin NY (%)	EBIT margin CY (%)	EBIT margin NY (%)	EV/Revs CY (x)	EV/Revs NY (x)	PE CY (x)	PE NY (x)
Salesforce.com	120,383	120,466	25.8	20.4	24.1	24.4	16.8	17.8	9.1	7.6	63.7	58.4
Workday	31,302	29,394	29.2	25.1	15.4	17.9	9.5	12.8	10.6	8.5	132.9	95.3
Servicenow	35,186	34,262	34.6	29.0	25.6	27.8	19.9	22.3	13.2	10.2	85.2	63.4
Atlassian	22,429	21,345	32.4	26.5	26.7	27.6	19.9	20.7	18.5	14.6	123.3	100.2
Ultimate Software	10,024	9,900	20.9	19.1	24.2	24.8	21.1	21.5	8.7	7.3	59.0	49.5
Paycom Software	9,323	9,303	28.4	23.6	41.3	41.1	36.9	36.2	16.7	13.5	59.8	49.1
Twilio	8,641	8,169	47.6	26.9	4.2	5.3	0.2	1.8	13.9	10.9	2856.7	578.8
Okta	7,629	7,307	43.7	32.3	-13.7	-4.9			19.6	14.8	-147.4	-221.8
Zendesk	7,568	7,135	35.7	30.7	6.8	9.4	0.5	4.5	12.2	9.3	492.6	211.3
Proofpoint	5,491	5,555	37.4	27.5	14.6	15.8	9.3	12.7	7.8	6.2	91.4	63.4
Hubspot	5,926	5,640	32.8	24.7	8.9	10.9	5.2	7.5	11.3	9.1	234.3	146.6
Blackbaud	5,015	5,153	10.9	9.3	23.2	23.7	20.7	21.2	5.9	5.4	37.1	32.7
Coupa Software	4,580	4,317	31.0	24.3	2.1	4.5	-0.8	0.1	17.6	14.2	-1153.8	1447.5
Paylocity	4,299	4,158	19.9	20.6	28.2	29.7			9.2	7.6	60.4	49.4
Box	3,603	3,489	20.0	21.1	3.3	7.0	-3.5	-1.9	5.7	4.7	-137.8	344.6
Qualys	3,539	3,087	20.8	18.5	37.3	37.4	28.3	29.4	11.1	9.3	60.5	51.3
Cornerstone Ondemand	3,426	3,317	8.7	8.1	18.1	22.8	11.8	16.0	6.3	5.9	83.9	54.5
Fireeye	3,350	3,220	10.1	7.3	12.2	13.5	1.9	5.0	3.9	3.6	711.3	107.4
Mimecast	2,597	2,414	26.8	21.5	13.6	16.3	5.7	8.6	7.3	6.0	212.0	100.1
Kinaxis	2,447	1,727	17.2	22.1	27.6	29.5	12.9	13.9	11.1	9.1	73.5	53.1
Hortonworks	1,893	1,816	30.3	22.4	-11.2	-7.4	-14.7	-10.3	5.3	4.3	-39.3	-61.0
Apptio - class A	1,683	1,454	23.2	16.7	4.3	6.3	2.0	4.6	6.3	5.4	730.9	163.8
Liveperson	1,632	1,562	12.7	11.8	9.1	10.5			6.3	5.7	232.6	145.5
Upland Software	705	844	44.7	7.4	35.0	36.1			6.0	5.5	21.7	20.1
Average			26.9	20.7	15.9	17.9	10.2	12.2	10.1	8.3	321.1	181.2
Median			27.6	21.8	15.0	17.1	9.4	12.8	9.2	7.6	78.7	63.4

Source: Bloomberg. Note: Priced at 26 September.

Exhibit 10: Financial summary

	€'000s	2014	2015	2016	2017	2018e	2019e
Year end 31 December		French GAAP	French GAAP	French GAAP	French GAAP	French GAAP	French GAAP
PROFIT & LOSS							
Revenue		46,061	58,457	65,990	76,064	85,364	97,079
EBITDA		8,979	13,405	14,871	16,399	19,595	22,499
Operating Profit (before amort and except)		5,700	9,257	9,934	10,547	13,195	15,599
Amortisation of acquired intangibles		0	(302)	(200)	(300)	(300)	(300)
Exceptionals and other income		53	(245)	(474)	(456)	0	0
Other income		0	0	0	0	0	0
Operating Profit		5,753	8,710	9,260	9,791	12,895	15,299
Net Interest		220	(6)	(108)	(110)	100	100
Profit Before Tax (norm)		5,920	9,312	9,949	10,669	13,527	15,931
Profit Before Tax (FRS 3)		5,973	8,765	9,275	9,913	13,227	15,631
Tax		(1,323)	(2,292)	(2,950)	(3,148)	(3,703)	(4,377)
Profit After Tax (norm)		4,609	6,877	6,785	7,281	9,739	11,471
Profit After Tax (FRS 3)		4,650	6,473	6,325	6,765	9,523	11,255
Average Number of Shares Outstanding (m)		4.8	5.0	5.3	5.3	5.4	5.5
EPS - normalised (c)		97	138	128	138	181	209
EPS - normalised fully diluted (c)		90	131	122	132	168	195
EPS - (GAAP) (c)		97	130	120	128	177	205
Dividend per share (c)		24.00	30.00	30.00	32.00	36.00	39.00
Gross margin (%)		N/A	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)		19.5	22.9	22.5	21.6	23.0	23.2
Operating Margin (before GW and except) (%)		12.4	15.8	15.1	13.9	15.5	16.1
BALANCE SHEET							
Fixed Assets		12,552	25,184	28,324	37,912	39,140	39,986
Intangible Assets		7,709	19,603	22,381	26,673	28,201	29,447
Tangible Assets		4,470	4,985	5,158	7,115	6,815	6,415
Other		373	596	785	4,124	4,124	4,124
Current Assets		33,894	36,110	42,024	42,823	51,485	59,374
Stocks		93	161	101	176	176	176
Debtors		15,110	18,073	19,523	21,253	23,855	27,129
Cash		17,559	16,295	21,338	20,632	26,692	31,307
Other		1,132	1,581	1,062	762	762	762
Current Liabilities		(19,827)	(24,789)	(28,299)	(27,399)	(29,201)	(31,471)
Creditors		(19,827)	(24,789)	(28,299)	(27,399)	(29,201)	(31,471)
Short term borrowings		0	0	0	0	0	0
Long Term Liabilities		(5,113)	(7,317)	(7,657)	(13,716)	(11,216)	(8,716)
Long term borrowings		(5,113)	(7,317)	(7,657)	(13,716)	(11,216)	(8,716)
Other long term liabilities		0	0	0	0	0	0
Net Assets		21,506	29,188	34,392	39,620	50,209	59,172
CASH FLOW							
Operating Cash Flow		9,245	14,307	15,331	17,311	18,794	21,496
Net Interest		310	(27)	(127)	(75)	100	100
Tax		(1,075)	(1,165)	(1,456)	(2,053)	(3,703)	(4,377)
Capex		(4,028)	(3,909)	(7,021)	(9,304)	(7,928)	(8,045)
Acquisitions/disposals		22	(11,700)	(335)	(7,551)	0	0
Financing		(694)	1,324	480	(345)	0	0
Dividends		(877)	(1,208)	(1,550)	(1,633)	(1,798)	(2,059)
Net Cash Flow		2,903	(2,378)	5,322	(3,650)	5,465	7,115
Opening net debt/(cash)		(11,961)	(12,446)	(8,978)	(13,681)	(10,011)	(15,476)
HP finance leases initiated		(2,293)	(1,090)	(645)	0	0	0
Other		(125)	0	26	(20)	(0)	0
Closing net debt/(cash)		(12,446)	(8,978)	(13,681)	(10,011)	(15,476)	(22,591)

Source: Esker, Edison Investment Research

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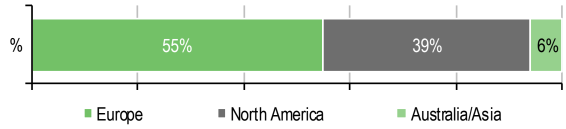
Revenue by geography



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	6.9
Thomas Wolfe	4.9
Credit Agricole	3.8
Wasatch Advisors	3.8
Financiere de l'Echiquier	2.9
Grandeur Peak Global Advisors	2.8
Danske Bank A/S	2.8
Treasury shares	2.8
BFT Investment Managers SA	2.6

Companies named in this report

Basware (BAS1V), Bottomline Technologies (EPAY), ITESOFT (ITE), OpenText (OTEX), Tungsten (TUNG)

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