EDISON **Scale research report - Update**

Beta Systems

Technology

28 May 2019

Guidance upgraded on German DCI activities

Beta Systems has been performing well, largely due to a strong performance from its core DCI mainframe software business. Consequently, in April, management upgraded FY19 guidance (revenue was upgraded by 4% and EBITDA by 27% at the mid-points) ahead of the interim results. While there has been a surprisingly strong level of orders in the group's core DCI business in Germany, the IAM business has been performing in line. 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%+).

H119 results: Operating cash flow jumps 21%

Revenue rose by 8% to €26.9m in H119, while EBITDA jumped by 15% to €6.9m, generating a margin of 25.7%. More importantly operating cash flow jumped by 21% to €10.6m. The bulk of licence revenue is recurring in nature and we note there is a mismatch between earnings and cash flow due to an accounting practice that recognises a new recurring style licence like a traditional up-front licence. Net cash jumped to €46.1m (including €26.3m on deposit) from €35.6m as at 30 September 2018. However, we note that the business is very H1-weighted with revenues and cash flow expected to be significantly weaker in H2.

Guidance: Upgraded in April

Management upgraded guidance in mid-April. FY19 management guidance is for revenues of €48.0–52.0m, which implies c 8.9% growth at the mid-point, and for EBITDA of €8.0–10.5m, implying margins of c 18.5% at the mid-point. The guidance upgrade was due to surprising orders in the DCI business in Germany.

Valuation: Modest valuation after adjusting for cash

After stripping out end-FY18 net cash of €35.6m, the group enterprise value is c €70m. Based on the mid-point of management's FY19 EBITDA guidance, this implies an EV/EBITDA ratio of a modest 7.5x. Longer-term guidance suggests EV/EBITDA could potentially fall below 6x in FY20 (eg 5% revenue growth and 20% top of range margins implies 6.6x EV/EBITDA, or 5.6x based on the end-H119 net cash position). 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	0.0	22.2	N/A
09/17	49.8	10.8	9.3	1.51	0.0	14.6	N/A
09/18	45.9	5.5	4.3	0.76	0.0	28.9	N/A

Source: Company accounts

Price	**€22.0**
Market cap	**€105m**

Share price graph

Share details

Code	BSS
Listing	Deutsche Börse Scale
Shares in issue	4.8m
Last reported net cash as at March 2019, including €26.3m on deposit	€46.1m

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 it 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.
- The strong orders indicate there remains life in the mainframe market.
- 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

H119 results: Strong orders for DCI mainframe software

Revenue rose by 8% to €26.9m in H119, while EBITDA jumped by 15% to €6.9m, generating a margin of 25.7%. More importantly operating cash flow jumped by 21% to €10.6m. We note that the business is very H1-weighted with revenues and cash flow expected to be significantly weaker in H2. The performance included full period contributions from LYNET and AUCONET, which were acquired in 2018. Revenues in DACH countries jumped by 17% to €19.9m, while in Western Europe, revenue surged by 30% to €3.4m.

The bulk of group software is sold on a rental basis and Beta recognises rental revenues on a similar basis to a traditional licence. This adds volatility to revenues and brings revenues forward compared with a cash flow model. The predominant rental model means that c 80%+ of group revenues are recurring (licences and maintenance), while much of the services revenues have a recurring feature, which would take the recurring revenues to more than 90% of the total.

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 in 2018. The DCI business has been performing particularly well with new business achieved from both existing and new clients. The strong new order situation was a surprise, resulting in the upgrade to guidance. The DCI market has long sales cycles and orders are typically between €0.1m and €3.0m. The strong order situation is a positive indication that there remains life in the mainframe market as big bank and insurance customers seek to optimise and modernise their equipment. There was particular interest in the new generation software product 'Symphony' for the intelligent data centre. The IAM business has been performing broadly in line with expectations. The three recent acquisitions have been successful integrated.

Licence revenues fell, as weakness in 'other Europe' and North America segments over-shone slightly stronger results in the DACH region and Western Europe. Maintenance and services made solid gains helped by the inclusion of LYNET. Other activities mainly reflects third-party product sales of LYNET.

Net cash jumped to €46.1m (including €26.3m on deposit at Deutsche Balaton, Beta's largest shareholder) from €35.6m as at 30 September 2018. The company received €3.8m back from Deutsche Balaton during the period. The company typically holds between €25m and €35m at Deutsche Balaton where it achieves attractive interest rates on its deposits, occasionally in special projects yielding 3–4%, but more typically at c 1%.

Exhibit 1: Revenue breakdown

€m	FY17	FY18	H118	H119	Change (%)
Licence	18.3	11.8	8.6	8.3	-3.3
Maintenance	24.1	24.9	12.0	13.5	12.1
Services	7.4	8.6	4.1	4.7	13.3
Other activities	0.0	0.6	0.2	0.4	117.2
Sales revenues	49.8	45.9	25.0	26.9	7.8

Source: Beta Systems

Guidance upgraded on core German DCI activities

FY19 management revenue guidance has been increased to a range of €48.0–52.0m, which implies c 8.9% growth at the mid-point, and for EBITDA of €8.0–10.5m. The guidance increase reflects stronger sales and stable costs. This translates to a margin of c 18.5% at the mid-points which makes management's long-term goal of 15–20% EBITDA margins look potentially very conservative. The EBIT guidance is €6.0–8.5m (previously €4.5–6.5m); we note that the difference between EBITDA and EBIT is mostly explained by amortisation of intangibles resulting from purchase price allocations according to IFRS.

Exhibit 2: Management's revised FY19e guidance

€m	FY14	FY15	FY16	FY17	FY18	FY19e (old)	FY19e(new)
Revenues	33.8	41.6	46.4	49.8	45.9	46.5–49.5	48.0–52.0
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	8.0–10.5
EBITDA margin	N/A	8%	15%	22%	12%	15%	
Liquidity	21.8	27.4	39	44.1	35.6		

Source: Company accounts and announcements