

GAMMA COMMUNICATIONS

SOFTWARE AND COMPUTER SERVICES

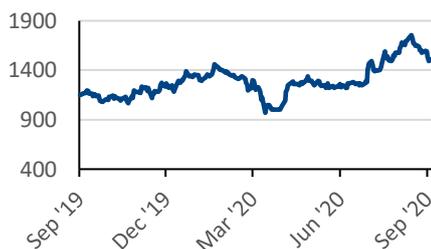
8 September 2020

GAMA.L

1510p

Market Cap: £1431.2m

SHARE PRICE (p)



12m high/low 1,755p/970p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£37.7m (at 30/06/20)
Enterprise value	£1406.1m
Index/market	AIM
Next news	Interims, Sep 2020
Shares in Issue (m)	94.8
Chairman	Richard Last
Chief Executive	Andrew Taylor
Finance Director	Andrew Belshaw

COMPANY DESCRIPTION

Gamma provides a broad range of communications products and services in the UK and Europe

www.gamma.co.uk

GAMMA COMMUNICATIONS IS A RESEARCH CLIENT OF PROGRESSIVE

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Resilience, growth and opportunity

Gamma has delivered this morning another strong set of results for H1 to June. Despite the COVID-19 challenges, the business has grown organically, and the acquisition programme is delivering well on its promise of European expansion. The group is positioned well to build revenues on and around Microsoft Teams, which is clearly benefiting from the work-from-home trend. We raise our profit estimates for all three forecast years as a sign of confidence in ongoing growth and look forward to further strong performance (and potentially even further M&A) into H2 and beyond.

- H1 financial performance** Revenue was some £177m, up 12% from the prior year (of this 9% was organic and the balance acquisitions, almost entirely the expanding European platform). Adjusted EBITDA also grew strongly (up 19% to £36.1m) and the end-June cash position was £42.5m, down from £53.9m at December 2019, after payments of some £21.5m relating to acquisitions in this and prior periods.
- Operational strength and European platform** In the UK, the group now has 1.1m SIP Trunks in the UK (up 8%) with Cloud PBX Horizon users up 7% in the six months to 560k. The Overseas business (Europe) continues to evolve through acquisition, and now boasts a total of 65,000 Cloud PBX users.
- COVID-19** The business appears to have weathered the COVID-19 pressures well; unsurprising given the installed base and the mission-critical nature of telephony and data. Nevertheless, it is pleasing to see both retention of existing customers and the ongoing winning of new business. The statement describes “net additions return[ing] to pre-COVID levels” and notes no material change to churn or bad debt. The “hibernation” scheme cost the business some £1.2m in H1, and ended at the end of the period.
- Forecast upgrades** Given the upbeat commentary and the clear strength of H1 performance, we upgrade our estimates by 1.7% at the Adjusted EBITDA level for both 2020E and 2021E, with a slightly smaller upgrade for 2022E. See the table overleaf for further detail.

Overall this is a very strong performance from Gamma, demonstrating genuine resilience during COVID-19 and a strong degree of ongoing growth in both the UK and European markets, with plenty of potential remaining in both geographies.

FYE DEC (£M)	2018	2019	2020E	2021E	2022E
Revenue	284.9	328.9	382.7	431.4	459.2
Adjusted EBITDA	48.3	63.5	74.9	82.0	89.2
Adjusted PBT	34.8	48.0	58.6	63.3	69.1
Adjusted EPS	30.3	40.8	49.8	53.7	58.7
EV/Sales (x)	4.9x	4.3x	3.7x	3.3x	3.1x
EV/ Adj. EBITDA (x)	29.1x	22.1x	18.8x	17.1x	15.8x
P/E (x)	49.9x	37.0x	30.3x	28.1x	25.7x

Source: Company Information and Progressive Equity Research estimates

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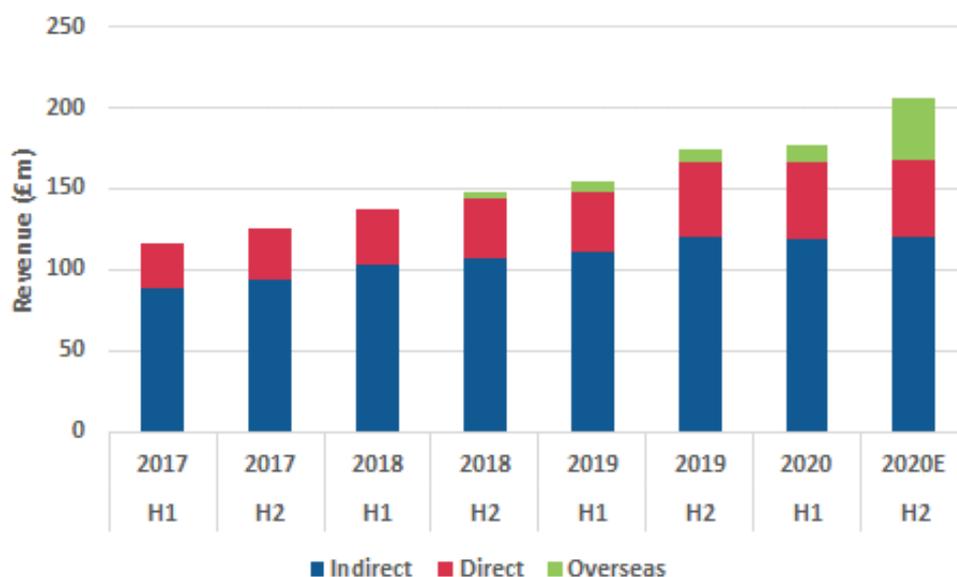
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Geographic performance

Gamma has once again delivered a strong performance, with figures that justify a modest upgrade to estimates. We believe that most investors accept that the group is highly competent in maintaining gross margins, controlling overheads and converting EBITDA into cash (and from there, dividends) – so the main area of interest is revenue and the ability of the group to sustain a good level of growth in the UK market as it matures, and to replicate its UK success in Continental Europe.

The chart below demonstrates, in our view, the resilience and dependability of the revenue performance over recent periods, showing both the reliability of the UK business and the fast-start growth in Europe. Clearly part of this is driven by acquisition, but the effect is to deliver a more balanced group with a degree of geographic diversification. The growth achieved in H1 2020 is shown with a degree of context, and we believe that our expectation for H2 2020 appears credible for the same reasons...the big jump in Overseas sales reflects the full-six-months contributions from the already-announced deals

REVENUE BY HALF-YEAR – DEMONSTRATING RESILIENCE, GROWTH AND EUROPEAN EXPANSION



Source: Company information

Acquisitions

The group continues apace with its acquisition programme, mainly targeted at rapidly expanding its European operations, but with smaller tactical acquisitions such as Exactive to add specific product knowhow and expertise.

The only obvious “gap” in the geographic reach into Europe is now France, with all of the other major countries now all covered by at least one acquisition. Given the number of deals announced in the last few months, we would not be surprised to see the pace of acquisition slow slightly across H2, but would expect the business to continue its growth, both adding new countries to the map and bolstering its early positions in certain locations.

Microsoft Teams opportunity

The Exactive acquisition, although relatively small, has allowed Gamma to rapidly build a direct customer base for connecting the MS Teams product to pre-existing telephony infrastructure. This allows customers – mainly Enterprise in scale – to make and receive calls within the Microsoft Teams platform.

Early successes include Metro Bank, Fraser Nash and Baillie Gifford, and although Exactive has probably been held back from some of its deployment activity during the recent lockdowns, the business seems extremely well placed to benefit from the significant numbers of organisations migrating to Microsoft Teams for collaboration in an increasingly work-from-home environment. These organisations would like to be able to manage their telephony needs from “within” Microsoft, and although Microsoft itself does offer calling plans, these are seen as expensive and Microsoft does not have a strong reputation for customer support and/or local telco knowhow.

Gamma has also launched a MS Teams Direct Routing product which allows channel partners to use Gamma’s SIP capability to assist end users to take advantage of Teams.

Changes to estimates and achievability of FY20 estimates

The table below details our forecast changes, driven largely by the strength of profit growth in the H1 period. We leave sales estimates unaltered, but the group is clearly delivering ahead of our expectations in terms of gross and EBITDA margin, so we upgrade our profit expectations by some £1.3m (1.7%) for 2020E, and a similar amount for 2021 with a slightly smaller upgrade for 2022. We have, following the H1 figures, slightly increased our expectations for depreciation costs, which explains the more-muted upgrade at the EPS level.

CHANGES TO ESTIMATES

£m unless stated	FY20E			FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenue	382.7	382.7	0.0%	431.4	431.4	0.0%	459.2	459.2	0.0%
Adj EBITDA	73.6	74.9	1.7%	80.7	82.0	1.7%	88.1	89.2	1.1%
Fully adj PBT	58.2	58.6	0.5%	62.9	63.3	0.6%	68.6	69.1	0.7%
Fully adj. Dil. EPS (p)	49.5	49.8	0.5%	53.4	53.7	0.6%	58.3	58.7	0.7%

Source: Progressive Equity Research Limited

Our FY2020E estimate for Adjusted EBITDA is now (following the upgrade) £74.9m. Doubling the H1 performance of £36.1m and adding c.£2.5m for the additional contribution in H2 from acquisitions during H1 and the early part of H2 would reach a figure of £74.7m. This suggests that even without any material “organic” growth in EBITDA, the company should still be able to reach our (and likely consensus) estimates. Even a modest level of organic H2 EBITDA growth (bearing in mind that H1 organic sales growth was some 9%) would therefore be likely to offer the potential for upgrades to estimates. This position clearly drives a significant reduction in forecast risk, although given the COVID-19 situation and other macro uncertainty, we believe that upgrading further at this point would be imprudent.

Financial Summary: Gamma Communications

Year end: December (£m unless shown)

	2018	2019	2020E	2021E	2022E
PROFIT & LOSS					
Revenue	284.9	328.9	382.7	431.4	459.2
Adj EBITDA	48.3	63.5	74.9	82.0	89.2
Adj EBIT	34.4	46.4	56.2	61.4	67.2
Reported PBT	34.6	45.2	56.7	61.4	67.2
Fully adj PBT	34.8	48.0	58.6	63.3	69.1
NOPAT	28.7	39.2	47.1	63.3	69.1
Reported EPS	30.1	36.1	47.8	51.8	56.7
Fully adj EPS	30.3	40.8	49.8	53.7	58.7
Dividend per share	9.3	10.5	11.6	12.6	13.8
CASH FLOW & BALANCE SHEET					
Operating cash flow	40.6	54.0	58.5	64.1	72.9
Free Cash flow	23.8	32.3	33.8	38.4	46.4
FCF per share	25.1	33.8	35.2	40.0	48.4
Acquisitions	(11.1)	(7.5)	(47.4)	(6.6)	(3.6)
Disposals	0.0	0.0	0.9	0.0	0.0
Shares issued	0.0	2.0	0.0	0.0	0.0
Net cash flow	3.9	18.4	(23.0)	20.6	30.6
Overdrafts / borrowings	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	35.5	53.9	30.9	51.5	82.1
Net (Debt)/Cash	35.5	53.9	30.9	51.5	82.1
NAV AND RETURNS					
Net asset value	121.7	152.5	188.1	226.4	268.3
NAV/share	129.5	160.9	198.5	238.8	283.1
Net Tangible Asset Value	83.7	115.1	111.0	147.0	186.9
NTAV/share	89.1	121.4	117.1	155.1	197.2
Average equity	108.5	137.1	170.3	207.3	247.6
Post-tax ROE (%)	26.3%	25.2%	27.0%	24.0%	22.0%
METRICS					
Revenue growth	17.7%	15.4%	16.3%	12.7%	6.4%
Adj EBITDA growth	34.2%	31.5%	17.9%	9.5%	8.7%
Adj EBIT growth	34.4%	34.9%	21.2%	9.1%	9.5%
Adj PBT growth	32.8%	37.9%	22.0%	8.0%	9.2%
Adj EPS growth	31.2%	34.7%	22.0%	8.0%	9.1%
Dividend growth	10.7%	12.9%	10.0%	9.1%	9.1%
Adj EBIT margins	12.1%	14.1%	14.7%	14.2%	14.6%
VALUATION					
EV/Sales	4.9	4.3	3.7	3.3	3.1
EV/EBITDA	29.1	22.1	18.8	17.1	15.8
EV/NOPAT	49.0	35.8	29.9	22.2	20.4
PER	49.9	37.0	30.3	28.1	25.7
Dividend yield	0.6%	0.7%	0.8%	0.8%	0.9%
FCF yield	1.7%	2.2%	2.3%	2.7%	3.2%

Source: Company information and Progressive Equity Research estimates

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