PROACTIS

SOFTWARE AND COMPUTER SERVICES

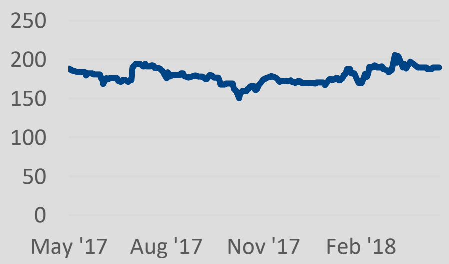
24 April 2018

PHD.L

185.5p

Market Cap: £180.7m

SHARE PRICE (p)



12m high/low	206p/150p

Source: LSE Data

KEY INFORMATION

Enterprise value	£207m
Index/market	AIM
Next news	Final results – Oct 2018
Gearing	14.6%
Interest cover	11.2x

PROACTIS IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

Gareth Evans

+44 (0) 20 7781 5301

gevans@progressive-research.com

Dan Gardiner

+44 (0) 20 7781 5303

dgardiner@progressive-research.com

H1 solid but short-term headwinds building

With headline figures already disclosed (see *Doubling and Delivering*, Feb '18), investors are likely to focus on the additional operational detail provided and the outlook commentary in today's results. Constant currency performance at Perfect was healthy, synergies are on track and PROACTIS is signing record numbers of new customers. However, strengthening Sterling and customer losses suggest a slower H2 than we were previously anticipating. We reduce our FY18 and FY19 Adjusted EPS forecasts by 18% and 22% respectively.

- **Encouraging KPIs highlight that the sales engine is still firing.** Headline constant currency organic growth of 3% in H1 does not tell the full story…with 35 new customers and £4.5m in initial contract value, new order intake was at record levels. The mix of business was good with nearly 90% of deals long-term SaaS contracts and the proportion of (higher margin) direct business also up. Notwithstanding the specific customer issues (see page 2), 46 upgrade deals in 1H suggests overall retention and upselling activity was healthy.
- **Perfect Performance.** The commentary highlights a good performance at Perfect (sales of £13.4m were in-line with expectations and profit was ahead). Overall group synergy targets of £3.0m in FY18 and £5m are on track, with a run-rate of £4.2m achieved to date; however ongoing strengthening of Sterling will impact reported performance in H2.
- **Consolidating Supplier Side Initiatives.** PROACTIS disclosed supplier side revenue of for the first time (£4.7m) and indicated it will consolidate its supplier side initiatives on The Business Network (TBN) software platform it acquired through Perfect. This will delay Accelerated Payment Facility (APF) uptake but should ensure the synergies with its other supplier side businesses are maximised.
- **Cautious H2 outlook leads to forecast changes.** The combination of strengthening Sterling, some customer losses, delays to APF roll-out and a cautious outlook on current order uptake leads us to lower our FY18 revenue forecast by £4.2m, or 7% (see page 2). With almost all of this foregone revenue falling to the bottom line our FY18 EBITDA forecast falls by £3.6m or 18%, and Adjusted EPS by 18%.

The reductions in revenues and EBITDA are disappointing, but the long term opportunity for PROACTIS remains attractive in our view (see *Going For Scale*, Jan '18). Currency headwinds are likely to abate, and the growth prospects for a supplier side business should ensure above average growth in a consolidating market over time.

FYE JUL (£M)	2015	2016	2017	2018E	2019E
Revenue	17.2	19.4	25.4	56.4	59.7
Adj EBITDA	4.7	5.3	7.9	16.5	19.3
Fully Adj PBT	2.8	3.1	5.2	10.2	13.2
Fully Adj EPS (p)	5.8	7.0	8.7	8.9	11.6
EV/Sales (x)	12.0	10.7	8.1	3.7	3.5
EV/EBITDA (x)	44.1	39.1	26.2	12.5	10.7
PER (x)	32.1	26.3	21.2	20.8	16.1

Source: Company Information and Progressive Equity Research estimates

Solid H1 Performance

PROACTIS' acquisition of Perfect Commerce saw revenue more than double year on year to £26.4m, EBITDA nearly treble to £8.4m and Adjusted EPS up 20% to 5.4p.

This M&A activity could have proved a distraction, but during the period customer sign-up activity was very healthy with 35 new customers added and £4.5m in initial contract value signed – a record period.

Management indicated the performance of Perfect had been impacted by currency but even despite this, sales of £13.4m were in line with our expectations and the company has already achieved annualised cost savings of £4.2m, closing in on the £5m target which appears achievable.

The high proportion of direct business in H1 also saw gross margins tick up to nearly 88%, again a good driver of long-term value.

Overall, the H1 FY18 result appears to be on track, with a strong execution of the Perfect integration, and with the business seemingly delivering on multiple fronts.

Changes to estimates

Heading into H2 FY18, the company is facing four headwinds that we believe will impact its financial performance.

In isolation any of these issues could have been managed without a significant impact on the business. Together, they lead us to adopt a more cautious view of the 2018 (and 2019) outcome:

- Firstly, the recent strengthening and apparent ongoing strength of Sterling relative to the US Dollar and other currencies will impact the translated value of the c.55% of the group's revenue now generated internationally.
- Secondly, the company indicates that it lost several large customers towards the end of the period; no specific reasons are given, although we believe these to be relatively isolated and unusual cases, without any generic theme or concerning read-across.
- Thirdly, the rate of new client wins in Q3 suggests a degree of caution may be warranted around the run-rate through to the end of the year. Nothing dramatic has been seen, but some of the win-rates are at the lower end of their long-term average channels.
- Finally, PROACTIS has elected to standardise its supplier-based platform onto The Business Network (TBN) technology, rather than push to roll out the PROACTIS platform. While this may prove a valuable long-term choice (keeping development costs lower and offering a superior solution) the short term impact is to delay any material revenues from the supplier platform and the associated Accelerated Payment Facility, probably for several months.

The combination of these four forces, and the relatively "late in the year" impact of their coincidence, makes it very difficult for the group to materially alter its costs base to reflect the changes.

The changes to estimates are shown in the table below – essentially a £4.2m reduction to sales expectations in FY18E, almost all of which is transferred directly to an EBITDA reduction, with a consequent impact on EPS (albeit slightly mitigated by assumptions around a slightly lower tax rate based on H1 results). For FY19E, the reduction to EBITDA is of a similar scale. We would note that most of the difficulties are transient in nature, and should therefore hopefully abate relatively quickly.

CHANGES TO ESTIMATES

	FY18E			FY19E		
£m unless stated	**Old**	**New**	**Change (%)**	**Old**	**New**	**Change (%)**
Revenue	60.6	56.4	-7%	66.7	59.7	-10%
Adj EBITDA	20.1	16.5	-18%	24.2	19.3	-20%
Fully adj PBT	13.8	10.2	-26%	18.1	13.2	-27%
Fully adj EPS (p)	10.9	8.9	-18%	14.8	11.6	-22%

Source: Progressive Equity Research

Strategic position remains strong

Finally, we would highlight that the group continues to enjoy a strong position in the global market for supply chain software – PROACTIS has executed a strategically bold, but well-positioned acquisition in Perfect Commerce. Delivery of the synergy targets is on track, and even without the acquisition, most of the four "challenge" areas would be causing difficulties at this time, but the group would not have the benefit of scale and reach with which to counter.

Financial Summary: PROACTIS

Year end: July (£m unless shown)

PROFIT & LOSS	**2015**	**2016**	**2017**	**2018E**	**2019E**
Revenue	17.2	19.4	25.4	56.4	59.7
Adj EBITDA	4.7	5.3	7.9	16.5	19.3
Adj EBIT	2.9	3.2	5.3	11.2	14.0
Reported PBT	1.5	1.8	(2.7)	5.7	11.2
Fully Adj PBT	2.8	3.1	5.2	10.2	13.2
NOPAT	3.4	3.9	6.4	13.4	16.9
Reported EPS (p)	4.9	5.9	(5.6)	5.0	9.8
Fully Adj EPS (p)	5.8	7.0	8.7	8.9	11.6
Dividend per share (p)	1.2	1.3	1.4	1.5	1.6
CASH FLOW & BALANCE SHEET	**2015**	**2016**	**2017**	**2018E**	**2019E**
Operating cash flow	3.4	5.4	5.6	14.3	18.1
Free Cash flow	0.8	2.2	1.4	7.2	9.4
FCF per share (p)	1.9	5.1	2.9	7.4	9.7
Acquisitions	(1.1)	(4.4)	(14.3)	(97.6)	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.2	0.2	12.7	65.0	0.0
Net cash flow	(0.1)	(2.0)	(0.4)	(25.4)	9.4
Overdrafts / borrowings	(1.9)	(4.0)	(5.2)	(26.3)	(26.3)
Cash & equivalents	3.4	3.6	4.3	0.0	9.4
Net (Debt)/Cash	1.5	(0.5)	(0.9)	(26.3)	(16.9)
NAV AND RETURNS	**2015**	**2016**	**2017**	**2018E**	**2019E**
Net asset value	11.5	13.0	22.5	26.7	35.5
NAV/share (p)	29.4	32.6	45.9	54.4	72.3
Net Tangible Asset Value	(5.1)	(8.6)	(16.1)	(13.3)	(6.5)
NTAV/share (p)	(13.2)	(21.7)	(32.7)	(27.1)	(13.2)
Average equity	10.5	12.2	17.8	24.6	31.1
Post-tax ROE (%)	19.2%	20.3%	(15.3%)	19.7%	30.7%
METRICS	**2015**	**2016**	**2017**	**2018E**	**2019E**
Revenue growth	69.6%	12.5%	31.1%	122.0%	5.9%
Adj EBITDA growth	129.6%	12.8%	49.4%	108.9%	17.2%
Adj EBIT growth	191.9%	14.2%	69.9%	111.0%	30.8%
Adj PBT growth	153.2%	11.8%	64.6%	97.8%	29.8%
Adj EPS growth	121.0%	22.1%	23.9%	1.9%	29.8%
Dividend growth	9.1%	8.3%	7.7%	7.1%	6.7%
Adj EBIT margins	16.6%	16.6%	20.9%	19.9%	23.5%
VALUATION	**2015**	**2016**	**2017**	**2018E**	**2019E**
EV/Sales (x)	12.0	10.7	8.1	3.7	3.5
EV/EBITDA (x)	44.1	39.1	26.2	12.5	10.7
EV/NOPAT (x)	61.3	53.6	32.5	15.4	12.3
PER (x)	32.1	26.3	21.2	20.8	16.1
Dividend yield	0.6%	0.7%	0.8%	0.8%	0.9%
FCF yield	1.0%	2.8%	1.5%	4.0%	5.2%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

 PERL provides professional equity research services, and the companies researched pay a fee in order for this research to be made available. This report has been commissioned by the subject company and prepared and issued by PERL for publication in the United Kingdom only. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable; however, PERL does not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of PERL at the time of publication, and any estimates are those of PERL and not of the companies concerned unless specifically sourced otherwise. PERL is authorised and regulated by the Financial Conduct Authority (FCA) of the United Kingdom (registration number 697355).

This document is provided for information purposes only, and is not a solicitation or inducement to buy, sell, subscribe, or underwrite securities or units. Investors should seek advice from an Independent Financial Adviser or regulated stockbroker before making any investment decisions. PERL does not make investment recommendations. Any valuation given in a research note is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. PERL does not undertake to provide updates to any opinions or views expressed in this document.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom. It has not been prepared in accordance with the legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research.

PERL does not hold any positions in the securities mentioned in this report. However, PERL's directors, officers, employees and contractors may have a position in any or related securities mentioned in this report. PERL or its affiliates may perform services or solicit business from any of the companies mentioned in this report.

The value of securities mentioned in this report can fall as well as rise and may be subject to large and sudden swings. In addition, the level of marketability of the shares mentioned in this report may result in significant trading spreads and sometimes may lead to difficulties in opening and/or closing positions. It may be difficult to obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance.