PROGRESSIVE EQUITY RESEARCH

12 October 2017

PROACTIS

SOFTWARE AND COMPUTER SERVICES

PHD.L

163p

Market Cap: £152m

SHARE PRICE (p)

12m high/low	198p/124p

Source: LSE Data

KEY INFORMATION

Enterprise value	£164m
Index/market	FTSE AIM
Next news	Trading Update, Feb '18
Gearing	10%
Interest cover	5.1x (FY18E)

PROACTIS IS A RESEARCH CLIENT OF PROGRESSIVE

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Setting the Stage

Full year results confirm PROACTIS' healthy financial performance continues. Against a backdrop of excellent deal volumes, gross margins improved sharply and underlying cash generation was strong. More importantly these results set the stage for the next act in the story. The Perfect acquisition transforms the company into a global player, doubling its size, expanding the product portfolio and broadening the customer base. It is this deal that will drive financial performance in FY18 and beyond. The company confirms its synergy targets and we leave our FY2018E forecast largely unchanged.

- Against a backdrop of significant strategic progress during the year, and with headline numbers (revenue and EBITDA) already disclosed, our focus within the full year results was on underlying performance. Organic revenue growth accelerated to 9% in FY17 (from 7% in FY16) backed by excellent deal volumes (54 new name deals and 110 upsell deals to existing customers). Gross margins ticked up to 86%, implying 87% in H2, driven by the consolidation of Millstream (see Figure 1). Free cashflow was £2m despite exceptional charges.
- Millstream appears to be bedding in nicely, with a pro-rata revenue contribution of £5m and adjusted EBITA margins approaching 45%, double the group average and better than our expectations (despite the company delaying some integration measures). On a smaller scale, disclosure of a £0.5m EBITA contribution from DueNorth, was also better than expectations. The exceptional profitability of these acquisitions post consolidation highlights the value created by PROACTIS' acquisition-driven strategy (see Figure 2).
- Consolidated just four days after the end of FY17, Perfect will be the driver of FY18 growth. No update on its financial performance was given but the £55m pro-rata revenue base of the enlarged group and FY18 acquisition synergy targets (£2.5m delivered and £5m on a run-rate basis) were confirmed. The company intends to give a fuller update on for the combined business at the interim results in April 2018.
- We leave our financial forecasts largely unchanged. Our FY18 revenue estimate of £60.5m implies 10% growth from the pro-forma base.
- We aim to publish a more detailed analysis of the Perfect deal, its strategic rationale and the benefits generated by a material increase in scale in due course. Clearly this will be the main driver of financial performance in FY18 and beyond. Nevertheless, these results provide reassurance that the underlying organic performance is on track.

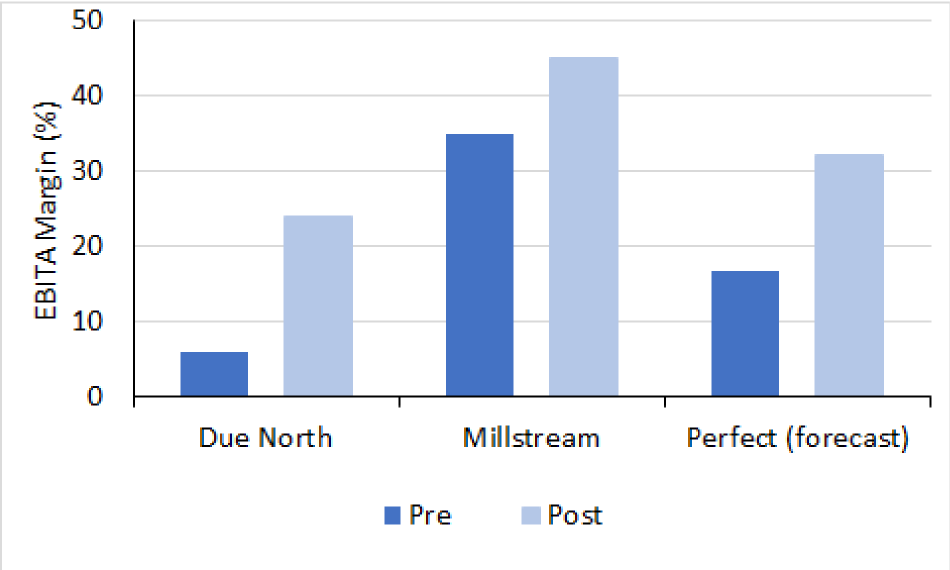
Y/E JULY	FY-15A	FY-16A	FY-17A	FY-18E	FY-19E
Revenue	17.2	19.4	25.4	60.5	66.2
Adjusted EBITDA	4.8	5.3	7.9	20.0	23.8
Adjusted EBIT	2.9	3.2	5.2	14.7	18.5
Adjusted EPS (p)	5.8	7.0	8.6	10.8	14.5
EV/Adj. EBITDA	35.8x	32.5x	21.9x	8.6x	7.2x
EV/Adj. EBIT	60.0x	53.5x	32.8x	11.7x	9.3x
P/E	28.0x	23.0x	18.8x	15.0x	11.2x

Source: Company Information and Progressive Equity Research estimates

Profitability of Acquisitions

The disclosure of the profit contribution from Due North and Millstream deals highlights the value created by PROACTIS' acquisition strategy. At the time of acquisition these businesses reported margins of 6% and ~35% respectively. As Figure 1 highlights, the period post-consolidation has seen profitability improve sharply; both are now reporting margins substantially ahead of the core business. While it is not strictly correct to look at the profitability of these acquisitions in isolation – it is only in combination with the group that these synergies are possible – as investors look to the potential benefits of the much larger Perfect acquisition, it highlights the value that scale and excellent execution can generate.

Figure 1: Benefits of Consolidation on Target Margins



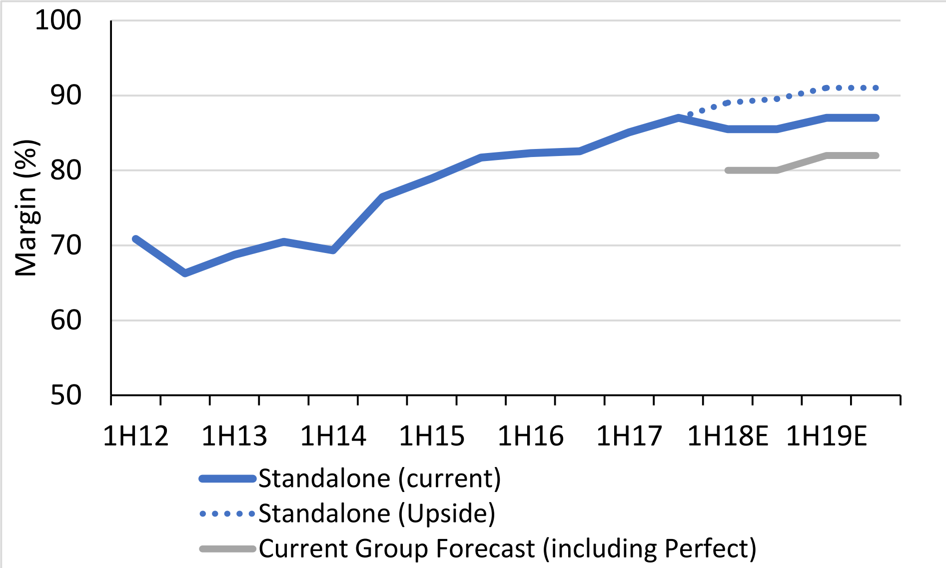
Source: Company Data, Progressive Research.

Gross Margin Trajectory

In our note *"PROACTIS: Execution engine" (April 2017)* we highlighted the steady improvement in gross margins driven by the shift towards more direct business and a rising proportion of SaaS deals. The consolidation of Millstream has accelerated this trend. Backing out H1 FY17 results from the full year numbers suggest that gross margins improved to 87% in H2 FY17, up over 4ppts yoy and above our forecast again.

With estimated gross margins of 76%, the consolidation of Perfect is expected to dilute group gross margins in FY18. Nevertheless, our forecast of 85% margins for the original PROACTIS business now implies that run rate profitability declines. While we make no changes to forecasts at present, with the proportion of SaaS deals rising, this assumption looks conservative.

Figure 2: Gross Margin Trajectory



Source: Company Data, Progressive Research.

Financials and Valuation

Table 2 presents our forecasts for FY2018E, highlighting the contribution from PROACTIS and Perfect businesses. We make no meaningful change to our estimates published in "*PROACTIS: Powering On*", (September 2017). Our revenue forecast of £60.5m implies organic growth of 10% from the pro-forma revenue base of £55m and we assume £3.0m of acquisition synergies delivered in FY18 (marginally ahead of company guidance). The combination more than doubles the size of business and by the time the full value of synergies are realised in FY19E, adjusted EBITA margins should rise more than 7ppts. Our FY2019E adjusted EPS forecast of 14.5p implies PROACTIS trading at 11.2x.

Table 2: Combining PROACTIS and Perfect Commerce Financials

	FY-18E PHD	FY-18E PC	FY-18E Adjust.	FY-18E Combined	FY-19E Combined
Revenue	**28.0**	**32.5**		**60.5**	**66.2**
Gross Profit	23.8	24.6		48.4	54.3
Gross margin (%)	**85.0**	**75.7**		**80.0**	**82.0**
Operating costs	(17.6)	(19.1)	3.0	(33.7)	(35.8)
Adjusted EBIT	**6.2**	**5.5**	**3.0**	**14.7**	**18.5**
Interest	(0.0)		(1.0)	(1.0)	(0.8)
Adjusted PBT	**6.2**		**2.0**	**13.7**	**17.7**
Tax	(1.3)		(1.9)	(3.2)	(3.5)
Adjusted income	**4.9**		**0.1**	**10.5**	**14.1**
Shares (m)	51.3		46.1	97.4	97.4
Adjusted EPS (p)	**9.6**			**10.8**	**14.5**

Source: Progressive Research

SUMMARY FINANCIALS

PROFIT & LOSS	FY-14A	FY-15A	FY-16A	FY-17A	FY-18E	FY-19E
Revenue	**10.2**	**17.2**	**19.4**	**25.4**	**60.5**	**66.2**
Adj EBITDA	2.0	4.8	5.3	7.9	20.0	23.8
Adj EBIT	**1.1**	**2.9**	**3.2**	**5.2**	**14.7**	**18.5**
Reported PBT	0.1	1.5	1.8	(2.7)	9.2	15.7
Fully adj PBT	**1.1**	**2.8**	**3.1**	**5.1**	**13.7**	**17.7**
NOPAT	1.4	3.4	3.9	6.3	17.6	22.2
Reported EPS (p)	0.9	4.9	5.9	(5.7)	7.3	12.9
Fully adj EPS (p)	**2.6**	**5.8**	**7.0**	**8.6**	**10.8**	**14.5**
Dividend per share (p)	1.1	1.2	1.3	1.4	1.5	1.6

CASH FLOW & BALANCE SHEET	FY-14A	FY-15A	FY-16A	FY-17A	FY-18E	FY-19E
Operating cash flow	1.6	3.4	5.4	5.5	18.7	23.0
Free Cash flow (£m)	0.1	0.8	2.2	1.3	10.2	12.6
FCF per share (p)	0.3	1.9	5.1	2.8	10.5	13.0
Acquisitions	(3.9)	(1.1)	(4.4)	(14.3)	(95.1)	0.0
Disposals	0.0	(0.0)	0.0	0.0	0.0	0.0
Shares issued	3.1	0.2	0.2	12.7	65.0	0.0
Net cash flow	**(0.7)**	**(0.1)**	**(2.0)**	**(0.4)**	**(19.9)**	**12.6**
Overdrafts / borrowings	(1.5)	(1.9)	(4.0)	(5.2)	(20.8)	(20.8)
Cash & equivalents	3.1	3.4	3.6	4.3	0.0	12.6
Net (Debt)/Cash	**1.6**	**1.5**	**(0.5)**	**(0.9)**	**(20.8)**	**(8.2)**

NAV AND RETURNS	FY-14A	FY-15A	FY-16A	FY-17A	FY-18E	FY-19E
Net asset value	9.5	11.5	13.0	22.5	28.9	40.8
NAV/share (p)	**28.1**	**29.4**	**32.6**	**45.9**	**58.9**	**83.0**
Net Tangible Asset Value	(5.8)	(5.1)	(8.6)	(16.1)	(11.1)	(1.2)
NTAV/share (p)	**(17.3)**	**(13.2)**	**(21.7)**	**(32.7)**	**(22.5)**	**(2.5)**
Average equity	7.9	10.5	12.2	17.8	25.7	34.8
Post-tax ROE (%)	**4.1%**	**19.2%**	**20.3%**	**-15.6%**	**27.5%**	**36.0%**

METRICS	FY-14A	FY-15A	FY-16A	FY-17A	FY-18E	FY-19E
Revenue growth	*26.2%*	*69.6%*	*12.5%*	*31.1%*	*138.2%*	*9.4%*
Adj EBITDA growth	*55.6%*	*129.6%*	*12.8%*	*48.5%*	*154.7%*	*18.9%*
Adj EBIT growth	*146.0%*	*191.9%*	*14.2%*	*68.0%*	*194.5%*	*29.8%*
Adj PBT growth	*85.9%*	*153.2%*	*11.8%*	*63.0%*	*168.2%*	*29.1%*
Adj EPS growth	*38.8%*	*121.0%*	*22.1%*	*22.5%*	*25.4%*	*34.1%*
Dividend growth	*10.0%*	*9.1%*	*8.3%*	*7.7%*	*7.1%*	*6.7%*
Adj EBIT margins	*11.1%*	*16.6%*	*16.6%*	*20.7%*	*24.3%*	*27.9%*

VALUATION	FY-14A	FY-15A	FY-16A	FY-17A	FY-18E	FY-19E
EV/Sales	17.6	10.4	9.2	7.0	3.0	2.7
EV/EBITDA	87.5	37.2	33.7	22.7	8.9	7.5
EV/NOPAT	129.9	52.9	46.3	28.4	10.1	8.1
PER	62.0	28.0	23.0	18.8	15.0	11.2
Dividend yield	0.7%	0.7%	0.8%	0.9%	0.9%	1.0%
FCF yield	0.2%	1.1%	3.2%	1.7%	6.5%	8.0%

Source: Company information, Progressive Equity Research estimates

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