Piteco

Acquisition

Bold entry into the US marketplace

Software & comp services

Piteco is buying the principal assets of LendingTools (LT), a small, privately owned US payments software provider, for up to $14.5m in cash. LT operates in the niche area of "correspondent banking", offering financial institutions an alternative to the Federal Reserve's FedLine Advantage. The deal provides Piteco with an attractive route into the lucrative US market, which it plans to use to grow its core treasury software solutions. On our updated forecasts, EPS rise by 12-14% over FY17 to FY19. Given the attractive growth opportunities, strong cash generation and healthy balance sheet, we continue to believe the shares are attractive on c 14x our FY18e earnings.

Year end	Net sales revenue* (€m)	EBITDA** (€m)	EPS** (c)	DPS (c)	P/E (x)	Yield (%)
12/15	12.8	5.7	21.5	10.0	23.4	2.0
12/16	13.5	5.6	25.1	15.0	20.1	3.0
12/17e	18.0	8.0	32.0	17.5	15.8	3.5
12/18e	20.9	9.1	34.9	20.0	14.5	4.0

Note: *Excludes the capitalisation of development costs, change in work in progress and other revenues (largely expenses charged back to customers). **Normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Acquisition of US payments software provider

Piteco is effectively paying $13m for an initial 55% of LT, based in Wichita, Kansas, which has net cash position of c $2m. The acquisition has been structured to enable two executives with strong expertise in the field to take significant minority shareholdings. Piteco plans to increase its shareholding to 60% for up to an additional $1.5m over the next two years but has no current plans to lift its stake any further than that. LT generated revenue of $5m in FY16, operates in a growth market and offers EBITDA margins of c 35-40%. It has long-term contracts and relatively low churn rates, and 90% of its revenues are recurring in nature.

Forecasts: FY18 revenues rise by 34%, EPS by 12%

We have included LT in our forecasts for 8.7 months in FY17, with annualised revenues of $5.2m (€4.9m), and growing at 10% pa in each of FY18 and FY19 as it gains market share. In all, group net sales revenues rise by 25% in FY17, 35% in FY18 and 36% in FY19. EBITDA rises by 27%, 32% and 33% in the respective years, while adjusted EPS goes up by 13%, 12% and 14%. We have assumed that Piteco has paid $13m for an initial 55% of LT, which has cash balances of $2m and no debt. We forecast the group to end FY17 with net debt of €4.5m (previously €4.5m net cash), falling to €1.0m at the end of FY18 (€7.1m net cash).

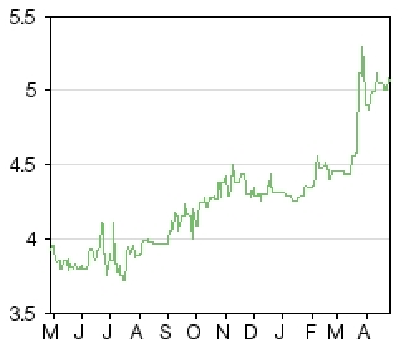
Valuation: DCF valuation moves up

The stock looks attractive, trading on c 15.8x our EPS in FY17e, falling to c 14.5x in FY18e and to c 13.7x in FY19e. Our DCF model suggests a valuation of 549c (previously 497c), which is 9% above the current price. The calculation uses conservative assumptions including a 4.7% CAGR in organic net sales revenue over 10 years, long-term operating margins of 40% to net sales and a WACC of 9%. It has also been adjusted for the dilution impact of the convertible bonds.

26 April 2017

Price	**€5.05**
Market cap	**€92m**
Net cash (€m) at end FY16	1.9
Shares in issue	18.1m
Free float	14.7%
Code	PITE
Primary exchange	AIM Italia
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	11.1	15.2	35.1
Rel (local)	7.0	10.2	16.8
52-week high/low		5.295	3.594

Business description

Piteco is Italy's leading company in designing, developing and implementation of software for treasury, finance and financial planning management.

Next events

AGM	28 April
Interim results	28 September

Analysts

Richard Jeans +44 (0)20 3077 5700

Katherine Thompson +44 (0)20 3077 5730

tech@edisongroup.com

Edison profile page

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Acquisition of LendingTools

Piteco is effectively paying $14.5m for 60% of Wichita, Kansas-based LendingTools (LT). LT has net working capital of c $2.25m, most of which is cash. The deal is being carried out through Piteco's fully owned subsidiary Piteco North America Corp, which is acquiring 55% of a special purpose vehicle (SPV) called Juniper Payments LLC (Juniper) for $3m and is providing Juniper with a $10m 10-year intercompany loan. Piteco is financing the deal through its internal cash resources and a €7m bank loan. Two key managers (see their biographies below) have each been granted a 22.5% stake in Juniper. Juniper has subsequently purchased the principal assets of LendingTools.com, Inc for $13m in cash. Piteco has an option to increase its stake by 2.5% in each of the next two years from the key managers for up to $1.5m, depending on the financial performance of the acquired business. Piteco does not plan to increase its stake any further, as it wants to keep the executives on board, with their interests tied to Piteco's interests. However, if the acquired business fails to meet undemanding targets, Piteco does have an option to purchase an additional 20%.

The two key managers who have taken stakes in Juniper are Jon Budd, who has become CEO of Juniper, and Jorge Jimenez, who has become chairman of Juniper.

Jon Budd joined LT in 2003 to lead the sales effort, and currently serves as senior vice president of business development. In this role, Jon leads the sales and marketing efforts, creates and manages partner relationships, and influences product strategy including new product development.

Jorge Jimenez is currently CEO of eZforex.com. Jorge recently left the Federal Reserve System where he served as the director for international payments and product development. Jorge has been involved in payments systems for over 15 years, and consequently has a very in depth knowledge of the payments industry, both in the US and in Europe.

Reasons for the deal

LT represents Piteco's entry into the US market. In our view, Piteco has secured this investment at an attractive price (c 5x historical revenues and 14x operating profit) given LT's growth prospects. Piteco is positioning itself for the accelerating development of the US payments market, which lags Europe in the payments space. The new LT management team has a bold plan to grow the business organically, by expanding the customer base and adding additional services. Further, Piteco aims to use the platform of LT to cross-sell its traditional Piteco treasury and cash management applications to clients of LT's bank customers. We note that Piteco's software is already operating in the US, via US branches of some of its Italian customers.

Rising market share

While the number of US financial institutions has been on a declining trend for decades due to mergers, consolidations and failures, the number of banks and credit unions utilising LT has been steadily increasing in recent years. Consequently, LT's market share has been increasing, with market penetration approaching 40%, and LT has a goal to reach 50% penetration by 2018. If achieved, this would mean c 5,000 banks and credit unions in the US would be utilising the LT platform to originate, receive and manage some, or all, of their inter-bank transactions and settlements.

Background on LendingTools

Based in Wichita, Kansas, close to the centre of the US, LT is the third largest player in the US correspondent banking software space, behind Fedline Advantage, which is owned by the Federal Reserve and another system owned by the banks. LT was founded in 2000 after three community bankers recognised there was a need for software tailored specifically for community bankers' needs. Early offerings included loan analysis tools, along with a general CRM, hence the name LendingTools. However, LT was mandated to develop solutions for a local correspondent bank and after thousands of hours of R&D, it launched ExtraNet FP-S, its correspondent banking platform, in 2003. Today ExtraNet FP-S is LT's technology backbone, flagship product and primary revenue generator. ExtraNet FP-S enables community banks to replace their Fedline connection with lower-cost services provided by their correspondent institution. LT has subsequently added additional services, primarily in the areas of cash management and cheque imaging. In 2005 LT launched its own data centre and all of LT's services are delivered over the internet as a hosted application.

LT is profitable, strongly cash generative, with very high recurring revenues (90%), and has long-term contracts and low churn rates. More than $3bn of transactions from over 3,500 financial institutions are routed through LT's data centre each day. A high proportion of its customer base are in the US mid-west. In FY16, LT generated revenue of $5m and pre-tax profit of $1.75m, for a 35% margin.

What is "correspondent banking"?

According to the Bank for International Settlements, correspondent banking can be defined, in general terms, as "an arrangement under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services to those respondent banks". Large international banks typically act as correspondent banks for thousands of other banks around the world. Similarly, in the US domestic market, credit unions are respondents, utilising the services of larger financial institutions, which act as correspondents. The correspondents provide respondents with a wide range of services, including cash management, international wire transfers, cheque clearing, payable-through accounts and foreign exchange services. LT provides the software that enables these processes within an electronic environment.

Revenue model

LT operates on a SaaS basis, with 90% of revenue generated from contracted monthly billing, similar to a subscription service. LT provides the 'right to use' by end-users via its customer contracts and bills the customer directly while the customer bills the end-users. The remaining 10% of revenue is generated from upfront fees, customisation fees and technical consulting and support. The average initial contract term is five years and the average renewal term is four years. LT's lifetime renewal rate is close to 85%, with many customers on their third or fourth renewal. LT charges a one-time fee for the implementation, which typically takes four to six months. This fee is primarily determined by the modules chosen and the size of the deployment, but also covers the length of term and the amount of customisation required.

Forecasts: FY18 revenues rise by 34%, EPS by 12%

We have included LT in our forecasts for 8.7 months in FY17, with annualised revenues of $5.2m (€4.9m) and growth at 10% pa in each of FY18 and FY19. We have not assumed any additional services or cross-selling of Piteco products and we have maintained all our operating assumptions for the rest of the business. We assume a 40% operating margin and a 35% tax rate for LT and have added minority interests and extra interest for the €7m borrowing facility.

In all, group net sales revenues rise by 25% in FY17, 35% in FY18 and by 36% in FY19. Adjusted EBITDA rises by 27%, 32% and 33% in the respective years, while adjusted EPS goes up by 13%, 12% and 14%.

We have assumed that Piteco has paid $13m for 55% of LT, which has cash balances of $2m and no debt. We assume that Piteco increases its stake over the next two years to 60%, at a cost of $750,000 in each year. Consequently, we forecast the group to end FY17 with net debt of €4.5m (previously €4.5m net cash), falling to €1.0m at the end of FY18 (previously €7.1m net cash) and swings to €2.5m net cash at the end of FY19 (previously €9.9m net cash).

We have assumed that costs relating to the transaction are included in the EBITDA. We have ignored amortisation of acquired intangibles, which have no impact on cash flows.

Exhibit 1: Forecast changes

(€000s)	Old 2017e	New 2017e	Change (%)	Old 2018e	New 2018e	Change (%)	Old 2019e	New 2019e	Change (%)
Revenues									
Software	3,098	3,098	0.0	3,410	3,410	0.0	3,660	3,660	0.0
Services	3,973	3,973	0.0	4,328	4,328	0.0	4,644	4,644	0.0
Maintenance	7,413	7,413	0.0	7,742	7,742	0.0	8,120	8,120	0.0
LendingTools		3,557	N/A		5,396	N/A		5,936	N/A
Net sales revenue	14,484	18,041	24.6	15,480	20,876	34.9	16,425	22,361	36.1
Capitalisation of dev'ment costs	290	361	24.6	310	418	34.9	328	447	36.1
Change in work in progress	0	0	N/A	0	0	N/A	0	0	N/A
Other revenues	507	507	0.0	542	542	0.0	575	575	0.0
Turnover	15,281	18,909	23.7	16,332	21,836	33.7	17,328	23,383	34.9
Growth (%)	8.2	33.9	313.1	6.9	15.5	125.2	6.1	7.1	16.1
Operating expenses before depn	(9,010)	(10,952)	21.6	(9,442)	(12,778)	35.3	(9,954)	(13,576)	36.4
EBITDA	6,271	7,957	26.9	6,889	9,058	31.5	7,374	9,807	33.0
Normal depreciation	(120)	(130)	8.3	(197)	(207)	4.8	(195)	(219)	12.2
Amortisation of development costs	(125)	(125)	0.0	(150)	(150)	0.0	(265)	(301)	13.5
Depreciation & amortisation	(245)	(255)	4.1	(347)	(357)	2.7	(460)	(520)	13.0
Adjusted operating profit	6,026	7,702	27.8	6,542	8,701	33.0	6,913	9,287	34.3
Operating margin (%)	39.4	40.7		40.1	39.8		39.9	39.7	
Growth (%)	10.2	40.9		8.6	13.0		5.7	6.7	
Net interest	(200)	(294)	46.9	(100)	(250)	150.0	0.0	(150)	N/A
Profit before tax norm	5,826	7,408	27.2	6,442	8,451	31.2	6,913	9,137	32.2
Amortisation of acquired intangibles*	0	0		0	0		0	0	
Exceptional items (net of tax)	0	0		0	0		0	0	
Profit before tax	5,826	7,408	27.2	6,442	8,451	31.2	6,913	9,137	32.2
Taxation	(699)	(1,185)	69.5	(789)	(1,521)	92.8	(1,037)	(1,827)	76.2
Minority interest	0	(416)	N/A	0	(596)	N/A	0	(617)	N/A
Net income	5,127	5,806	13.3	5,653	6,334	12.0	5,876	6,692	13.9
Statutory EPS (c)	28.3	32.0	13.3	31.2	34.9	12.0	32.4	36.9	13.9
Adjusted EPS (c)	28.3	32.0	13.3	31.2	34.9	12.0	32.4	36.9	13.9
P/E – adjusted EPS (x)		**16.0**			**14.6**			**13.8**	

Source: Edison Investment Research

Valuation: Deal is value accretive even before synergies

In our view, this transaction offers high potential rewards for Piteco shareholders, if Piteco can execute its plans effectively. Our DCF model suggests a valuation of 549c (previously 497c), which is 9% above the current price. The calculation uses the maintained assumption of a conservative 4.7% CAGR in organic net sales revenue over 10 years, a 9% CAGR for LT over 2017-26, a long-term operating margin (40% of net sales) that is below current levels and a WACC of 9%. It has also been adjusted for the dilution impact of the convertible bonds. Our forecasts do not take into account any additional services added at LT or cross-selling opportunities of Piteco's existing solutions.

Exhibit 2: Financial summary

	€000s	2014	2015	2016	2017e	2018e	2019e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Turnover		12,334	13,384	14,122	18,909	21,836	23,383
Net Sales Revenue		11,550	12,838	13,477	18,041	20,876	22,361
EBITDA		5,229	5,719	5,606	7,957	9,058	9,807
Adjusted Operating Profit		5,149	5,620	5,466	7,702	8,701	9,287
Amortisation of acquired intangibles		(623)	(157)	(157)	0	0	0
Exceptionals		17	(323)	106	0	0	0
Share based payments		0	0	0	0	0	0
Operating Profit		4,543	5,140	5,415	7,702	8,701	9,287
Net Interest		(1,011)	(585)	(365)	(294)	(250)	(150)
Profit Before Tax (norm)		4,139	5,035	5,102	7,408	8,451	9,137
Profit Before Tax (FRS 3)		3,532	4,555	5,050	7,408	8,451	9,137
Tax		(1,090)	(1,130)	(547)	(1,185)	(1,521)	(1,827)
Profit After Tax (norm)		3,049	3,905	4,554	6,223	6,930	7,309
Profit After Tax (FRS 3)		2,443	3,426	4,503	6,223	6,930	7,309
Average Number of Shares Outstanding (m)		0.0	18.1	18.1	18.1	18.1	18.1
EPS - normalised (c)		0.0	21.5	25.1	32.0	34.9	36.9
EPS - FRS 3 (c)		0.0	18.9	24.8	32.0	34.9	36.9
Dividend per share (c)		0.00	10.00	15.00	17.50	20.00	22.50
Gross Margin (%)		0.0	0.0	0.0	0.0	0.0	0.0
EBITDA Margin (%)		42.4	42.7	39.7	42.1	41.5	41.9
Op Margin (before GW and except.) (%)		41.7	42.0	38.7	40.7	39.8	39.7
BALANCE SHEET							
Fixed Assets		29,303	30,055	30,090	40,718	40,946	41,052
Intangible assets and deferred tax		27,442	28,522	28,626	39,239	39,506	39,653
Tangible Assets		1,455	1,421	1,365	1,380	1,340	1,300
Investments		406	112	99	99	99	99
Current Assets		6,005	14,846	15,531	7,682	9,942	12,157
Stocks		0	0	0	0	0	0
Debtors		4,013	4,494	4,524	4,858	4,904	4,950
Cash		1,862	10,198	10,870	2,685	4,900	7,070
Current Liabilities		(4,994)	(5,408)	(5,023)	(6,395)	(7,347)	(7,935)
Creditors		(3,794)	(3,688)	(3,304)	(4,675)	(5,628)	(6,215)
Short term borrowings		(1,200)	(1,720)	(1,719)	(1,719)	(1,719)	(1,719)
Long Term Liabilities		(12,052)	(10,114)	(8,576)	(6,826)	(5,514)	(4,201)
Long term borrowings		(10,694)	(8,825)	(7,204)	(5,454)	(4,142)	(2,829)
Other long term liabilities		(1,359)	(1,289)	(1,372)	(1,372)	(1,372)	(1,372)
Net Assets		18,262	29,379	32,022	35,179	38,027	41,073
CASH FLOW							
Operating Cash Flow		5,739	5,056	5,525	8,008	9,352	10,028
Net Interest		(1,011)	(585)	(365)	(294)	(250)	(150)
Tax		(973)	(1,146)	(661)	(547)	(1,111)	(1,437)
Capex		(273)	(330)	(347)	(505)	(585)	(626)
Acquisitions/disposals		0	(972)	0	(10,377)	(708)	(708)
Financing		(2,265)	7,671	0	0	0	0
Dividends		0	0	(1,860)	(2,719)	(3,172)	(3,625)
Net Cash Flow		1,217	9,695	2,293	(6,435)	3,527	3,482
Opening net debt/(cash)		11,249	10,032	347	(1,946)	4,488	961
Other		()	(10)	0	0	0	0
Closing net debt/(cash)		10,032	347	(1,946)	4,488	961	(2,521)

Source: Piteco (historics), Edison Investment Research (forecasts)

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia