Beta Systems

Technology

28 January 2020

DCI business stronger than expected

Beta Systems delivered full year results at the upper end of company guidance (upgraded in April 2019), underpinned by the solid performance of its core DCI division in the DACH region. The group continues to develop the product portfolio organically, supported by M&A activity. This includes the recent acquisitions of HABEL/Akzentum Group and infinIT Codelab. FY20e EV/EBITDA is 7.4x, underpinned by strong cash generation and high level of total recurring revenues (well in excess of 80% currently).

DCI activities in DACH region deliver growth

In FY19, Beta Systems achieved €53.3m in sales, with EBITDA of €10.5m, which implies an EBITDA margin of 19.6%, up from 11.9% in the previous year. The bulk of the growth was organic, driven by good progress in the existing business and a better than expected volume of new orders, in the DCI division in particular. The company guides to FY20 sales of €67–74m, assisted by the recent acquisitions of HABEL/Akzentum Group and infinIT Codelab, and expects stable EBITDA of €9–12m (pre-IFRS 16). FY21 and FY22 guidance indicates volatile earnings, but this is due to the accounting treatment of its licence agreements with clients. Meanwhile, cash generation remains strong, enhanced by a high level of recurring revenues.

Acquisitions strengthen offering

The takeover of HABEL/Akzentum Group in July 2019 has strengthened the company's product portfolio in the DCI division, including the offering outside the mainframe. In December 2019, Beta Systems acquired infinIT Codelab, which has led to a diversification in its revenue streams and an expansion in development resources of 200 employees. Beta Systems highlights that it may make further M&A deals, which should be supported by the strong balance sheet position (net cash was €31.9m at end-September 2019, including €26m on deposit).

Valuation: Trading at discount to peers

Following an upgrade to management guidance in April 2019 and the completion of two acquisitions in July and December 2019, Beta Systems' share price has increased c 27% over the last 12 months. The midpoint of management's EBITDA guidance implies an EV/EBITDA ratio of 7.4x in FY20e and 12.0x in FY21e. This translates into a 31% discount and a 16% premium to a set of global infrastructure software companies in FY20e and FY21e respectively, which could be related to the high volatility of Beta Systems' earnings.

Historical financials

Year end	Revenue (€m)	EBITDA (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
09/16	46.4	6.9	5.7	0.99	0	23.2	N/A
09/17	49.8	10.8	9.3	1.51	0	15.2	N/A
09/18	45.9	5.5	4.3	0.76	0	30.3	N/A
09/19	53.3	10.5	9.1	1.26	0.2*	18.3	0.9

Source: Beta Systems accounts. Note: *Management dividend proposal subject to shareholder approval.

Price	**€23.0**
Market cap	**€110m**

Share price graph

Share details

Code	BSS
Listing	Deutsche Börse Scale
Shares in issue	4.8m
Last reported net cash at 30 September 2019, including €26m on deposit	€31.9m

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 13 markets globally. Approximately 75% of sales are derived in the DACH region.

Bull

- Market leader in mainframe environments and DCI in Europe.
- Strong order profile indicates that life remains in the mainframe market.
- Strong balance sheet.

Bear

- Mature mainframe market backdrop.
- Subscale IAM business.
- Strong dependence on DACH region.

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Edison profile page

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DCI activities in DACH region drive organic growth

In FY19, revenues increased c 16% y-o-y to €53.3m and EBITDA reached €10.5m, up 91% y-o-y. This included a three-month contribution from HABEL/Akzentum Group and an eleven-month contribution from Categis. Organic revenues were up 11% y-o-y to €51m and organic EBITDA was €10.2m, with both figures at the upper end of company guidance (€48–52m for revenues and €8–10.5m for EBITDA). Solid organic growth resulted from good progress in the existing business and a better than expected volume of new orders, in the DCI division in particular (representing 73% of revenue in FY19). Group results were also supported by Lynet and Auconet, which were acquired in FY18. Performance was driven by the largest business segment (DACH region), where sales to customers increased 23% y-o-y to €40.1m (16% organic growth y-o-y to €37.8m).

The strong growth of 2019 followed a weaker FY18 sales performance resulting from the licence renewal cycle. The bulk of group software is sold on a rental basis and Beta recognises rental revenues on a similar basis to a traditional licence (eg c 60% of total revenues from a three-year rental contract are recognised in the first year, with c 20% in each of years two and three). This adds volatility to revenues and brings them forward compared with Beta Systems' operating cash flows (which remained broadly stable in FY19 at €8.2m vs FY18 at €8.3m). The predominant rental model means that c 80%+ of the group's licence and maintenance revenues are recurring, while a large portion of the services revenues also have a recurring feature, which would take total recurring revenues to more than 90% of the overall total.

FY19 R&D expenses of €10.8m represented 20% of sales (vs 22% in FY18), which compares with the company's target of more than 20%. The group has expanded its R&D team to 166 employees (at end-FY19) from 127 at end-FY18, representing 39% of the company's total headcount of 442.

Exhibit 1: Financial summary and management guidance

€m	2017	2018	2019	2020e*	2020e**	2021e*	2022e*
Year-end 30 September	IFRS	IFRS	IFRS	Management guidance			
Revenue	49.8	45.9	53.3	67–74			
o/w licence	18.3	11.8	13.6				
o/w maintenance	24.1	24.9	28.9				
o/w services	7.4	8.6	9.6				
o/w other sales	0.0	0.6	1.2				
EBITDA	10.8	5.5	10.5	9–12	11–14.5	5–8	13–16
EBITDA margin	21.7%	12.0%	19.6%				
Total operating expenses	(40.8)	(42.1)	(44.7)				
EBIT	9.0	3.8	8.5	7–10			
Profit before tax	9.3	4.3	9.1				
Net income	8.0	4.0	6.0				
EPS (€)	1.51	0.76	1.26				
Operating cash flow	5.3	8.3	8.2	7–10	9–12.5		

Source: Beta Systems accounts. Note: *Pre-IFRS 16 including PROXESS and infinIT Codelab acquisitions. **Post-IFRS 16.

During FY19, the company arranged an €8.0m loan, which it used to finance the c €10.8m acquisition of PROXESS (net of PROXESS cash). It also received €4.1m back from the deposit it had granted to its majority shareholder, Deutsche Balaton, as part of a cash-pooling arrangement (the company normally holds between €25m and €30m at Deutsche Balaton; its interest rate is typically c 1% and the investment horizon is up to six months). Consequently, net cash was €31.9m at end-September 2019 (including a €26m deposit from Deutsche Balaton) compared with €35.6m at end-September 2018. Hence the group has ample balance sheet headroom available to support ongoing portfolio development and modernisation, as well as acquisitions.

Management will recommend a dividend payout of €0.20 per share from FY19 income, translating into a dividend yield of c 1%. It is worth noting that Beta Systems has not paid a dividend yet as shareholders rejected management's dividend proposal for the last two years. In this respect, we note that the shareholder base has not materially changed since then and Deutsche Balaton, a private equity company, remains Beta Systems' majority shareholder with a stake of 59%.

Operating cash flow to remain firm

FY20 management guidance is for revenues of €67–74m (implying 32% y-o-y growth at the midpoint), EBITDA of €9–12m (unchanged vs FY19 at the midpoint) and EBIT of €7–10m (up 2% year-on-year). Beta Systems guides to operating cash flow of €7–10m in FY20. These are on a comparable basis, ie excluding the impact of IFRS 16, which Beta Systems will adopt from FY20. We present management guidance pre- and post-IFRS 16 adoption in Exhibit 1.

The company expects sales growth in FY20 to be largely driven by the first full-time consolidation of PROXESS and the first-time consolidation of infinIT Codelab (see details below). It is also worth noting that licences tend to be renewed on a three- to five-year basis and Beta Systems recorded a high number of high-value clients renewing their licences in FY17. Thus, the company estimates that renewal volumes in FY21 will be comparable to FY18, which will result in a drop in EBITDA and a subsequent rebound in FY22. However, this does not affect cash flows as the bulk of revenues are on a recurring rental basis.

Product developments and acquisitions continue

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), was established via the acquisition of LYNET in 2018.

The DCI division delivered 20% y-o-y growth in sales to €39m, driven by solid performance in existing and new orders, as well as a first-time, full period consolidation of AUCONET. DCI recently benefited from strong demand for new-generation Symphony software, as well as the placement of new web modules. Revenues in the IAM division were broadly flat at €11.1m, as declining service revenues (down 14% y-o-y) offset higher licence and maintenance sales. Recent major product portfolio developments in the IAM division include front- and back-end improvements to one of the core products, Garancy Identity Manager.

Beta Systems' current focus is to strengthen its DCI and IAM software portfolio organically, in the DACH region in particular. DCI plans to launch new archiving systems for the SAP environment in early FY20. The company is also working on the development of new product generations for Unix/Linux Output-Management and UX Suite's Log Management (to be launched in FY21). IAM is preparing for market launch of RoleCenter, a new product for onboarding and maintenance of authorisation roles, in FY21. Beta Systems is looking to develop its product portfolio further (including an offering outside mainframe) with further investments in the internal innovation team (the company plans to spend €0.5m in FY20, and €1m in FY21 and FY22 on this).

Meanwhile, Beta Systems has continued integration and development of the six companies it has acquired in the last five years and highlights that it may use its strong balance sheet in the future to conduct further M&A deals.

With respect to its M&A activity in FY19, its subsidiary PROXESS Holding GmbH acquired HABEL/Akzentum Group for c €11.9m in July 2019. HABEL/Akzentum Group offers archiving, document recognition and workflow solutions and provides digitalisation and process automation support to medium-sized companies. It has 2,600 customers and operates in Germany, Austria and Switzerland. The company generated revenues of c €9.5m and EBITDA of c €1.1m in FY18. The acquisition has strengthened Beta Systems' product portfolio in the DCI division, including the offering outside the mainframe. At the time of the acquisition, Beta Systems expected the transaction to have a positive impact on both sales and EBITDA, starting from FY20.

In December 2019, Beta Systems acquired an 80% stake in infinIT Codelab from insolvency for c €0.7m. Codelab offers software solutions for the automotive sector (c 80% of its sales), including tier one automotive suppliers, and telecom industries. Its focus is on embedded software systems, IoT solutions, connectivity and web portals. It has c 200 employees in Poland and generates annual sales of c €10m with an EBITDA margin close to zero. Beta Systems anticipates that Codelab will contribute €7–8m to group sales while being EBITDA neutral in FY20. That said, the company's long-term EBITDA target is c 10%.

Beta Systems highlights that the shortage of qualified workers in mainframe technology remains a bottleneck for all companies in the market and one of its key aims is to acquire and train new DCI mainframe software developers. Beta Systems has a leading position in the mature mainframe software market in Europe (the company estimates its market share in selected segments at 50%+), which gives it a niche position in the market. Moreover, it made the first replacement deals after its main competitors, BMC Software and CA Technologies, were sold in 2018 and hopes to further benefit from post-transaction disturbances at these companies.

Valuation

Beta Systems' share price has increased c 27% over the last 12 months following an upgrade to management guidance in April 2019 and the completion of two acquisitions in July and December 2019. The company's closest peers, CA Technologies and BMC Software, are not listed so we compare Beta Systems to a set of global infrastructure software companies, including IBM, Cisco, Citrix, HPE, Juniper and VMware. There is no consensus for Beta Systems, so we use management guidance for EBITDA at the midpoint. We also adjust our calculation of the EV to account for the €26m cash deposit with Deutsche Balaton, which we see as a cash equivalent given its accessibility. This implies an FY20e EV/EBITDA at 7.4x for Beta Systems, translating into a c 31% discount to its peers. Due to the volatility of the company's EBITDA related to its renewal cycle, the EV/EBITDA ratio implies a 16% premium and a 44% discount to its peers in FY21e and FY22e, respectively. However, we again underline the stability of the company's cash flows and high portion of total recurring revenues (well above 80% currently).

Exhibit 2: Peer group comparison

	Market cap	P/E (x)			EV/EBITDA (x)		
Company	**(lcy m)**	**2020e**	**2021e**	**2022e**	**2020e**	**2021e**	**2022e**
Cisco	US$ 207,022	15.1	14.4	13.7	10.6	10.4	10.2
IBM	US$ 123,254	10.4	9.8	9.3	9.2	8.9	8.6
VMware	US$ 60,945	22.6	21.1	18.9	16.2	15.4	13.9
HPE	US$ 19,265	8.0	7.6	7.1	5.6	5.5	5.6
Citrix	US$ 15,346	21.7	18.6	16.0	16.0	14.8	N/A
Juniper Networks	US$ 8,207	13.2	12.3	9.5	7.0	7.0	N/A
Peer average		**14.2**	**13.4**	**11.6**	**9.4**	**9.2**	**10.2**
Beta Systems	€110	N/A	N/A	N/A	7.4*	12.0*	5.4*
Premium/(discount) to peers		**N/A**	**N/A**	**N/A**	**(31%)**	**16%**	**(44%)**

Source: Refinitiv consensus at 22 January 2020. Note: *Based on the midpoint of company guidance.

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