EDISON

Scale research report - Update

Beta Systems Software

Technology

2 June 2021

Lower H1 results, but within guidance

Beta Systems, a software provider for data centre intelligence and identity access management, has reported weaker H1 results to March. Due to lower contract renewals in the DCI unit, FY21 EBITDA is expected to decrease, but this is guided to reverse next year. As a smaller player in the sector, Beta Systems trades at a discount of 54% versus international peers on an FY22 EV/EBITDA basis.

Revenues drop 4% in H121; EBIT down 34%

Beta Systems Software reported lower H121 results as was already anticipated, with a revenue drop of 4.1% to €36.5m. The decrease was driven by lower contract renewals in its most important division Data Center Intelligence, a development that is guided to reverse next year. Operating expenses increased, mostly because of higher staffing expenses, which was partly offset by lower marketing and travel expenses. All in all, EBIT decreased 34.3% to €5.8m and net income fell by 33.9% to €4.4m. We believe operational cash flow might provide a better reflection of the business compared to the volatile IFRS revenue recognition. It increased 15% from €13.9m in H120 to €16.0m in H121.

Pick up in FY22 EBITDA guided after weaker FY21e

Having reiterated its 2021 guidance with the H1 results, the company noted that thanks to cost savings it is optimistic that the upper half of the FY21 EBITDA and EBIT guidance might be reached. Due to a lower number of client contracts up for renewal in the current reporting year with lower upfront revenue recognition, revenue guidance remains at €68–76m. This is in line with FY20, mostly as a result of the positive effect of the acquisition of Codelab, offset by the lower expected revenues in DCI. In FY22, a high volume of customer contracts is up for renewal, which provided Beta Systems the confidence to indicate €15–19m EBITDA after the FY20 results, after a guided decrease to €9.2–14.2m in FY21e.

Large EV/EBITDA discount compared to peers

With a market cap of €126m and a limited free float of below 30%, Beta Systems is a small player in the data centre/mainframe space, which is dominated by US and Asian tech giants. At the same time, the fact that Beta Systems is a European company supports the investment case, as government and financial clients appreciate local control of sensitive data. Beta Systems trades at an FY22 EV/guided EBITDA multiple of 4.9x, implying a discount of 54% compared to global, larger-cap peers.

Historical financials

Year end	Revenue (€m)	EBITDA (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
09/17	49.8	10.8	9.3	1.51	0.0	18.9	N/A
09/18	45.9	5.5	4.3	0.76	0.0	37.6	N/A
09/19	53.3	10.5	9.1	1.26	0.2	22.7	0.7
09/20	72.1	17.2	12.4	1.92	0.2	14.9	0.7

Source: Beta Systems data

Price	**€28.6**
Market cap	**€137m**

Share price graph

Share details

Code	BSS
Listing	Deutsche Börse Scale
Shares in issue	4.8m
Last reported net cash at end H121, including €25m in deposits	€53.9m

Business description

Beta Systems Software provides data centre intelligence solutions that enable efficient and secure bulk processing of data and identity access management solutions. The company's headquarters are in Berlin and it has sales and support offices in 13 markets globally. Approximately 65% of sales are derived in the DACH region.

Bull

- Market leader in mainframe environments and DCI in Europe.
- Strong order profile indicates 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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H121 lower as anticipated

Beta Systems Software reported lower H121 results, as was already anticipated, with a revenue drop of 4.1% to €36.5m. The decrease was driven by lower contract renewals in its most important division Data Center Intelligence (DCI), which accounted for 67% of revenues, partly offset by higher revenues of Identity Access Management (IAM), which accounted for 19% of sales. Sales in Digitisation accounted for 14% of revenues.

Beta Systems has a business model with highly recurring revenue and is less affected by the COVID-19 crisis. The predominant software 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. This takes total recurring revenues to around 85% of the overall total. Even if Beta Systems bills its typical multi-year contract product as a service (the predominant revenue model) on an annual basis, it has to recognise licence and maintenance separately, which means that contract renewals lead to a relatively volatile reported top line.

Staffing expenses increased to €22.0m from €20.1m as a result of higher salaries and a different mix (more DACH staff). On the other hand, marketing and travel expenses decreased as a result of the COVID-19 pandemic. All in all, EBITDA including the IFRS 16 treatment of leases (€1.6m) decreased 25.4% to €8.5m and EBIT fell 34.3% to €5.8m. Net income decreased 33.9% to €4.4m.

We believe operational cash flow might provide a better reflection of the business compared to the volatile IFRS revenue recognition. Operational cash flow increased 15% to €16.0m in H121 from €13.9m in H120.

In September last year, Beta Systems reported its first FY21 guidance with revenues of €68–76m and EBITDA of €9.2–14.2m. While the company reiterated this guidance with its H121 results, it has also noted that because of cost savings it is optimistic that the upper half of the EBITDA and EBIT guidance might be reached. The guidance includes an anticipated decrease in revenues for the DCI division, due to a lower number of contract renewals. However, the company expects this to reverse in FY22; with the FY20 results Beta Systems already indicated FY22 EBITDA guidance of €15–19m, which at the midpoint is broadly in line with EBITDA in FY20.

Exhibit 1: Financial summary

€m	FY19	FY20	H120	H121	Change	FY21e*
	IFRS	IFRS	IFRS	IFRS	(%)	Management guidance
Revenue	53.3	72.1	38.1	36.5	-4.1	68–76
o/w licence	13.6	18.4	11.3	9.0	-20.5	
o/w maintenance	28.9	32.3	17.1	17.3	1.3	
o/w services	9.6	18.1	9	9.7	8.2	
o/w other sales	1.2	1.3	0.7	0.5	-31.9	
EBITDA	10.5	17.3	11.4	8.5	-25.4	9.2–14.2
EBITDA margin	19.6%	24.0%	29.9%	23.3%		
EBIT	8.5	12.0	8.9	5.8	-34.3	3.8–8.8
Profit before tax (as reported)	9.1	12.4	9	6.0	-33.5	
Net income (as reported)	6.0	9.2	6.6	4.4	-33.9	
EPS (as reported) (€)	1.26	1.92	1.38	0.91	-34.1	

Source: Beta Systems accounts. Note: *FY20 numbers and management guidance include IFRS 16.

Stepping up product development

Beta Systems continues to build out its product portfolio beyond its traditional DCI mainframe solutions like document archiving, log management and access management by stepping up the development of products for the 'decentralized world' outside the mainframe.

However, the mainframe product range is also being continuously enhanced and the new Symphony software generation still has good traction, according to the company in the H1 report. The majority of clients have now moved to the new software. A month ago, Beta Systems and Software AG, a large German software company (FY20 sales €835m), announced a partnership in which Software AG will use Beta Systems products and technologies to create data-audit and compliance solutions for its customers.

Beta Systems also continues to invest in the IAM division, where it generated good growth in H1 and is optimistic about attracting additional new business.

In the digitalisation division, the automotive software company Codelab (acquired in December 2019) had to cope with a challenging automotive market in Q1, but recovered well in Q2. The start of Q3 has been promising as well. Codelab also provides operational flexibility, as its developers can also be deployed in other parts of Beta Systems if needed.

M&A is a prominent part of Beta Systems' strategy, which can be supported by the strong balance sheet position (net cash was €53.9m at end-March 2021, including deposits but excluding IFRS 16 related leases). No new acquisitions were announced in H121, but Beta Systems completed the divestment of Lynet Kommunikation for €2.7m. The synergies with the Beta System organisation that were targeted with Lynet's acquisition did not materialise, but the company generated a positive return on the sale.

Trading at a discount on FY22 multiples

With a market cap of €137m and a limited free float of just short of 30% (the majority shareholder Deutsche Balaton controls around 70%), Beta Systems is a small player in the data centre/mainframe space, which is dominated by tech giants mostly from North America and Asia.

Its financial position is strong, with a solid net cash position comprising €5.2m debt, deposits of €25m and €34.1m in cash. Compared to the larger-cap companies (as we are not aware of similar size peers), Beta Systems trades at a discount of 54% on FY22 EV/guided EBITDA, based on the current market capitalisation.

Exhibit 2: Peer group comparison

	Market cap	P/E (x)			EV/EBITDA (x)		
Company	**(local CCY m)**	**2020**	**2021e**	**2022e**	**2020**	**2021e**	**2022e**
Cisco	US$222,974	16.5	16.5	15.6	11.3	11.3	11.0
IBM	US$128,113	16.5	13.2	11.9	11.4	9.4	9.5
VMware	US$67,349	25.8	22.8	23.3	17.7	15.1	15.3
HPE	US$21,131	12.0	8.8	8.4	7.7	6.2	6.1
Citrix	US$14,258	18.8	20.1	16.7	13.3	13.7	12.1
Juniper Networks	US$8,708	17.1	15.6	14.1	10.5	9.6	9.3
Peer average		**17.8**	**16.2**	**15.0**	**12.0**	**10.9**	**10.5**
Beta Systems	€137	14.9	N/A	N/A	10.0	4.8	4.9
Premium/(discount)		***(16%)***	***N/A***	N/A	***(17%)***	***(56%)***	***(54%)***

Source: Refinitiv. Note: Priced at 27 May 2021. Beta System numbers not calendarised. *Based on the mid-point of company EBITDA guidance.

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