



Keyware

Smart Cards-Security / Belgium



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Mixed quarter, negatively impacted by a disappointing performance in Terminals

Earnings/sales releases - 05/09/2017

Fact

Keyware released its Q2 17 results, with revenues reaching €4,482k, corresponding to a 14.3% decrease yoy. Terminals came in at €2,086k (-18.7% yoy), Authorisations at €2,345k (-11.9% yoy), and the new business unit Software at €51k.

The gross margin reached 53.5%, down 670bp sequentially and 70bp yoy, and the operating margin came in at 7.1%, down 1290bp yoy. Profit before tax came in at €495k, leading to a net result of €338k, which was impacted by €53k of positive results from associated companies.

The company announced in June 2017 the acquisition of the remaining stake in Magellan, the French fintech in which Keyware had acquired 40% of the shares for €4m in Q3 16. The price for the remaining 60% is €6m, paid through own resources and a €4.5m bank loan.

Analysis

Tough quarter in Terminals

This quarter was marked by what can be called a poor performance in Terminals, as the substantial drop should be compared with the already strong drop from Q2 16 (-21.7%). The reasons remain the same as in Q1, i.e. a smaller number of contracts signed, and an unfavourable product mix with more cheaper terminals. Moreover, Germany is not performing as well as expected, to say the least, as the number of contracts signed appears to be below initial expectations, and the growth slower than expected as well.

Unfortunately for Keyware, these headwinds are likely to persist as the measures taken to reverse the trend will need some time to deliver their full effect. The fastest one should be the increase in the sales team, decided during Q1 but for which the first results should start to appear in Q3. However, for Germany and the product mix, the roots are deeper. The German market is highly competitive due to strong barriers to entry, so it will be some time before the sales curve accelerates. For the product mix, the company is walking on a razor's edge: competing with its terminals' suppliers Ingenico and Worldline, it must find a way to balance its Average Selling Price (ASP), the induced gross margin and the potential acquiring kickbacks from Worldline's terminals.

On the other side, the update of the PCI-DSS regulation has already triggered the start of an upgrade cycle before the existing terminals become obsolescent, which will favour the company and boost revenues, along with the expected results from the new sales teams. However, our initial expectation of more than €1m in revenues from Terminals is becoming unlikely, forcing us to a downgrade which will have a substantial impact, as the margins are typically much better in this business.

AlphaValue is contracted by Keyware to provide equity research on Keyware, using AlphaValue's unique and transparent methods and procedures. Target price and opinion are thus exclusively determined by those methods and procedures.

Buy	Upside : 74.4%
Target Price (6 months)	€ 2.51
Share Price	€ 1.44
Market Capitalisation €M	31.1
Price Momentum	UNFAVORABLE
Extremes 12Months	1.10 ▶ 1.99
Bloomberg	KEYW BB Equity
Reuters	KEYW.BR

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PERF	1w	1m	3m	12m
Keyware	3.38%	-4.20%	0.14%	-26.1%
IT Hardware	-1.68%	-7.47%	-16.4%	-6.57%
STOXX 600	0.51%	-2.18%	-4.68%	6.77%

Last updated: 15/06/2017	12/15A	12/16A	12/17E	12/18E
Adjusted P/E (x)	2.80	8.48	5.96	5.65
Dividend yield (%)	0.00	1.11	1.39	1.39
EV/EBITDA(R) (x)	3.95	6.54	4.49	3.64
Adjusted EPS (€)	0.30	0.21	0.24	0.25
Growth in EPS (%)	131	-28.2	13.5	5.57
Dividend (€)	0.00	0.02	0.02	0.02
Sales (€th)	12,491	18,721	20,183	22,150
EBIT margin (%)	25.0	17.0	17.4	17.5
Attributable net profit (€th)	5,182	3,101	3,810	3,908
ROE (after tax) (%)	24.9	12.4	13.2	11.7
Gearing (%)	15.3	16.3	14.9	8.57

[Company Valuation](#) - [Company Financials](#)

Growth drivers remain for the long term

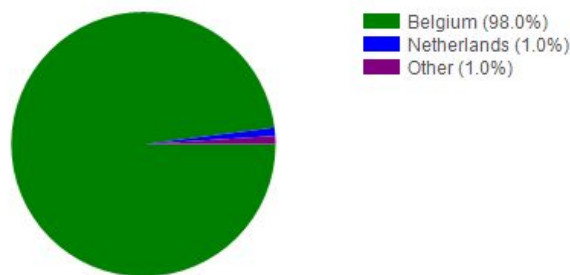
The negative performance of the Authorisations business should be minimised in our view: Q2 16 had been truly outstanding, with a +56.9% increase yoy, thus leading to a very high basis of comparison. The transition towards the brokering model appears to be following its course.

The major piece of news is the acquisition of the remaining stake in Magellan. Although the price paid may appear high at first, the company is already bringing in substantial profits, and is displaying appreciable growth: the objective is to double its revenues by 2023, i.e. about €6.5m. Moreover, the integration will demand minimal costs, as Magellan will operate as an independent business within the company and will bring its expertise as an additional layer to the other businesses. Combined with the acquisition of EasyOrder, Keyware is therefore building up a substantial software offer, which will act as a clear differentiator among competitors and bring a strong cash generation thanks to the inherent higher margins... although it will more than probably result at first in the dividend being cut to finance the acquisition.

■ Impact

Due to the current negative in Terminals, we are going to trim our expectations as we had computed more than €10m of revenues in 2017. This is going to have a substantial negative impact on the valuation, as this business is a major driver for margins and cash generation, while the acquisition of Magellan will lead to the removal of the dividend in our model.

Sales by Geography



Consolidated P&L Accounts

		12/16A	12/17E	12/18E
Sales	€th	18,721	20,183	22,150
Change in sales	%	49.9	7.81	9.75
Change in staff costs	%	-4.64	32.9	1.99
EBITDA	€th	5,339	5,623	6,075
EBITDA(R) margin	%	28.5	27.9	27.4
Depreciation	€th	-268	-293	-321
Underlying operating profit	€th	5,071	5,330	5,753
Operating profit (EBIT)	€th	3,174	3,514	3,871
Net financial expense	€th	1,018	1,096	1,245
of which related to pensions	€th		0.00	0.00
Exceptional items & other	€th			-750
Corporate tax	€th	-1,196	-1,000	-1,058
Equity associates	€th	105	200	600
Minority interests	€th			
Adjusted attributable net profit	€th	4,998	5,626	5,790
NOPAT	€th	3,655	3,931	4,627

Cashflow Statement

		12/16A	12/17E	12/18E
EBITDA	€th	5,339	5,623	6,075
Change in WCR	€th	-3,468	-2,517	-2,120
Actual div. received from equity holdi...	€th	0.00	0.00	0.00
Paid taxes	€th	0.00	-1,000	-1,058
Exceptional items	€th			-750
Other operating cash flows	€th	-53.0		
Total operating cash flows	€th	1,818	2,106	2,146
Capital expenditure	€th	-311	-343	-377
Total investment flows	€th	-4,541	-943	-577
Net interest expense	€th	1,018	1,096	1,245
Dividends (parent company)	€th	-424	-417	-401
Dividends to minorities interests	€th	0.00	0.00	0.00
New shareholders' equity	€th	76.0	-500	-500
Total financial flows	€th	2,787	-1,611	-1,464
Change in cash position	€th	64.0	-448	106
Free cash flow (pre div.)	€th	2,525	2,859	3,015

Per Share Data

		12/16A	12/17E	12/18E
No. of shares net of treas. stock (year...	Th	21,212	20,837	20,038
Number of diluted shares (average)	Th	23,538	23,345	22,758
Benchmark EPS	€	0.21	0.24	0.25
Restated NAV per share	€			
Net dividend per share	€	0.02	0.02	0.02

Valuation Summary

Benchmarks	Value	Weight	Largest comparables
DCF	€ 2.47	35%	■ Gemalto
NAV/SOTP per share	€ 2.37	20%	■ Ingenico
EV/Ebitda	€ 2.87	20%	■ Dassault Systemes
P/E	€ 2.87	10%	■ Logitech International
Dividend Yield	€ 1.62	10%	
P/Book	€ 2.87	5%	
TARGET PRICE	€ 2.51	100%	

NAV/SOTP Calculation

Balance Sheet

		12/16A	12/17E	12/18E
Goodwill	€th	5,248	5,480	5,480
Total intangible	€th	5,398	6,289	6,208
Tangible fixed assets	€th	491	636	668
Financial fixed assets	€th	4,585	4,677	4,770
WCR	€th	19,236	21,753	23,873
Other assets	€th	2,056	1,994	1,934
Total assets (net of short term liab.)	€th	31,766	35,349	37,454
Ordinary shareholders' equity	€th	26,436	31,361	35,380
Quasi Equity & Preferred	€th			
Minority interests	€th			
Provisions for pensions	€th		0.00	0.00
Other provisions for risks and liabilities	€th			
Total provisions for risks and liabilities	€th	0.00	0.00	0.00
Tax liabilities	€th			
Other liabilities	€th			
Net debt (cash)	€th	5,330	3,988	2,074
Total liab. and shareholders' equity	€th	31,766	35,349	37,454

Capital Employed

		12/16A	12/17E	12/18E
Capital employed after depreciation	€th	29,710	33,355	35,519

Profits & Risks Ratios

		12/16A	12/17E	12/18E
ROE (after tax)	%	12.4	13.2	11.7
ROCE	%	12.3	11.8	13.0
Gearing (at book value)	%	16.3	14.9	8.57
Adj. Net debt/EBITDA(R)	x	1.00	0.71	0.34
Interest cover (x)	x	-4.98	-4.86	-4.62

Valuation Ratios

		12/16A	12/17E	12/18E
Reference P/E (benchmark)	x	8.48	5.96	5.65
Free cash flow yield	%	6.61	9.55	10.5
P/Book	x	1.44	0.95	0.81
Dividend yield	%	1.11	1.39	1.39

EV Calculation

		12/16A	12/17E	12/18E
Market cap	€th	38,172	29,943	28,794
+ Provisions	€th	0.00	0.00	0.00
+ Unrecognised actuarial losses/(gains)	€th	0.00	0.00	0.00
+ Net debt at year end	€th	5,330	3,988	2,074
+ Leases debt equivalent	€th	0.00	0.00	0.00
- Financial fixed assets (fair value)	€th	8,585	8,677	8,770
+ Minority interests (fair value)	€th	0.00	0.00	0.00
= EV	€th	34,917	25,254	22,098
EV/EBITDA(R)	x	6.54	4.49	3.64
EV/Sales	x	1.87	1.25	1.00

Analyst : Charles Bordes, Changes to Forecasts : 15/06/2017.