

NetDimensions (Holdings)

Interim results

On target for FY17 profitability

While NetDimensions (AIM: NETD, OTCQX: NETDY) announced a modest reduction in H1 revenue due to a decline in services and support, this masked an 8% improvement in high-margin licence revenues to \$6.8m. Costs fell dramatically, enabling a sharp reduction in the EBITDA loss. New business is increasingly lumpy as the group targets large enterprises in high-consequence industries and we have conservatively eased our numbers. Nevertheless, the quality of business continues to improve with the emphasis on recurring software rental revenue. Following the recent decline, the shares look attractive, given the \$11.2m cash position (c 16.5p per share), an attractive growth profile, the cash-generative business model and an EV/sales rating at just 0.4x.

Year end	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/14	22.7	(3.5)	(9.4)	0.9	N/A	1.8
12/15	25.4	(0.7)	(2.2)	0.9	N/A	1.8
12/16e	26.6	(0.4)	(0.6)	1.0	N/A	2.0
12/17e	31.5	1.2	1.7	1.1	29.3	2.2

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. P/E and yield calculated in pence.

Interim results: High-margin licence revenue up 8%

Group revenue slipped by 1% to \$10.5m but costs fell, enabling the group to reduce its EBITDA loss by 58% to \$0.8m. Secure SaaS revenue lifted by 6% to \$5.4m, while software licensing (mostly onsite rental) rose by 11% to \$1.3m. Services revenues were weaker due to the delay in roll-outs highlighted in the July trading update, while the de-emphasising of perpetual licences led to a 33% decline in support and maintenance revenue. Invoiced sales to clients in high-consequence industries represented 91% of total invoiced sales. The group is becoming increasingly specialised on a select few verticals including precision engineering (especially automotive) and healthcare, with the latter growing by 11%. The group generated \$0.3m in H1 gross operating cash flow and modestly positive free cash flow, but the net cash position dipped by \$0.8m to \$11.2m over the six months, due to the decline in sterling as the group has significant GBP deposits.

Forecasts: Conservatively eased

We have conservatively eased our revenue forecasts by \$0.4m in FY16, \$0.5m in FY17 and \$0.6m in FY18. We have tweaked the gross margin forecast upwards, while conservatively increasing operating expenses, which results in operating profit falling by \$0.4m in FY16 (to a \$0.4m loss) and by \$0.2m in each of FY17 and FY18. We forecast the group to end the year with \$10.7m cash (previously \$11.1m), which rises to \$11.7m a year later (previously \$12.2m).

Valuation: High-growth sector with punchy valuations

If NETD can manage the growth effectively, we continue to see significant upside, as the shares trade on an EV of 0.4x our FY17e revenues, compared to the group's larger US peers (its key competitors), which typically trade at 2.7-6.8x revenues.

Software & comp services

19 September 2016

Price 38p/\$2.45*

Market cap £19m/\$25m

\$1.30/£

*ADR price

Net cash (\$m) at 30 June 2016 11.2

Shares in issue 51.2m

Free float 78%

Code NETD/NETDY

Primary exchange AIM

Secondary exchange OTCQX (ADR 5:1)

Share price performance



% 1m 3m 12m

Abs 7.9 (36.6) (50.3)

Rel (local) 10.2 (43.6) (53.7)

52-week high/low 76.50p 33.50p

Business description

NetDimensions provides talent and learning management systems (LMS) to global enterprises. The company's solutions allow organisations to deliver personalised learning, share knowledge, enhance performance, foster collaboration and manage compliance for employees, customers, partners and suppliers.

Next events

Q3 trading update October 2016

Q4 trading update January 2017

Final results April 2017

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Interim results: High-margin software shows growth

Group revenue slipped by 1% to \$10.5m. However, within the mix, the key Secure SaaS revenue lifted by 6% to \$5.4m, while software licensing (annual licences – effectively onsite rental) rose by 11% to \$1.3m. Services revenues slipped by 6% to \$3.2m due to the delay in roll-outs highlighted in the July trading update. The group has been de-emphasising legacy perpetual licences for several years and this led to a 33% decline in support and maintenance revenue to \$0.6m. Recurring revenue (SaaS, annual licence and support) represented 70% of total revenue. The revenue slowdown is a disappointment for the company and we understand the focus on developing larger accounts has led to some distraction from selling the group's "off-the-shelf" product to smaller customers that do not require customisation. We note that the group currently has 16 quota-carrying sales people, along with regional hands and relationship managers.

The group gross margin rose by 410bp to 85.0% largely due to the increase in high-margin software licensing revenues (ie the software licensing revenue plus hosting services) in the revenue mix, while operating costs (before depreciation) fell by 7% to \$9.7m. In July we noted that expenses had been tightly controlled due to a significant slowdown in new hires, which was below budget. This enabled the group to reduce its EBITDA loss by 58% to \$0.8m. We note the software licensing revenue line represents annual licences, which represents onsite installations of the software that are typically sold for a period of three years. It also used to include perpetual licences, which are de-emphasised and hence very rarely sold, and legacy perpetual installations are reflected in the support and maintenance revenue line. Hosting services represents the group's Secure SaaS product, which is a fully hosted solution and supported by the ISO 27001 security standard.

In its July trading update, the group reported that revenue for the period was broadly unchanged from H115, while the adjusted EBITDA loss for the period was less than \$1m. We said we understood that the company has received open purchase orders for significant annual on-premise licences. However, due to delays in the roll-outs, it has not been able to recognise the revenue or cash flow. We note that the group has been winning increasingly larger customers and these customers have increasingly complex services requirements. This typically involves complex customisation and data migration is also an issue, with data from as many as 20 systems transitioning to the NetDimensions platform. The roll-outs can be lengthy and complex, across multiple countries, languages and across a high level of users. This can lead to delays.

Exhibit 1: Half-by-half analysis

US\$000s	H115	H215	FY15	H116	H216e	FY16e	FY17e
Software licensing	1,211	4,679	5,890	1,343	3,153	4,496	7,046
Hosting services	5,127	5,323	10,450	5,445	6,390	11,835	13,220
Support and maintenance	890	690	1,580	551	1,186	1,738	1,722
Professional services	3,364	4,106	7,470	3,152	5,417	8,569	9,522
Total revenue	10,592	14,804	25,396	10,492	16,146	26,638	31,509
Cost of sales	(2,021)	(2,172)	(4,193)	(1,576)	(2,812)	(4,388)	(4,871)
Gross profit	8,571	12,632	21,203	8,915	13,335	22,250	26,638
Gross Margin	80.9%	85.3%	83.5%	85.0%	82.6%	83.5%	84.5%
Opex before depreciation	(10,461)	(11,242)	(21,704)	(9,709)	(12,744)	(22,453)	(25,183)
Adjusted EBITDA	(1,890)	1,390	(501)	(794)	591	(203)	1,455
Dep'n & s/w amortisation	(121)	(89)	(210)	(97)	(134)	(231)	(262)
Adjusted operating profit	(2,011)	1,301	(710)	(890)	591	(434)	1,194
Operating Margin	(19.0%)	8.8%	(2.8%)	(8.5%)	3.7%	(1.6%)	3.8%
Net interest	(0)	(14)	(15)	(0)	25	25	25
Edison Profit Before Tax (norm)	(2,011)	1,287	(725)	(891)	616	(409)	1,219
Amortisation of acquired intangibles	(236)	(252)	(488)	(152)	(152)	(304)	(304)
Share-based payments	(87)	(291)	(377)	(317)	(58)	(375)	(400)
Exchange movements	(155)	(165)	(319)	169	(169)	0	0
Exceptional items	0	0	0	0	0	0	0
Profit before tax (FRS 3)	(2,489)	580	(1,909)	(1,191)	237	(1,088)	514

Source: NetDimensions accounts, Edison Investment Research

Forecasts: Conservatively eased

We have conservatively eased our revenue forecasts by \$0.4m in FY16, \$0.5m in FY17 and \$0.6m in FY18. We have tweaked the gross margin forecast upwards, while conservatively increasing operating expenses, which results in operating profit falling by \$0.4m in FY16 (to a \$0.4m loss), and by \$0.2m in each of FY17 and FY18. We forecast the group to end the year with \$10.7m cash (previously \$11.1m), which rises to \$11.7m a year later (previously \$12.2m). We have also reduced the amortisation of acquired intangibles to H116 levels going forward.

We believe our forecasts are conservative, particularly operating costs, which we forecast will be \$3m higher in H2, mainly due to the increased sales and marketing activity in the period.

Nevertheless, while a busy Q4 performance could potentially boost the FY16 results if annual licences or perpetual licences are sold, the increasing focus on recurring Secure SaaS rental revenues means that a strong new business performance in Q4 will not necessarily boost FY16 numbers.

Exhibit 2: Forecasts

Revenues (\$'000s)	2013	2014	2015	2016e	2017e	2018e
Software licensing	3,673	5,381	5,890	4,496	7,046	7,617
Hosting services	6,072	8,279	10,450	11,835	13,220	14,612
Support and maintenance	2,433	2,644	1,580	1,738	1,722	1,757
Content, implementation and customisation	4,030	6,397	7,470	8,569	9,522	10,524
Group revenue	16,208	22,701	25,396	26,638	31,509	34,509
Growth (%)	17.5	40.1	11.9	4.9	18.3	9.5
Gross Profit	14,622	18,699	21,203	22,250	26,638	29,173
Gross margin (%)	90.2	82.4	83.5	83.5	84.5	84.5
Operating expenses	(18,893)	(22,230)	(21,913)	(22,684)	(25,444)	(26,589)
Adjusted operating profit	(4,272)	(3,531)	(710)	(434)	1,194	2,584
Operating margin (%)	(26.4)	(15.6)	(2.8)	(1.6)	3.8	7.5
Growth (%)	(1,566.0)	(17.3)	(79.9)	(38.9)	(375.0)	116.5
Net interest	65	25	(15)	25	25	25
Profit before tax norm	(4,207)	(3,507)	(725)	(409)	1,219	2,609
Amortisation of acquired intangibles	(477)	(472)	(488)	(304)	(304)	(304)
Share based payments	(266)	(674)	(377)	(375)	(400)	(425)
Exchange movements	4	(364)	(319)	0	0	0
Profit before tax	(4,946)	(5,016)	(1,909)	(1,088)	514	1,880
Taxation	(0)	(124)	(193)	115	(341)	(731)
Net income	(4,946)	(5,141)	(2,102)	(974)	173	1,149
Adjusted EPS (c)	(12.4)	(9.4)	(2.2)	(0.6)	1.7	3.5
Adjusted EPS (p)	(9.4)	(7.2)	(1.7)	(0.4)	1.3	2.7
P/E - Adjusted EPS	N/A	N/A	N/A	N/A	29.3	13.9

Source: NetDimensions accounts, Edison Investment Research

Exhibit 3: Forecast changes

	Revenues (\$m)			Adjusted operating profit (\$m)			EPS (c)		
	Old	New	% change	Old	New	% change	Old	New	% change
2016e	27.0	26.6	(1)	0.0	(0.4)	N/A	0.0	(0.6)	N/A
2017e	32.0	31.5	(2)	1.4	1.2	(14)	2.0	1.7	(15)
2018e	35.1	34.5	(2)	2.7	2.6	(4)	3.8	3.5	(8)

Source: Edison Investment Research

Valuation: High-growth sector with punchy valuations

We compare the stock with its listed US competitors and UK peers, which are not direct competitors (except for Access Intelligence, which has an LMS solution). NetDimensions' stock trades on 0.4x our FY17 revenue forecast, which is well below its UK peers, and just a fraction of its US peers. This is in spite of NetDimensions' very good track record of profitability and cash generation before the accelerated investment in 2013.

Exhibit 4: Peer valuations

	Share price	Market cap	EV/sales (x)		EV/EBITDA (x)		P/E (x)	
		m	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
NetDimensions (£)	37.75p	19.3	0.5	0.4	N/A	9.2	N/A	29.3
1) North American Human Capital Management software peers (\$'m)								
Callidus Software	18.725	1164	5.2	4.4	41.4	32.0	67.4	51.2
Cornerstone OnDemand	44.07	2465	5.7	4.7	78.6	45.1	3672.5	158.5
Halogen Software (C\$)	10.18	219	1.8	1.6	29.2	21.8	N/A	N/A
HealthStream	26.4	838	3.1	2.7	19.9	15.2	88.0	58.9
Paycom Software	48.73	2915	8.8	6.8	33.9	26.3	63.2	51.0
Paylocity	42.285	2163	7.0	5.5	54.1	40.3	115.5	83.9
Ultimate Software	205.6	5950	7.5	6.1	30.9	24.6	62.5	50.4
Workday	88.53	17617	10.3	7.9	127.1	92.4	N/A	275.8
Medians			6.3	5.1	37.7	29.1	77.7	58.9
2) Human Capital Management software peers quoted on AIM (£'m)								
Access Intelligence	5.125	15	N/A	N/A	N/A	N/A	N/A	N/A
Bond Intl Software	108.5	46	N/A	N/A	N/A	N/A	N/A	N/A
Dillistone Systems	83.5	16	1.5	1.5	6.1	5.8	13.3	12.3
EG Solutions	54	11	0.9	0.7	5.6	3.9	23.5	11.0
Learning Technologies	30.5	128	4.6	3.9	18.3	15.6	27.7	21.8
ServicePower	2.625	6	0.4	0.3	9.1	5.1	N/A	26.3
Tracsis	530	147	4.4	3.9	18.8	16.8	26.1	23.2
Medians			1.5	1.5	9.1	5.8	24.8	21.8
Source: Edison Investment Research, Bloomberg. Prices as at London close on 16 September 2016.								

Exhibit 5: Financial summary

	US\$'000s	2013	2014	2015	2016e	2017e	2018e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		16,208	22,701	25,396	26,638	31,509	34,509
Cost of Sales		(1,586)	(4,002)	(4,193)	(4,388)	(4,871)	(5,336)
Gross Profit		14,622	18,699	21,203	22,250	26,638	29,173
EBITDA		(4,105)	(3,335)	(501)	(203)	1,455	2,913
Adjusted Operating Profit		(4,272)	(3,531)	(710)	(434)	1,194	2,584
Amortisation of acquired intangibles		(477)	(472)	(488)	(304)	(304)	(304)
Exceptional items and exchange movements		4	(364)	(319)	0	0	0
Associates and joint ventures		0	0	0	0	0	0
Share based payments		(266)	(674)	(377)	(375)	(400)	(425)
Operating Profit		(5,011)	(5,041)	(1,894)	(1,113)	489	1,855
Net Interest		65	25	(15)	25	25	25
Profit Before Tax (norm)		(4,207)	(3,507)	(725)	(409)	1,219	2,609
Profit Before Tax (FRS 3)		(4,946)	(5,016)	(1,909)	(1,088)	514	1,880
Tax		(1)	(124)	(193)	115	(341)	(731)
Profit After Tax (norm)		(4,207)	(3,631)	(918)	(294)	878	1,878
Profit After Tax (FRS 3)		(4,946)	(5,141)	(2,102)	(974)	173	1,149
Average Number of Shares Outstanding (m)		33.8	38.5	40.8	51.6	52.3	53.2
EPS - normalised (c)		(12.4)	(9.4)	(2.2)	(0.6)	1.7	3.5
EPS - FRS 3 (c)		(14.6)	(13.3)	(5.2)	(1.9)	0.3	2.2
Dividend per share (c)		0.99	0.90	0.90	1.00	1.10	1.20
Gross Margin (%)		90.2	82.4	83.5	83.5	84.5	84.5
EBITDA Margin (%)		(25.3)	(14.7)	(2.0)	(0.8)	4.6	8.4
Operating Margin (%)		(26.4)	(15.6)	(2.8)	(1.6)	3.8	7.5
BALANCE SHEET							
Fixed Assets		3,980	3,359	3,019	2,803	2,615	2,395
Intangible Assets		3,522	3,059	2,591	2,286	1,982	1,677
Tangible Assets		316	270	260	349	465	550
Other		142	30	168	168	168	168
Current Assets		15,031	13,104	21,011	20,166	22,904	25,973
Stocks		0	0	0	0	0	0
Debtors		7,303	8,197	9,030	9,472	11,204	12,271
Cash		7,728	4,907	11,981	10,694	11,700	13,702
Current Liabilities		(10,673)	(12,476)	(11,830)	(12,050)	(14,144)	(15,610)
Creditors		(10,671)	(12,473)	(11,826)	(12,045)	(14,140)	(15,606)
Short term borrowings		(2)	(2)	(4)	(4)	(4)	(4)
Long Term Liabilities		(113)	(182)	(80)	(80)	(80)	(80)
Long term borrowings		(6)	(3)	(14)	(14)	(14)	(14)
Other long term liabilities		(106)	(179)	(65)	(65)	(65)	(65)
Net Assets		8,225	3,805	12,120	10,840	11,295	12,679
CASH FLOW							
Operating Cash Flow		(2,514)	(2,085)	(2,349)	(432)	1,793	3,296
Net Interest		65	25	(15)	25	25	25
Tax		(31)	(57)	(148)	(193)	82	(329)
Capex		(256)	(144)	(205)	(320)	(378)	(414)
Acquisitions/disposals		(2,242)	(258)	0	0	0	0
Equity financing		6,133	250	10,553	0	0	0
Dividends		(287)	(389)	(374)	(367)	(516)	(576)
Net Cash Flow		868	(2,658)	7,464	(1,287)	1,006	2,002
Opening net debt/(cash)		(6,814)	(7,719)	(4,902)	(11,963)	(10,676)	(11,681)
Other		37	(160)	(403)	0	0	0
Closing net debt/(cash)		(7,719)	(4,902)	(11,963)	(10,676)	(11,681)	(13,684)

Source: NetDimensions accounts, Edison Investment Research

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