

Expert System

H1 results

Building the foundations for growth

Software & comp services

The focus on integrating the TEMIS acquisition slowed the pace of customer wins in H116, resulting in a dip in revenues and EBITDA. With this integration largely complete, we expect a better rate of new business wins in H216. We have reduced our forecasts to reflect H1 performance and incorporated the recent fund-raising. The company continues to focus on evolving the product, developing indirect sales channels and building the business in the US.

Year end	Revenue (€m)	EBITDA (€m)	EPS* (c)	DPS (c)	EV/EBITDA (x)	Yield (%)
12/14	13.0	2.3	0.1	0.0	28.9	N/A
12/15	18.9	1.2	(3.3)	0.0	56.7	N/A
12/16e	25.7	0.1	(8.2)	0.0	N/A	N/A
12/17e	30.4	3.4	(0.5)	0.0	20.1	N/A

Note: *EPS is normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Contract wins delayed by integration efforts

Expert reported H116 revenues of $\text{€}8.57\text{m}$, reflecting the first full six-month contribution from TEMIS. This was lower than the $\text{€}10.89\text{m}$ reported in H215 as integration work in H1 reduced the focus on new business wins. Lower revenues resulted in an EBITDA loss of $\text{€}1.95\text{m}$ and the company finished H116 with a net debt position of $\text{€}15.85\text{m}$. In September, the company raised $\text{€}4.7\text{m}$ from the issue of 2.6m new shares at $\text{€}1.80/\text{share}$.

Company confident that outlook remains positive

With integration processes substantially complete, management expects stronger pipeline conversion in H216. According to management, interest in its cognitive computing solutions remains strong. The sales pipeline at the end of August was 240% higher than a year ago and with the combined sales force now primed to sell the group's portfolio of solutions, we expect a higher rate of contract wins in H216. Expert continues to develop vertical expertise for its solutions and is focused on growing the business in the US while supporting its existing strong position in Europe. We have revised our forecasts to reflect the delay in new contract wins and the recent fundraising. We reduce our revenue forecasts by 7.7% in FY16 and 6.6% in FY17 and reduce our EBITDA forecasts accordingly.

Valuation: Reflects growth potential

Expert System trades on a 2017e EV/EBITDA of 20.1x. This places it at a premium to traditional linguistic services companies, but in line with more tech-focused enterprise search businesses. Our DCF valuation of Expert System suggests a value of $\text{€}2.60/\text{share}$ (down from our previous $\text{€}2.78$) reflecting the short-term delay to the revenue ramp up. Expert's ability to convert customer interest in the fast-growing data mining and analytics market into commercial contracts will be key to share price upside from this point.

17 November 2016

Price **€1.99**

Market cap **€55m**

\$1.10:€1

Net debt (€m) at end H116 15.9

Shares in issue 27.7m

Free float 61.7%

Code EXSY

Primary exchange AIM Italia

Secondary exchange N/A

Share price performance



Rel (local) (1.1) 10.5 33.3

52-week high/low €2.17 €1.78

Business description

Expert System has developed and patented technology that extracts useful information from unstructured text using semantic-based techniques. It applies this technology to a number of verticals including enterprise search, customer experience management and big data analytics.

Next events

FY16 results May 2017

Analysts

Katherine Thompson +44 (0)20 3077 5730

Dan Ridsdale +44 (0)20 3077 5729

tech@edisongroup.com

[Edison profile page](#)

Expert System
Expert System is a research client of Edison Investment Research Limited

Review of H116 results

Exhibit 1: Half-yearly results summary

€m	H115	H215	H116	y-o-y	h-o-h
Revenue	5.50	10.89	8.57	55.8%	-21.3%
Grants and other income	0.81	1.65	1.25	53.5%	-24.4%
Total revenue	6.32	12.54	9.82	55.5%	-21.7%
Capitalised development costs	1.63	1.99	2.94	80.1%	48.2%
Changes in WIP	-0.66	0.84	0.39	-159.5%	-53.0%
Total production value	7.29	15.36	13.15	80.5%	-14.3%
Staff costs	4.46	6.84	9.10	103.9%	33.0%
Other costs	4.31	5.85	6.01	39.6%	2.7%
EBITDA	-1.48	2.67	-1.95	32.0%	-173.2%
Depreciation & amortisation - in-house	1.04	1.18	1.45	39.1%	22.1%
Normalised EBIT	-2.52	1.49	-3.40	34.9%	-328.8%
Depreciation & amortisation - acquired	0.00	3.00	1.50		
Exceptional costs/(income)	0.09	-0.35	-0.05		
EBIT	-2.61	-1.16	-4.84	85.6%	316.0%
Net income	-2.07	-1.21	-5.05	144.0%	316.3%
Net debt	3.98	12.43	15.85	297.9%	27.6%

Source: Expert System

Expert System reported H116 revenues of €8.6m, of which €2.7m was contributed by TEMIS. This implies the original Expert business grew 6% y-o-y. We note that revenues totalled €10.9m in H215, of which €2.9m was generated from TEMIS from the date on which it was acquired (23 September), implying €7.9m of revenues were generated by the original Expert business in that half. This implies that both parts of the business saw lower sales in H116 compared to H215. The company was focused on integrating TEMIS into the Expert Group through the course of H116. This included training the salesforce to enable them to sell the combined portfolio of solutions and we believe that this distraction delayed new business.

At the production value level, €4.8m was contributed by TEMIS (which implies €2.0m of grants, other income, and capitalised development costs were attributable to TEMIS).

Costs excluding depreciation and amortisation increased to €15.1m in H116 from €12.7m in H215. The majority of the increase is accounted for by a full six-month inclusion of TEMIS versus three months in H215. In addition, Expert has increased investment in headcount to accelerate R&D and grow the US business. The drop in revenues resulted in an EBITDA loss of €1.95m for H116.

The company ended H116 with a net debt position of €15.9m.

Recent fundraising supports growth plans

In September, the company completed a fundraising issuing 2,609,552 shares at €1.80 per share for gross proceeds of €4.7m. Shareholders who subscribed also received one warrant per share. Warrants are convertible at a rate of four warrants per ordinary share. There are two exercise periods: 1-31 October 2017 at an exercise price €2.40 per share and 1-31 October 2018 at a price of €2.70 per share. Total warrants issued totalled 2,497,552, which could convert into a maximum of 624,388 shares.

Business update

Here we assess the progress the company has made with its strategy year-to-date:

Product development

The company released a new solution, Cogito Studio, during H116. This solution should help companies optimise the launch of new projects by automatically learning new knowledge, such as that for a specific domain, by applying Cogito's semantic technology to read and understand words in context. The automatic learning process no longer requires constant supervision from humans or the manual acquisition of large volumes of data.

The company has enhanced the functionality of its finance and insurance sector solution with additional insurance claims management functionality.

Build the indirect sales channel

To complement the company's direct sales effort, Expert is partnering with companies in target markets and is aiming to grow the reseller channel. Expert announced a partnership with Quantic Research (QR), a subsidiary of Nivi Group SpA. QR develops innovative security sector solutions and will work with Expert to target the defence and intelligence sector. Expert has also partnered with Onix, a US-based IT services provider, which will integrate Cogito into its commercial and federal market solutions. Most recently, Expert has partnered with NominoDataLLC, a US provider of risk management and compliance solutions. Expert's platform will be combined with data provided by NominoData to enable customers to reduce operational risk by reviewing open source intelligence information. The company continues to discuss partnerships with a number of large consulting firms.

Develop sales in the US

As we have previously written, Expert has two separate divisions in the US: one focused on the public sector (originally Expert's US business) and one focused on enterprise customers (originally the TEMIS US business). In addition, in April the company opened new R&D centres in Washington DC and Silicon Valley to get access to expertise and to be closer to potential customers. Management continues to talk to US customers in both markets; however, this is taking longer than expected (partly due to pre-election inertia) and is likely to push the timing of new contracts by out by at least six months.

New business wins

Contracts signed in the year to date show the range of applications that Expert's technology supports:

- Corriere della Sera: signed up to use Cogito to automatically classify data in its digital archives so that readers can easily access its extensive library of articles that extend back to 1876.
- FinecoBank: the multi-channel bank of UniCredit is using Cogito to optimise its customer self-service solutions.
- Inserm: the French National Institute of Health and Medical Research signed a licence for the Luxid Navigator biomedical information portal. Inserm is using Luxid to automate the process of identifying subject matter experts to review prospective new hires. Luxid Navigator provides detailed information such as publication metrics and collaboration networks to help Inserm identify both established opinion leaders and rising stars.

- L'Argus de la Presse: the French economic intelligence supplier to marketing and communication professionals has integrated the Luxid Annotation Server into LuQi, its 360° media intelligence suite. This should enable users of the LuQi suite to transform brand-oriented media mentions and conversations into actionable structured information.
- Mondadori Magazines France: the French subsidiary is using the Luxid Annotation Server to enhance the use of its editorial content to drive the creation of new data-oriented digital products and services.

Outlook and changes to forecasts

We have revised our forecasts to reflect the lower than expected revenues in H116 – see Exhibit 2. We now forecast a step up in revenues to €15m in H216, resulting in FY16e revenues of €23.6m (down from our previous forecast of €25.5m). This is dependent on the company closing a number of deals in its current pipeline. We have also revised down our FY17 revenue forecast from €30.0m to €28.3m.

We have increased our operating cost assumptions for FY16 but have assumed that staff costs will only show a minimal increase in FY17. This results in a reduction in FY16 EBITDA from €2.5m to €0.1m, and in FY17 a 36% reduction in EBITDA to achieve a margin of 11.1%.

We have factored in the H216 fundraising – this reduces the net debt position at the end of FY16 and FY17.

Exhibit 2: Changes to forecasts

	16e old	16e new	Change	y-o-y	17e old	17e new	Change	y-o-y
Revenues	25.5	23.6	-7.4%	43.8%	30.0	28.3	-5.8%	20.0%
Other income & grants	2.4	2.2	-10.7%	-12.3%	2.5	2.1	-16.0%	-2.8%
Total revenues	27.9	25.7	-7.7%	36.5%	32.5	30.4	-6.6%	18.1%
EBITDA	2.5	0.1	-97.3%	-94.4%	4.9	3.4	-31.3%	4969.8%
<i>EBITDA margin</i>	8.8%	0.3%	-8.6%	-6.1%	15.1%	11.1%		10.8%
D&A	(2.3)	(2.3)	-1.4%		(2.6)	(2.6)	0.0%	
Normalised operating profit	0.2	(2.3)	-1551.5%	-119.3%	2.3	0.8	-66.7%	-134%
<i>Normalised operating margin</i>	0.6%	-8.8%	-9.4%	-3.3%	7.1%	2.5%		11.3%
Exceptionals	0.0	0.0			0.0	0.0		
Amortisation of acquired intangibles	(3.0)	(3.0)			(3.0)	(3.0)		
Reported operating profit	(2.8)	(5.3)	85.2%	-39.5%	(0.7)	(2.2)	219.5%	57.6%
Normalised EPS (c)	(1.8)	(8.2)	357.5%		3.6	(0.5)	-114.9%	
Net debt	17.8	14.1	-20.4%	13.8%	20.6	18.4	-10.9%	29.9%

Source: Edison Investment Research

Exhibit 3: Financial summary

	€'000s	2012	2013	2014	2015	2016e	2017e
		IT GAAP	IT GAAP				
31-December							
PROFIT & LOSS							
Revenue	11,593	11,109	13,045	18,853	25,731	30,385	
EBITDA	2,624	2,014	2,339	1,189	66	3,365	
Operating Profit (before amort. and except.)	1,765	916	609	(1,033)	(2,266)	766	
Intangible Amortisation	0	0	0	(3,000)	(3,000)	(3,000)	
Exceptionals	(319)	45	59	258	0	0	
Other	0	0	0	0	0	0	
Operating Profit	1,446	961	669	(3,775)	(5,266)	(2,234)	
Net Interest	(298)	(376)	29	215	(1,161)	(995)	
Profit Before Tax (norm)	1,467	539	638	(818)	(3,428)	(229)	
Profit Before Tax (reported)	1,148	584	697	(3,560)	(6,428)	(3,229)	
Tax	(452)	(359)	(609)	277	2,462	1,130	
Profit After Tax (norm)	1,015	180	29	(754)	(2,115)	(149)	
Profit After Tax (reported)	697	225	89	(3,282)	(3,966)	(2,099)	
Average Number of Shares Outstanding (m)	22.0	22.0	22.0	22.8	25.8	27.7	
EPS - normalised (c)	4.6	0.8	0.1	(3.3)	(8.2)	(0.5)	
EPS - normalised and fully diluted (c)	4.6	0.8	0.1	(3.3)	(8.2)	(0.5)	
EPS - (IFRS) (c)	3.2	1.0	0.4	(14.4)	(15.4)	(7.6)	
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0	
Gross Margin (%)	100.0	100.0	100.0	100.0	100.0	100.0	
EBITDA Margin (%)	22.6	18.1	17.9	6.3	0.3	11.1	
Adj Operating Margin (%)	15.2	8.2	4.7	-5.5	-8.8	2.5	
BALANCE SHEET							
Fixed Assets	6,691	9,905	5,719	20,301	20,083	19,869	
Intangible Assets	1,111	2,462	4,640	18,539	18,176	17,800	
Tangible Assets	635	606	692	916	1,061	1,223	
Investments	4,945	6,836	387	846	846	846	
Current Assets	12,767	15,491	32,681	43,149	46,505	44,934	
Stocks	722	476	1,563	1,797	2,156	2,156	
Debtors	5,488	5,820	7,866	10,228	10,228	11,251	
Cash	2,065	2,967	4,900	11,249	11,964	7,740	
Other	4,492	6,228	18,352	19,875	22,156	23,787	
Current Liabilities	(8,871)	(10,333)	(13,639)	(20,517)	(20,500)	(20,814)	
Creditors	(6,538)	(7,350)	(10,698)	(15,082)	(15,065)	(15,379)	
Short term borrowings	(2,332)	(2,984)	(2,940)	(5,435)	(5,435)	(5,435)	
Long Term Liabilities	(4,642)	(5,172)	(7,803)	(22,214)	(24,667)	(24,667)	
Long term borrowings	(4,642)	(5,172)	(4,799)	(18,240)	(20,671)	(20,671)	
Other long term liabilities	0	0	(3,005)	(3,974)	(3,996)	(3,996)	
Net Assets	5,945	9,890	16,958	20,718	21,420	19,322	
CASH FLOW							
Operating Cash Flow	8,077	2,891	737	2,738	(288)	2,657	
Net Interest	(298)	(376)	29	(324)	(938)	(995)	
Tax	(452)	(359)	(609)	(1,576)	(300)	(500)	
Capex	(3,095)	(2,384)	(3,905)	(20,045)	(5,122)	(5,386)	
Acquisitions/disposals	0	0	(6,436)	3,045	3	0	
Financing	0	0	12,341	6,573	4,927	0	
Dividends	0	(180)	0	0	0	0	
Net Cash Flow	4,232	(408)	2,156	(9,588)	(1,718)	(4,224)	
Opening net debt/(cash)	6,352	4,909	4,822	2,839	12,426	14,142	
HP finance leases initiated	0	0	0	0	0	0	
Other	(2,788)	128	(173)	0	2	0	
Closing net debt/(cash)	4,909	5,189	2,839	12,426	14,142	18,366	

Source: Expert System, Edison Investment Research

Edison, the investment intelligence firm, is the future of investor interaction with corporates. Our team of over 100 analysts and investment professionals work with leading companies, fund managers and investment banks worldwide to support their capital markets activity. We provide services to more than 400 retained corporate and investor clients from our offices in London, New York, Frankfurt, Sydney and Wellington. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison and is not regulated by the Australian Securities and Investment Commission. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. www.edisongroup.com

DISCLAIMER

Copyright 2016 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Expert System and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Aus and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2016. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.