

Expert System

H120 results

Laying the foundations for growth

Expert System's H120 financial results were affected by COVID-19 restrictions and the start of investment in the company's new five-year growth plan. So far in H220, the company is making good progress in executing this plan, with funds raised to support the required investment and technology development on track to launch the new end-to-end SaaS platform in Q121.

Year end	Revenue (€m)	EBITDA* (€m)	EPS* (c)	DPS (€)	P/E (x)	EV/Sales (x)
12/18	30.5	4.6	(1.4)	0.0	N/A	3.1
12/19	33.7	5.5	(1.6)	0.0	N/A	2.8
12/20e	31.2	(0.4)	(15.5)	0.0	N/A	3.0
12/21e	32.5	(5.7)	(24.0)	0.0	N/A	2.9
12/22e	45.7	(1.0)	(17.3)	0.0	N/A	2.1

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

COVID-19 slows new business in H120

Expert System reported a 19% y-o-y decline in sales in H120, as COVID-19 restrictions made it harder to sign new business in Q220. Combined with increased investment as part of the company's new five-year strategy (Path to Lead), this resulted in an EBITDA loss of €4.6m compared to €0.4m in H119. Net cash at the end of H120 was €3.8m and was boosted post period end by the €25m raised to fund the Path to Lead plan. While we expect a pick-up in revenues in H2 (partly due to normal seasonality and partly due to fewer COVID-19 restrictions), we have trimmed our forecasts to reflect the sales decline in H1.

Path to Lead on track

In July, the company launched its natural language API (application programming interface) and hired senior management in the US to drive international expansion. It is on track to deliver product updates during the course of Q420 and Q121, building up to the full launch of the end-to-end SaaS platform in March 2021. The company is also rebranding to expert.ai reflecting its desire to democratise the use of artificial intelligence for natural language understanding.

Valuation: Considerable upside if executed well

With the full SaaS platform not scheduled to launch until the end of Q121, the plan calls for significant investment before adoption of the SaaS platform is expected to drive material revenue growth in FY22. Based on a DCF valuation, we estimate that successful execution of the plan (which is targeting revenues of €100m and EBITDA margins of 22% by FY24) could see the stock valued in the region of €4.7 per share. To monitor progress towards the revenue inflection, we look to track the number of users signing up to use the platform, length and frequency of platform usage, conversion rates to paid subscriptions, net dollar retention and contribution from channel partners.

Software & comp services

1 October 2020

Price €2.30

Market cap €116m

Net cash (€m) at end H120 3.8

Shares in issue 50.4m

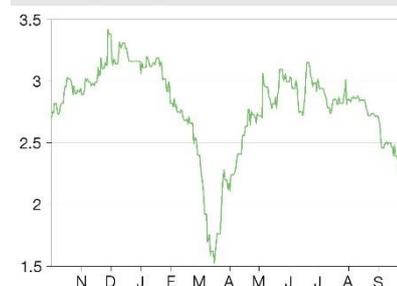
Free float 75%

Code EXSY

Primary exchange AIM Italia

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (15.3) (23.6) (21.3)

Rel (local) (12.8) (22.5) (9.2)

52-week high/low €3.43 €1.52

Business description

Expert System has developed and patented an AI-based technology platform that extracts useful information from unstructured text using a unique mix of natural language understanding and machine learning algorithms and applies it to verticals such as enterprise search, customer experience management and big data analytics.

Next events

FY20 trading update January 2021

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Review of H120 results

Exhibit 1: Half-year results highlights			
€m	H119	H120	y-o-y
Sales	11.87	9.57	-19.4%
Grants and other income	0.81	1.10	35.0%
Total revenue	12.69	10.67	-15.9%
Capitalised development costs	2.76	3.11	12.6%
Changes in WIP	-0.09	-0.05	-46.4%
Total production value	15.36	13.73	-10.6%
Staff costs	9.44	10.88	15.2%
Other costs	6.35	7.42	16.8%
EBITDA	(0.43)	(4.56)	953.2%
EBITDA margin	-3.4%	-42.7%	-39.3%
Depreciation & amortisation - in-house	2.53	2.82	11.3%
Normalised EBIT	(2.96)	(7.38)	149.0%
Normalised EBIT margin	-23.4%	-69.1%	-45.8%
Depreciation & amortisation - acquired	1.26	0.45	-64.2%
EBIT	(4.22)	(7.83)	85.4%
Net income	(4.02)	(3.05)	-24.1%
Net debt/(cash)	5.70	(3.82)	-167.0%

Source: Expert System

Expert System reported a 16% y-o-y decline in revenue in H120 as COVID-19 restrictions made it more difficult to sign new business. At the same time, the company started ramping up investment in its new five-year strategy (see below for more detail), which resulted in the EBITDA loss expanding to €4.6m from €0.4m a year ago. The EBIT loss also expanded, with slightly higher depreciation and amortisation reflecting the increase in capitalised development costs in recent years. Reported net income included an exceptional gain of €5.1m on the disposal of the stake in CY4GATE during H1.

The company closed the half with a net cash position of €3.8m, up from a net debt position of €5.7m a year ago and €2.8m at the end of FY19. During H120, the company benefited from the sale of its stake in CY4GATE for €5.4m and the issue of 1.11m shares, generating gross proceeds of €3m. The company raised a further €25m from the issue of 9.26m shares in July.

Exhibit 2: Sales by geography			
€m	H119	H120	y-o-y
Italy	5.0	4.9	(2.1%)
Europe (ex-Italy)	4.2	2.7	(35.5%)
US	2.7	2.0	(26.4%)
Total	11.9	9.6	(19.4%)
Revenue contribution			
Italy	42%	51%	
Europe (ex-Italy)	35%	28%	
US	23%	21%	

Source: Expert System

The table above shows the split of sales by geography and the decline for each region on a year-on-year basis. Management noted that it was easier to generate business in Italy as it has a well-established customer base there, whereas new business in the US was harder to come by as this relies to a greater extent on winning new customers.

Services made up 43.4% of H120 sales compared to 40.5% in H119. This means that licence-based sales declined 23% y-o-y and service sales were down 14% y-o-y. Recurring licences made up 80% of total licence sales. The company noted that at 10% of sales, business via the channel was at a similar proportion in H120 to FY19.

Update on Path to Lead

In June, the company announced plans to accelerate growth with its Path to Lead growth strategy (see [Five year growth strategy unveiled](#)). It has already met two milestones on the plan: raising €25m from the issue of 9.26m shares and launching the expert.ai natural language API. The company has also invested in the sales & marketing function in the US, hiring a chief revenue officer, Colin Matthews, and a chief marketing officer, Keith C Lincoln.

The next target on the timeline is in October when Expert System plans to launch a new version of expert.ai studio and provide a preview of the core capabilities of the SaaS platform. It will also be undertaking a rebranding exercise to raise awareness of the company's technology, with a new logo 'Expert.ai' and strapline 'Expert.ai makes AI available, makes AI simple, makes everyone...expert'.

Through the remainder of Q420 and into Q121, the company is targeting ongoing enhancements to its technology:

- November: new features and verticals for the API.
- December: launch of a commercial offering for the API.
- January 2021: new verticals and an early adopters programme (EAP) for the platform.
- March 2021: launch of the full end-to-end SaaS platform.

Outlook and changes to forecasts

In previous years, Expert System has seen much stronger revenues in H2 compared to H1. This is likely to be the case again in 2020, and is likely to be even more pronounced because of the COVID-19-related slowdown in Q2. We have trimmed our revenue forecasts to reflect the lower level of revenues in H120, resulting in reduced EBITDA forecasts.

Exhibit 3: Changes to forecasts

€m	FY20e old	FY20e new	Change	y-o-y	FY21e old	FY21e new	Change	y-o-y	FY22e old	FY22e new	Change	y-o-y
Sales	31.7	29.7	(6.5%)	(6.2%)	32.9	31.0	(6.0%)	4.3%	46.2	44.2	(4.4%)	42.6%
Other income & grants	1.5	1.5	0.0%	(27.1%)	1.5	1.5	0.0%	0.0%	1.5	1.5	0.0%	0.0%
Total revenues	33.2	31.2	(6.2%)	(7.5%)	34.4	32.5	(5.7%)	4.1%	47.7	45.7	(4.2%)	40.6%
Capitalised development costs & changes in WIP	6.5	6.5	0.0%	8.3%	8.0	8.0	0.0%	22.3%	10.3	10.3	0.0%	29.6%
Production value	39.8	37.7	(5.2%)	(5.1%)	42.4	40.5	(4.6%)	7.3%	58.0	56.0	(3.5%)	38.5%
EBITDA	2.0	(0.4)	(121%)	(108%)	(5.0)	(5.7)	14.5%	1233%	(0.5)	(1.0)	102.0%	(83.0%)
EBITDA margin	6.0%	-1.4%	(7.4%)	(17.6%)	(14.4%)	(17.5%)	(3.1%)	(16.1%)	(1.0%)	(2.1%)	(1.1%)	15.4%
D&A	(6.4)	(6.4)	0.0%		(6.9)	(6.9)	0.0%		(7.9)	(7.9)	0.0%	
Normalised operating profit	(4.4)	(6.9)	55.1%	N/A	(11.9)	(12.6)	6.0%	83.5%	(8.4)	(8.8)	5.8%	(29.7%)
Normalised operating margin	(13.3%)	(22.0%)	(8.7%)	(20.9%)	(34.5%)	(38.8%)	(4.3%)	(16.8%)	(17.5%)	(19.4%)	(1.8%)	19.4%
Amortisation of acquired intangibles	(0.9)	(0.9)	0.0%	N/A	0.0	0.0	0.0%	N/A	0.0	0.0		N/A
Exceptional items	0.0	0.0	0.0%	N/A	0.0	0.0	0.0%	N/A	0.0	0.0		N/A
Reported operating profit	(5.3)	(7.8)	45.7%	N/A	(11.9)	(12.6)	6.0%	N/A	(8.4)	(8.8)	5.8%	N/A
Normalised net income	(4.7)	(6.9)	46.6%	N/A	(11.5)	(12.1)	5.7%	75.1%	(8.3)	(8.7)		27.8%
Reported net income	(0.9)	(3.1)	236.6%	N/A	(11.5)	(12.1)	5.7%	N/A	(8.3)	(8.7)		27.8%
Diluted normalised EPS (c)	(10.6)	(15.5)	46.6%	N/A	(22.7)	(24.0)	5.7%	(54.9%)	(16.5)	(17.3)	5.3%	27.8%
Net debt/(cash)	(23.6)	(21.3)	-9.8%	N/A	(10.1)	(7.1)	-29.7%	(66.6%)	0.7	4.0	474.4%	(156%)

Source: Edison Investment Research

Exhibit 4: Financial summary

	€'000s	2015	2016	2017	2018	2019	2020e	2021e	2022e
31-December		IT GAAP							
PROFIT & LOSS									
Revenue		19,368	25,057	27,783	30,457	33,712	31,192	32,481	45,683
EBITDA		1,463	(2,245)	1,711	4,638	5,459	(426)	(5,679)	(963)
Operating Profit (before amort. and except.)		(1,226)	(5,941)	(3,189)	(662)	(358)	(6,864)	(12,593)	(8,848)
Intangible Amortisation		(2,549)	(2,608)	(2,608)	(2,567)	(2,520)	(902)	0	0
Exceptionals		0	0	(700)	0	0	0	0	0
Other		0	0	0	0	0	0	0	0
Operating Profit		(3,775)	(8,549)	(6,496)	(3,229)	(2,878)	(7,765)	(12,593)	(8,848)
Net Interest		213	(156)	(2,191)	97	(123)	(821)	(859)	(859)
Profit Before Tax (norm)		(1,013)	(6,097)	(5,380)	(565)	(481)	(7,685)	(13,452)	(9,707)
Profit Before Tax (reported)		(3,562)	(8,705)	(8,687)	(3,131)	(780)	(3,436)	(13,452)	(9,707)
Tax		277	579	348	(650)	(203)	344	1,345	971
Profit After Tax (norm)		(934)	(5,692)	(5,164)	(508)	(607)	(6,916)	(12,107)	(8,736)
Profit After Tax (reported)		(3,284)	(8,126)	(8,339)	(3,781)	(983)	(3,093)	(12,107)	(8,736)
Average Number of Shares Outstanding (m)		22.8	25.8	28.1	35.8	38.6	44.6	50.4	50.4
EPS - normalised (c)		(4.1)	(22.0)	(18.3)	(1.4)	(1.6)	(15.5)	(24.0)	(17.3)
EPS - normalised and fully diluted (c)		(4.1)	(22.0)	(18.3)	(1.4)	(1.6)	(15.5)	(24.0)	(17.3)
EPS - (IFRS) (c)		(14.4)	(31.5)	(29.6)	(10.6)	(2.5)	(6.9)	(24.0)	(17.3)
Dividend per share (c)		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA Margin (%)		7.6	-9.0	6.2	15.2	16.2	-1.4	-17.5	-2.1
Adj Operating Margin (%)		-6.3	-23.7	-11.5	-2.2	-1.1	-22.0	-38.8	-19.4
BALANCE SHEET									
Fixed Assets		20,301	20,379	18,864	16,655	14,761	14,190	15,748	18,694
Intangible Assets		18,539	18,372	16,944	14,734	13,092	12,790	14,380	17,373
Tangible Assets		916	915	792	715	702	684	652	604
Investments		846	1,092	1,128	1,206	968	716	716	716
Current Assets		42,588	37,012	37,634	38,004	51,442	78,924	66,078	59,544
Stocks		1,797	627	99	109	59	59	59	59
Debtors		10,228	10,233	12,384	15,792	20,447	21,060	21,060	24,641
Cash		11,249	9,063	11,235	7,883	21,647	48,172	33,981	22,896
Other		19,314	17,088	13,916	14,220	9,289	9,633	10,978	11,949
Current Liabilities		(20,517)	(22,679)	(19,480)	(21,170)	(22,839)	(23,264)	(24,083)	(29,230)
Creditors		(15,082)	(16,459)	(14,104)	(15,511)	(16,945)	(17,370)	(18,189)	(23,336)
Short term borrowings		(5,435)	(6,219)	(5,376)	(5,659)	(5,893)	(5,893)	(5,893)	(5,893)
Long Term Liabilities		(22,227)	(18,275)	(17,742)	(18,411)	(22,464)	(24,852)	(24,852)	(24,852)
Long term borrowings		(18,240)	(15,252)	(14,683)	(14,811)	(18,588)	(20,976)	(20,976)	(20,976)
Other long-term liabilities		(3,987)	(3,023)	(3,060)	(3,600)	(3,876)	(3,876)	(3,876)	(3,876)
Net Assets		20,145	16,437	19,276	15,077	20,901	44,999	32,892	24,156
CASH FLOW									
Operating Cash Flow		2,738	2,088	(1,921)	2,583	2,479	(639)	(4,884)	579
Net Interest		(324)	(155)	(626)	(441)	(558)	(797)	(835)	(835)
Tax		(1,576)	0	0	0	0	0	0	0
Capex		(20,045)	(6,378)	(6,321)	(5,830)	(6,749)	(7,020)	(8,472)	(10,830)
Acquisitions/disposals		3,045	46	1,275	(76)	7,496	5,492	0	0
Financing		6,573	4,418	11,178	0	7,084	27,100	0	0
Dividends		0	0	0	0	0	0	0	0
Net Cash Flow		(9,588)	18	3,585	(3,764)	9,753	24,137	(14,191)	(11,085)
Opening net debt/(cash)		2,839	12,426	12,408	8,824	12,587	2,834	(21,303)	(7,112)
HP finance leases initiated		0	0	0	0	0	0	0	0
Other		0	0	0	0	0	0	0	0
Closing net debt/(cash)		12,426	12,408	8,824	12,587	2,834	(21,303)	(7,112)	3,974

Source: Expert System, Edison Investment Research

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