

Expert.ai

H121 results

Growth in focus areas

Expert.ai reported 11% y-o-y revenue growth in H121, and as a result of the focus on product development and strengthening the sales and marketing function the EBITDA loss widened to €7.0m from €4.6m in H120. We maintain our forecasts for FY21, which assume similar seasonality to previous years. The planned shift in listing from AIM Italia to Borsa Italiana should widen the potential investor audience for expert.ai and improve liquidity.

Year end	Revenue (€m)	EBITDA* (€m)	EPS* (c)	DPS (€)	P/E (x)	EV/sales (x)
12/19	33.7	5.5	(1.6)	0.0	N/A	3.2
12/20	30.6	(1.9)	(20.2)	0.0	N/A	3.6
12/21e	32.4	(7.2)	(26.7)	0.0	N/A	3.4
12/22e	45.5	(2.9)	(20.5)	0.0	N/A	2.4
12/23e	64.5	5.7	(7.8)	0.0	N/A	1.7

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

H121: Building capacity and launching the platform

Expert.ai focused on the launch of its end-to-end hybrid natural language processing (NLP) SaaS platform during H121, with a beta version available from March and the platform commercially available from the end of June. The company also bolstered its sales and marketing team, particularly in the United States, with sales headcount up 52% y-o-y. H121 total revenue grew 11% y-o-y, with good performance in focus areas: subscription licences grew by 102% and revenue via channel partners by 133%. The company announced that it plans to move to the Borsa Italiana, and as part of the exchange's requirements, will start to report financials according to IFRS rather than Italian accounting standards.

Estimates maintained for FY21

Management expects revenue to follow a similar pattern to previous years, with one-third of revenue typically generated in H1. Our revenue forecasts are substantially unchanged, assuming a near doubling in revenue in H221 versus H121 and stronger growth in FY22 as the recently hired salespeople start to generate new business. As indications that the sales engine is building momentum, the company noted that it had seen 23% month-on-month lead generation growth during H121 and a 40% increase in the new business funnel. Reflecting the acceleration in sales hiring in H121, we have increased our forecasts for staff costs in FY21–23, which reduces our EBITDA forecasts for FY22 and FY23.

Valuation: Considerable upside if executed well

Expert.ai currently trades at a discount to peers on an EV/sales basis in FY21 and FY22. As the full SaaS platform has only just been launched, it is unlikely to drive material revenue growth until FY22. Based on a discounted cash flow (DCF) valuation, we estimate that successful execution of the plan could see the stock valued in the region of €4.9 per share. To monitor progress towards the revenue inflection, we look to track the rate of new customer acquisition, net dollar retention and contribution from channel partners and North America.

Software & comp services

5 October 2021

Price €2.38

Market cap €123m

Net cash (€m) at end H121 13.3

Shares in issue 51.5m

Free float 73.5%

Code EXAI

Primary exchange AIM Italia

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (15.0) (19.2) (6.2)

Rel (local) (12.7) (19.8) (20.6)

52-week high/low €3.4 €2.0

Business description

Expert.ai 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

Shareholders' meeting 14/15 October

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Review of H121 results

For the first time, expert.ai published H121 results according to both Italian GAAP and IFRS. As our forecasts are according to Italian GAAP, we discuss the H121 performance with respect to H120 on that basis. We also include the results on an IFRS basis for information purposes. We discuss in more detail the key changes to reporting once moving to IFRS on page 4.

Exhibit 1: H121 results highlights

€m	Italian GAAP			IFRS		
	H121	H120	y-o-y	H121	H120	y-o-y
Sales	10.8	9.6	13%	10.8	9.6	13%
Grants and other income	1.0	1.1	-6%	1.0	1.1	-6%
Total revenue	11.8	10.7	11%	11.8	10.7	11%
Capitalised development costs	4.3	3.1	40%	4.3	3.1	40%
Changes in WIP	0.0	0.0	-79%	0.0	0.0	-79%
Total production value	16.2	13.7	18%	16.2	13.7	18%
Staff costs	(15.8)	(10.9)	45%	(15.8)	(10.9)	45%
Other costs	(7.3)	(7.4)	-1%	(6.9)	(7.1)	-3%
Adjusted EBITDA	(7.0)	(4.6)	54%	(6.5)	(4.2)	54%
EBITDA margin						
Depreciation & amortisation - in-house	(3.1)	(2.8)	12%	(3.4)	(3.1)	10%
Normalised EBIT	(10.2)	(7.4)	38%	(9.9)	(7.4)	35%
Normalised EBIT margin						
Depreciation & amortisation - acquired	0	(0.5)	N/A	0	0	N/A
Share-based payments	0	0	N/A	(1.6)	(1.7)	N/A
EBIT	(10.2)	(7.8)	30%	(11.5)	(9.1)	27%
Net income	(9.9)	(3.1)	224%	(11.0)	(4.3)	155%
Net cash	13.3	3.8	250%	11.2	N/A	N/A

Source: expert.ai

Expert.ai reported an 11% y-o-y increase in revenue in H121. The EBITDA loss widened to €7.0m reflecting an acceleration in hiring, which can be seen in the 45% increase in staff costs over the period, while other costs reduced slightly. The company ended H121 with net cash of €13.3m, made up of a cash position of €44.6m and debt of €31.3m. The table below shows the breakdown of revenue:

Exhibit 2: Revenue breakdown

€m	H121	H120	y-o-y
Recurring licences	4.5	2.2	102%
Maintenance	1.7	2.2	-23%
Perpetual licences	0.7	0.7	0%
Professional services	3.5	4.1	-15%
Hosting	0.3	0.3	0%
Total sales	10.8	9.6	13%
Other income (grants)	1.0	1.1	-6%
Total revenue	11.8	10.7	11%
<i>Subscription licences/total licences</i>	<i>87%</i>	<i>76%</i>	
<i>Recurring revenue/total revenue</i>	<i>52%</i>	<i>41%</i>	
Partner channel sales	2.0	0.9	133%
<i>As % of total revenue</i>	<i>17%</i>	<i>8%</i>	

Source: expert.ai

Recurring licence sales increased 102% y-o-y, more than compensating for the decline in maintenance and professional services revenue. As the company is focused on growing the partner channel and has worked to standardise software so that it is not so complicated to install, we would not expect professional service revenue to grow at the same rate as group revenue. Revenue from the partner channel increased 133% y-o-y and made up 17% of total revenue in H121. In H121, the company signed up two new global partners and 23 projects were delivered by partners.

Recurring revenue (recurring licences plus maintenance) now makes up more than half of total revenue. As a reminder, the company is targeting group revenue of €100m by FY24 and expects c 80% to be generated from subscription licences. The company only made its NLP platform available at the end of June, so H121 revenue does not include any benefit from that. The company noted that revenue from existing customers increased 5% y-o-y (ie net dollar retention of 105%).

Moving to the Borsa Italiana

The company is planning to shift its listing (translist) from AIM Italia to Borsa Italiana MTA (mercato telematico azionario) and hopes to complete this by the end of this year (subject to approval by shareholders). One of the Borsa Italiana requirements is for companies to report according to IFRS, which has prompted the company to publish its first set of results on that basis. This move should open up a wider investor audience for expert.ai, as not all investors are able to invest on AIM Italia. The higher level of reporting requirements is also likely to give investors more confidence. This move will not be done in conjunction with a capital raise, as the company currently has more than sufficient cash resources to fund growth, although to maintain financial flexibility, the company is seeking approval at the upcoming shareholders' meeting for the ability to issue shares or convertible bonds without pre-emption rights up to the value of €10m.

Outlook and changes to forecasts

The company has not yet made any changes to its 2020–24 strategic plan, although it is currently reviewing it. Management highlighted that seasonality is likely to be similar this year to previous years, that is one-third of revenue is generated in H1. On that basis, our FY21 target looks achievable.

Until FY20 results are fully available on an IFRS basis, we maintain our forecasts based on Italian GAAP. We expect to switch to IFRS-based forecasts once expert.ai reports FY21 results; see below for discussion of the likely impact on forecasts.

While our revenue forecasts are substantially unchanged for all three years, we have adjusted the mix of revenue to reflect faster growth of subscription licences and a faster decline in maintenance revenue. As the company hired at a more rapid rate than originally planned in H121, we have revised our cost estimates to reflect higher staff costs in H221 and FY22/23 while we have reduced other operating expenses. Overall, our EBITDA forecast is unchanged in FY21 and reduces by €1.6m in FY22 and €1.9m in FY23. We assume a slightly higher rate of capitalisation of development costs in FY21, reflecting higher headcount, which translates to slightly higher amortisation in FY21.

Exhibit 3: Changes to forecasts

€m Italian GAAP	FY21e old	FY21e new	Change	y-o-y	FY22e old	FY22e new	Change	y-o-y	FY23e old	FY23e new	Change	y-o-y
Sales	30.7	30.7	0.1%	9.4%	44.0	44.0	(0.1%)	43.0%	63.0	63.0	(0.1%)	43.2%
Other income & grants	1.5	1.7	13.3%	(32.5%)	1.5	1.5	0.0%	(11.8%)	1.5	1.5	0.0%	0.0%
Total revenues	32.2	32.4	0.7%	6.0%	45.5	45.5	(0.1%)	40.2%	64.5	64.5	(0.1%)	41.8%
Capitalised development costs & changes in WIP	8.0	8.2	2.7%	19.9%	10.3	10.3	0.0%	26.1%	12.0	12.0	(0.0%)	15.9%
Production value	40.2	40.6	1.1%	8.5%	55.9	55.8	(0.1%)	37.3%	76.5	76.4	(0.1%)	37.0%
EBITDA	(7.2)	(7.2)	0.1%	275.7%	(1.3)	(2.9)	124.4%	(60.4%)	7.6	5.7	(24.9%)	N/A
EBITDA margin	-22.4%	-22.2%	0.1%	(16.0%)	-2.8%	-6.3%	(3.5%)	15.9%	11.8%	8.8%	(2.9%)	15.1%
D&A	(7.1)	(7.2)	1.6%		(8.1)	(8.2)	1.4%		(9.5)	(9.6)	1.2%	
Normalised/reported operating profit	(14.3)	(14.4)	0.8%	67.3%	(9.3)	(11.0)	18.1%	(23.5%)	(1.9)	(3.9)	107.4%	(64.9%)
Normalised/reported net income	(13.5)	(13.6)	0.6%	N/A	(9.0)	(10.4)	15.5%	(23.3%)	(2.3)	(4.0)	72.9%	(61.9%)
Diluted normalised EPS (c)	(26.6)	(26.7)	0.6%	(32.2%)	(17.8)	(20.5)	15.5%	(23.3%)	(4.5)	(7.8)	72.9%	(61.9%)
Net debt/(cash)	(5.3)	(5.1)	-2.9%	(75.5%)	6.6	8.3	25.0%	(262.6%)	10.2	13.6	33.5%	63.8%

Source: Edison Investment Research

Transition to IFRS reporting

We summarise below the key changes to financials from moving to IFRS reporting and the impact on our forecasts when we eventually switch to an IFRS basis.

- **Lease accounting:** capitalise operating leases and create a related financial liability. This reduces other operating expenses (by the value of the operating leases), increases depreciation and increases net interest costs. This will benefit EBITDA but will have limited impact at the operating profit level.
- **Share-based payments:** charge the cost of stock option and stock grants to the income statement. As Edison normalised profitability metrics exclude share-based payments, this will have no impact on our normalised forecasts but will reduce reported profitability metrics.
- **Intangible assets:** expert.ai has amortised goodwill from the acquisition of Temis since 2015. This will be reversed and no longer charged to the income statement. We already excluded this from our normalised profitability metrics, but it will improve reported profitability metrics. Expert.ai capitalised certain start-up and expansion costs that are not deemed to constitute intangible assets according to IFRS. This intangible has been written down to zero and the costs will be charged directly to the income statement. This has limited impact at the operating profit level but will slightly reduce EBITDA.
- **Derivatives:** interest rate hedges are reclassified as a financial liability. This will have a small impact on tax.
- **Severance provision:** the method of calculating defined benefits, particularly for severance pay, is different and results in a higher provision. This has been taken through equity and has limited impact on the income statement.

Valuation

The table below shows Expert's valuation and financial metrics compared to three different peer groups:

- software companies providing natural language understanding, big data analytics, enterprise search and/or information management applications;
- software companies selling on a SaaS or subscription basis; and
- Italy-listed companies providing software and/or IT services.

As Expert is a loss-making company, we look at EV/sales metrics and sales growth rates as the primary metrics for comparison. Based on the average EV/sales multiple for the first group (most

relevant due to the applications), Expert is trading at a large discount to peers. Over the two-year forecast period, its average sales growth of 23% compares to 20% for the peer group. Expert also trades at a discount to subscription software companies, which are growing at an average of 21% over the next two years, and Italian peers, growing at an average of 18%. As evidence emerges that the company is tracking the revenue growth and margins targeted in the five-year plan, we would expect the valuation to move more in the direction of the first two peer groups.

DCF valuation

We have performed a DCF analysis based on our forecasts to FY24 (which essentially follow the company's plan) and for the following six years, trending revenue growth down to 5% by FY30, trending EBITDA margins up to 30% (which results in an EBIT margin of 20%) and reducing capex/sales to 9% by FY30 (compared to 24% in FY20 and 15% in FY24). We have included the FY20–23 share grant and option grant plans, which add 4.4m additional shares to the existing 51.5m outstanding shares.

Using a WACC of 9% and a long-term growth rate of 3%, we arrive at a per share value of €4.86. We note that this valuation assumes perfect execution of the plan, and we would expect the share price to move towards this value as progress according to the plan becomes evident. This valuation would equate to an EV/sales multiple of 2.7x and an EV/EBITDA multiple of 12.2x in FY24. A 1pp increase in the WACC results in a per share value of €3.95, while a 1pp decrease results in a value of €6.17/share.

Exhibit 4: Peer financial and valuation metrics

	Market cap (m)	Quote ccy	EV/sales		EV/EBITDA		P/E		EBIT margin		EBITDA margin		Sales growth		EPS growth	
			CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY	CY	NY
Expert System	122	EUR	3.4	2.4	N/A	N/A	N/A	N/A	-44.4%	-24.2%	-22.2%	-6.3%	6.0%	40.2%	N/A	N/A
Natural Language Understanding, Big Data Analytics, Enterprise Search & Info Management																
C3Ai	4,725	USD	14.7	11.0	N/A	N/A	N/A	N/A	-45.7%	-33.3%	-43.3%	-29.8%	N/A	34.1%	N/A	-14%
Commvault Systems	3,527	USD	4.1	3.8	17.7	15.3	29.8	25.3	21.8%	23.7%	23.2%	25.1%	6.4%	7.0%	22%	18%
Elastic	13,563	USD	16.1	12.8	N/A	1020	N/A	N/A	-3.4%	-1.0%	-0.7%	1.3%	33.7%	26.3%	562%	-45%
Livechat Software	2,697	PLN	11.2	9.9	18.5	15.9	21.8	19.7	57.8%	58.1%	60.9%	62.2%	28.5%	13.9%	22%	11%
Nuance Communications	17,299	USD	13.0	12.1	46.0	41.6	71.7	64.7	26.2%	26.8%	28.4%	29.2%	-6.9%	7.4%	-8%	11%
Open Text	16,996	CAD	4.4	4.4	11.6	11.2	14.3	13.9	35.2%	32.5%	38.2%	38.8%	1.7%	2.2%	1%	3%
Splunk	22,224	USD	8.8	7.4	N/A	N/A	N/A	-	-15.0%	-7.2%	-11.4%	-3.6%	15.5%	20.0%	261%	-46%
Teradata	6,174	USD	3.2	3.1	14.4	13.5	28.8	31.5	17.4%	15.5%	22.0%	23.1%	4.4%	2.2%	50%	-8%
Veritone	765	USD	6.5	3.8	N/A	211	N/A	88.6	-7.3%	7.8%		1.8%	72.9%	71.4%	-70%	N/A
Average			9.1	7.6	21.6	189.9	33.3	31.0	9.7%	13.7%	14.7%	16.4%	19.5%	20.5%	105%	N/A
SaaS/subscription software companies																
Adobe	275,216	USD	17.4	15.1	34.5	30.3	46.3	40.6	45.9%	45.7%	50.4%	49.7%	22.5%	15.2%	23%	14%
Atlassian	97,643	USD	17.4	15.1	149.9	117.0	239.1	183.2	23.3%	24.9%	25.5%	26.4%	21.5%	23.5%	16%	31%
Salesforce.Com	264,820	USD	38.2	31.0	33.9	27.8	61.2	58.4	18.6%	19.9%	29.9%	30.2%	23.8%	20.8%	-10%	5%
Workday	61,878	USD	10.2	8.4	42.7	39.1	68.2	70.1	21.1%	18.8%	27.7%	25.4%	18.2%	19.3%	25%	-3%
Average			20.8	17.4	65.3	53.6	103.7	88.1	27.2%	27.3%	33.4%	32.9%	21.5%	19.7%	13%	12%
Italian software & services																
TXT e solutions	114	EUR	1.1	1.0	8.6	7.4	17.3	13.8	8.7%	10.0%	13.1%	13.6%	0.6%	32.3%	32%	26%
Piteco	232	EUR	7.0	6.5	14.8	13.5	24.3	20.7	30.3%	32.7%	47.5%	48.4%	0.6%	50.9%	N/A	17%
Reply	5,932	EUR	3.9	3.5	23.2	20.9	41.1	36.5	13.7%	13.8%	16.9%	16.8%	4.3%	17.2%	16%	12%
Average			4.0	3.7	15.5	13.9	27.6	23.7	17.6%	18.8%	25.8%	26.2%	1.8%	33.5%	24%	18%

Source: Edison Investment Research, Refinitiv (as at 30 September)

Exhibit 5: Financial summary

	€'000s	2017	2018	2019	2020	2021e	2022e	2023e
		IT GAAP						
PROFIT & LOSS								
31-December								
Revenue		27,783	30,457	33,712	30,617	32,446	45,479	64,469
EBITDA		1,711	4,638	5,459	(1,919)	(7,210)	(2,856)	5,700
Operating Profit (before amort. and except.)		(3,189)	(662)	(358)	(8,610)	(14,406)	(11,022)	(3,866)
Intangible Amortisation		(2,608)	(2,567)	(2,520)	(902)	0	0	0
Exceptionals		(700)	0	0	0	0	0	0
Other		0	0	0	0	0	0	0
Operating Profit		(6,496)	(3,229)	(2,878)	(9,511)	(14,406)	(11,022)	(3,866)
Net Interest		(2,191)	97	(123)	(2,011)	(548)	(548)	(548)
Profit Before Tax (norm)		(5,380)	(565)	(481)	(10,621)	(14,953)	(11,570)	(4,414)
Profit Before Tax (reported)		(8,687)	(3,131)	(780)	(6,373)	(14,953)	(11,570)	(4,414)
Tax		348	(650)	(203)	948	1,384	1,157	441
Profit After Tax (norm)		(5,164)	(508)	(607)	(9,041)	(13,570)	(10,413)	(3,973)
Profit After Tax (reported)		(8,339)	(3,781)	(983)	(5,424)	(13,570)	(10,413)	(3,973)
Average Number of Shares Outstanding (m)		28.1	35.8	38.6	44.7	50.8	50.8	50.8
EPS - normalised (c)		(18.3)	(1.4)	(1.6)	(20.2)	(26.7)	(20.5)	(7.8)
EPS - normalised and fully diluted (c)		(18.3)	(1.4)	(1.6)	(20.2)	(26.7)	(20.5)	(7.8)
EPS - (IFRS) (c)		(29.6)	(10.6)	(2.5)	(12.1)	(26.7)	(20.5)	(7.8)
Dividend per share (c)		0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA Margin (%)		6.2	15.2	16.2	-6.3	-22.2	-6.3	8.8
Adj Operating Margin (%)		-11.5	-2.2	-1.1	-28.1	-44.4	-24.2	-6.0
BALANCE SHEET								
Fixed Assets		18,864	16,655	14,761	14,598	16,103	18,767	21,671
Intangible Assets		16,944	14,734	13,092	13,635	15,147	17,832	20,773
Tangible Assets		792	715	702	719	712	690	654
Investments		1,128	1,206	968	244	244	244	244
Current Assets		37,634	38,004	51,442	83,621	69,383	60,690	59,987
Stocks		99	109	59	11	11	11	11
Debtors		12,384	15,792	20,447	20,861	20,861	24,407	28,556
Cash		11,235	7,883	21,647	53,978	38,245	24,849	19,555
Other		13,916	14,220	9,289	8,771	10,267	11,424	11,865
Current Liabilities		(19,480)	(21,170)	(22,839)	(21,748)	(22,584)	(26,968)	(33,142)
Creditors		(14,104)	(15,511)	(16,945)	(16,280)	(17,116)	(21,500)	(27,673)
Short term borrowings		(5,376)	(5,659)	(5,893)	(5,469)	(5,469)	(5,469)	(5,469)
Long Term Liabilities		(17,742)	(18,411)	(22,464)	(31,902)	(31,902)	(31,902)	(31,902)
Long term borrowings		(14,683)	(14,811)	(18,588)	(27,675)	(27,675)	(27,675)	(27,675)
Other long term liabilities		(3,060)	(3,600)	(3,876)	(4,227)	(4,227)	(4,227)	(4,227)
Net Assets		19,276	15,077	20,901	44,570	31,000	20,587	16,615
CASH FLOW								
Operating Cash Flow		(1,921)	2,583	2,479	(1,934)	(6,485)	(2,019)	7,725
Net Interest		(626)	(441)	(558)	(456)	(548)	(548)	(548)
Tax		0	0	0	0	0	0	0
Capex		(6,321)	(5,830)	(6,749)	(8,059)	(8,700)	(10,830)	(12,470)
Acquisitions/disposals		1,275	(76)	7,496	5,889	0	0	0
Financing		11,178	0	7,084	28,228	0	0	0
Dividends		0	0	0	0	0	0	0
Net Cash Flow		3,585	(3,764)	9,753	23,669	(15,733)	(13,397)	(5,293)
Opening net debt/(cash)		12,408	8,824	12,587	2,834	(20,835)	(5,102)	8,295
HP finance leases initiated		0	0	0	0	0	0	0
Other		0	0	0	0	0	0	(0)
Closing net debt/(cash)		8,824	12,587	2,834	(20,835)	(5,102)	8,295	13,588

Source: expert.ai, Edison Investment Research

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