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Nitro Software (NTO)

Game changer

Recommendation
Buy (unchanged)
Price
\$3.77 (TERP)
Target (12 months)
\$4.50 (unchanged)

GICS Sector
Software and Services

Expected Return

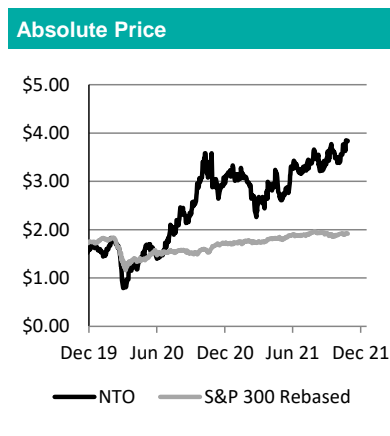
Capital growth	19.4%
Dividend yield	0.0%
Total expected return	19.4%

Company Data & Ratios

Enterprise value	\$854.5m
Market cap	\$916.9m
Issued capital	243.2m
Free float	95%
Avg. daily val. (52wk)	\$2.6m
12 month price range	\$2.10 - \$3.93

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.48	3.37	3.30
Absolute (%)	10.34	13.95	16.36
Rel market (%)	8.00	14.96	-5.03



SOURCE: IRESS

Strategic acquisition

Nitro announced it has entered into a binding agreement to acquire Connective NV for an EV of €70m (~US\$81m). Connective is Belgium's leading eSign SaaS business with fast growing market share in France and customers in 11 other European countries. The rationale for the acquisition is it will accelerate and enhance Nitro's eSign, eID (electronic identity) and document workflow capabilities. It will also position Nitro to become the third global player in the enterprise eSign market along with DocuSign and Adobe. The €70m consideration equates to a 2021 revenue multiple of 11.5x which is not dissimilar to Nitro's multiple this year. The company expects the acquisition to generate annualised revenue synergies of US\$2.5m by December 2022 – by offering Connective's solutions to Nitro's 12,000+ business customers – and including these synergies reduces the revenue multiple to 8.5x. The acquisition is to be funded by a fully underwritten A\$140m capital raising.

Revenue upgrades

We have updated our forecasts for the acquisition and the impact is revenue upgrades in 2022 and 2023 of 13% and 16%. There is no change in our 2021 forecasts as the acquisition is only expected to be completed in late December and the company also reiterated its 2021 guidance with the announcement of the acquisition today. We have modestly increased our forecast operating EBITDA loss in 2022 but also modestly increased our forecast operating EBITDA profit in 2023 as we expect Connective to be EBITDA positive in that period.

Investment view: \$4.50 PT unchanged, Maintain BUY

We have updated each valuation used in the determination of our price target for the revenue/earnings changes as well as market movements and time creep. We have also increased the premium we apply in the EV/Revenue valuation from 20% to 50% and reduced the WACC we apply in the DCF from 9.0% to 8.5%. The net result, however, is no change in our PT of \$4.50 which is >15% premium to the share price so we maintain our BUY recommendation.

Earnings Forecast

Year end 30 December	2020	2021e	2022e	2023e
Total revenue (US\$m)	40.2	50.7	71.5	93.7
EBITDA (operating) (US\$m)	-2.4	-9.0	-4.2	5.7
NPAT (US\$m)	-7.5	-19.3	-20.8	-11.1
EPS (diluted) (US¢ps)	-4.0	-9.6	-8.5	-4.5
EPS growth (%)	NM	NM	NM	NM
PER (x)	NM	NM	NM	NM
Price/CF (x)	NM	NM	NM	NM
EV/Revenue (x)	14.9	12.6	9.1	7.0
Dividend (A¢ps)	0.0	0.0	0.0	0.0
Yield (%)	0.0%	0.0%	0.0%	0.0%
ROE (%)	NM	NM	NM	NM
Franking (%)	0%	0%	0%	0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Earnings and Valuation Changes

Revenue Upgrades

We have updated our forecasts for the acquisition and the impact is revenue upgrades in 2022 and 2023 of 13% and 16%. There is no change in our 2021 forecasts as the acquisition is only expected to be completed in late December and the company also reiterated its 2021 guidance with the announcement of the acquisition today. We have modestly increased our forecast operating EBITDA loss in 2022 but also modestly increased our forecast operating EBITDA profit in 2023 as we expect Connective to be EBITDA positive in that period.

A summary of the changes in our key forecasts is shown below. We continue to forecast no dividends over the next three years despite the company remaining in a strong cash position. We have not assumed any more acquisitions in our forecasts but figure another could occur – potentially in the CLM space – in the next year or two.

Figure 1 - Change in key forecasts

Year end 31 December	2021e			2022e			2023e		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue (US\$m)	50.7	50.7	0.0%	63.2	71.5	13.1%	80.6	93.7	16.4%
Operating EBITDA (US\$m)	-9.0	-9.0	NM	-3.3	-4.2	NM	5.1	5.7	12.2%
NPAT (statutory) (US\$m)	-19.3	-19.3	NM	-17.0	-20.8	NM	-9.8	-11.1	NM
Diluted EPS (statutory) (Ac)	-13.2c	-12.8c	NM	-11.3c	-11.3c	NM	-6.5c	-6.0c	NM
DPS (Ac)	0.0c	0.0c	NM	0.0c	0.0c	NM	0.0c	0.0c	NM

SOURCE: BELL POTTER SECURITIES ESTIMATES

\$4.50 PT Unchanged

We have updated each valuation used in the determination of our price target for the revenue/earnings changes as well as market movements and time creep. We have also increased the premium we apply in the EV/Revenue valuation from 20% to 50% and reduced the WACC we apply in the DCF from 9.0% to 8.5% given the strategic nature of this acquisition and how well it now positions Nitro in the global eSign market as well as enhancing its eID (electronic identity) and document workflow capabilities.

The change in each valuation and the impact on our PT calculation is shown below.

Figure 2 - Change in valuations and impact on PT

Methodology	Old (as at 27-Oct-21)			New (as at 10-Nov-21)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
EV/Revenue	\$4.67	75%	\$3.50	\$4.50	75%	\$3.38
DCF	\$4.00	25%	\$1.00	\$4.48	25%	\$1.12
Total			\$4.50			\$4.50

SOURCE: BELL POTTER SECURITIES ESTIMATES

The figure shows a modest decrease in the EV/Revenue valuation – driven by a reduction in the average multiple of the listed comps – but a more material increase in the DCF (driven by the reduction in the WACC). The net result, however, is no change in our PT of \$4.50 which is >15% premium to the share price so we maintain our BUY recommendation.

Nitro Software

Company Description

Nitro Software (Nitro) is a global document productivity software company that enables digital transformation in organisations around the world through a suite of products built to enable digital workflows. The company's core offering, the Nitro Productivity Suite, comprises three key products: (1) Nitro Pro – a premium Portable Document Format (PDF) productivity desktop application; (2) Nitro Sign – a cloud-based eSignature and digital document workflow solution; and (3) Nitro Analytics – business intelligence and insights that help drive adoption and accelerate workflow digitisation.

Nitro was founded in 2005 in Melbourne, Australia. The company has sold over 2.6m licenses of its software and today has circa 11,700 business customers in 154 countries. Nitro is now headquartered in San Francisco and has around 200 full-time employees.

Investment Thesis

We maintain our BUY recommendation on Nitro. Our investment thesis is based on:

- **Valuation:** Our 12 month price target on Nitro is \$4.50. The price target is generated from a blend of two valuation methodologies we apply to the company: EV/Revenue and DCF. The price target is a 19% premium to the current share price and the total expected return is the same given there is no forecast dividend yield.
- **Global, established player:** Nitro is an established player in the global document productivity software market with circa 11,700 business customers including 68% of the Fortune 500. The company has been successfully competing against and gaining market share from more entrenched providers in the market by providing a more cost effective and easier to deploy solution for both PDF productivity and electronic signing.
- **Large cross sell opportunity:** To date Nitro has generated revenue growth mostly through adding new customers and increasing the number of licenses with existing customers. The company now has a new area of growth, however, with the release of Nitro Sign as a standalone product so most customers will likely have to start paying more for using this product.

Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Failure to retain clients or attract new customers:** Nitro's business depends on its ability to retain its existing customers and its growth depends on its ability to attract further business from existing customers and to attract new customers. If customers do not continue to use Nitro's software or increase their use over time, and if new customers do not choose to use Nitro's software, the growth in revenue may slow.
- **Nitro operates in a competitive industry:** Nitro competes against other international document productivity and electronic signature software providers as well as with internally developed or manual paper based systems. There is a risk that time Nitro may compete less effectively against its competitors causing it to lose market share.
- **Success of sales and marketing strategy:** Nitro's business is partly dependent on the conversion of customer sales from investment in sales and marketing campaigns and initiatives. Failure to realise the intended benefits from sales and marketing investment could negatively impact Nitro's ability to attract new customers.

Table 1 - Financial summary

Nitro Software (NTO)						Share price:	\$3.77	Target price:	\$4.50		
						No. of issued shares:	243.2m	Market cap:	\$916.9m		
Profit & Loss (US\$m)						Valuation data					
Year end 30 Dec	2019	2020	2021e	2022e	2023e	Year end 30 Dec	2019	2020	2021e	2022e	2023e
Revenue	35.7	40.2	50.7	71.5	93.7	NPAT (US\$m)	-7.9	-7.5	-19.3	-20.8	-11.1
Change	10%	13%	26%	41%	31%	Diluted EPS (USc)	-10.8	-4.0	-9.6	-8.5	-4.5
						Change		NM	NM	NM	NM
Cost of sales	-3.6	-3.8	-4.6	-6.0	-7.4	Diluted EPS (Ac)	-16.7	-5.7	-12.8	-11.3	-6.0
Gross profit	32.0	36.4	46.1	65.5	86.3	P/E ratio (x)	NM	NM	NM	NM	NM
Gross margin	89.8%	90.6%	90.9%	91.6%	92.1%	CFPS (Ac)	0.8	-1.1	-6.2	-5.7	-0.5
Expenses (excl. D&A, int.)	-37.0	-41.8	-64.0	-84.9	-96.1	Price/CF (x)	NM	NM	NM	NM	NM
% of revenue	-103.7%	-104.1%	-126.3%	-118.8%	-102.5%	DPS (Ac)	0.0	0.0	0.0	0.0	0.0
Other income	1.2	-0.4	0.0	0.0	0.0	Yield	0.0%	0.0%	0.0%	0.0%	0.0%
EBITDA (statutory)	-3.8	-5.8	-17.9	-19.4	-9.8	Franking	0%	0%	0%	0%	0%
Depreciation	-0.8	-0.1	-0.1	-0.1	-0.1	EV/Revenue (x)	15.4	14.9	12.6	9.1	7.0
Amortisation	-1.2	-1.7	-1.7	-1.7	-1.8	EV/EBITDA (x)	NM	NM	NM	NM	NM
EBIT	-5.8	-7.5	-19.7	-21.2	-11.6	NTA per share (Ac)	24.7	20.7	12.3	1.7	-3.6
Net interest (expense)/revenue	-1.8	-0.2	-0.1	-0.1	-0.1	Price/NTA (x)	15.3	18.2	30.6	226.4	-103.8
Pre-tax profit	-7.6	-7.7	-19.8	-21.3	-11.7	Operating EBITDA	-1.1	-2.4	-9.0	-4.2	5.7
Income tax expense	-0.4	0.1	0.5	0.5	0.6	Performance ratios					
NPAT	-7.9	-7.5	-19.3	-20.8	-11.1	Year end 30 Dec	2019	2020	2021e	2022e	2023e
						EBITDA margin	-10.7%	-14.4%	-35.3%	-27.2%	-10.4%
						Return on assets	NM	NM	NM	NM	NM
						Return on equity	NM	NM	NM	NM	NM
						ROIC	NM	NM	NM	NM	NM
						Payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%
						Effective tax rate	4.7%	-1.5%	-2.5%	-2.5%	-5.0%
						Leverage ratios					
						Year end 30 Dec	2019	2020	2021e	2022e	2023e
						Net debt/(cash) (A\$m)	-72.3	-62.5	-62.3	-47.6	-45.6
						Net debt/equity	NM	NM	NM	NM	NM
						Gearing	NM	NM	NM	NM	NM
						Net debt/EBITDA (x)	NM	NM	NM	NM	NM
						Net interest cover (x)	NM	NM	NM	NM	NM
						Segmentals (US\$m)					
						Year end 30 Dec	2019	2020	2021e	2022e	2023e
						Revenue					
						Subscription	13.2	21.3	34.6	58.6	85.7
						Perpetual	22.5	18.9	16.1	12.9	8.1
						Total revenue	35.7	40.2	50.7	71.5	93.7
						Growth					
						Subscription	92%	61%	63%	69%	46%
						Perpetual	-12%	-16%	-15%	-20%	-38%
						Total revenue	10%	13%	26%	41%	31%
						Gross profit					
						Subscription	12.0	19.8	32.0	54.2	79.3
						Perpetual	20.0	16.6	14.1	11.3	7.0
						Total GP	32.0	36.4	46.1	65.5	86.3
						Gross margin					
						Subscription	91.1%	93.1%	92.5%	92.5%	92.5%
						Perpetual	89.0%	87.8%	87.5%	87.5%	87.5%
						Total GM	89.8%	90.6%	90.9%	91.6%	92.1%
						Interims (A\$m)					
						Year end 30 Dec	1H2020	2H2020	1H2021	2H2021e	
						Revenue	19.1	21.1	24.1	26.6	
						Change	14%	11%	27%	26%	
						Cost of sales	-1.8	-2.0	-2.0	-2.6	
						Gross profit	17.3	19.1	22.1	24.0	
						Gross margin	90.6%	90.6%	91.6%	90.3%	
						Expenses (excl. D&A, int.)	-17.8	-24.1	-29.4	-34.6	
						% of revenue	-93.2%	-113.9%	-122.1%	-130.0%	
						Other income	-1.0	0.7	-0.1	0.0	
						EBITDA (statutory)	-1.5	-4.3	-7.5	-10.4	

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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