BELL POTTER

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Integrated Research (IRI)

In transition

Recommendation
Hold (unchanged)
Price
$0.885
Target (12 months)
$1.00 (previously $1.50)

GICS Sector

Software and Services

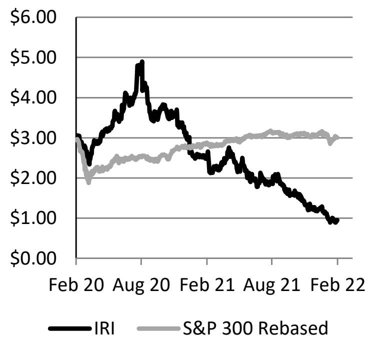
Expected Return	
Capital growth	**13.0%**
Dividend yield	**0.0%**
Total expected return	**13.0%**

Company Data & Ratios	
Enterprise value	**$143.3m**
Market cap	**$152.7m**
Issued capital	**172.4m**
Free float	**70%**
Avg. daily val. (52wk)	**$903,440**
12 month price range	**$0.86 - $2.78**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	1.12	1.43	2.52
Absolute (%)	-15.18	-33.33	-62.30
Rel market (%)	-11.52	-30.73	-67.65

Absolute Price



SOURCE: IRESS

Revenue and PBT below our forecast, NPAT in line

Integrated Research (IR) reported 1HFY22 revenue and PBT below our forecasts ($32.2m vs BP $38.0m and $0.6m vs BP $2.2m) but NPAT was close to in line ($1.8m vs BP $1.7m). The make-up at NPAT was driven by a tax benefit of $1.2m rather than a tax expense which we were forecasting. The result also included other gains of $2.2m – driven by currency exchange movements – which we had not forecast and lowered the quality of the result. Operating cash flow fell 23% to $8.7m but the cash flow conversion was good at 92% (and there was no debtor factoring). The net cash position improved from $5.5m at 30 June to $9.4m at 31 December. There was no interim dividend but we did not expect any.

Guidance of NPAT growth

IR did not provide any specific guidance but did say it expects both TCV and NPAT to grow relative to FY21. On the conference call the company also said it expects pro forma revenue to be similar in H2 to H1 implying 2HFY22 pro forma revenue of around $80m (though it was not clear what this implies for statutory revenue). IR said it is confident of a better 2H relative to 1H on the back of more renewals, recent product releases and a strong pipeline of opportunities with both new and existing customers.

EPS downgrades

We have downgraded our EPS forecasts by 11%, 21% and 21% in FY22, FY23 and FY24. The downgrades have been driven by 7-8% reductions in our revenue forecasts and also reductions in our margin forecasts.

Investment view: PT down 33% to $1.00, Maintain HOLD

We have updated each valuation used in the determination of our price target for the earnings changes and also increased the discount in the relative valuations from 30% to 40% and the WACC in the DCF from 9.2% to 9.7% given the weaker-than-expected H1 result. The net result is a 33% decrease in our PT to $1.00 which is <15% premium to the share price so we maintain our HOLD recommendation.

Earnings Forecast

Year end 30 June	2021	2022e	2023e	2024e
Total revenue (A$m)	78.5	78.2	87.3	94.8
EBITDA (A$m)	21.9	21.0	26.0	30.3
NPAT (A$m)	7.9	8.3	11.1	13.5
EPS (diluted) (cps)	4.6	4.8	6.4	7.8
EPS growth (%)	-67%	4%	34%	21%
PER (x)	19.3	18.5	13.8	11.4
Price/CF (x)	7.2	10.7	8.6	6.9
EV/EBITDA (x)	6.7	6.9	5.3	4.3
Dividend (¢ps)	0.0	0.0	0.0	1.0
Yield (%)	0.0%	0.0%	0.0%	1.1%
ROE (%)	9.5%	9.0%	10.8%	11.7%
Franking (%)	0%	0%	100%	100%

SOURCE: BELL POTTER SECURITIES ESTIMATES

1HFY22 Result

A summary of the 1HFY22 result is shown below.

Figure 1 - 1HFY22 result summary

	Result vs PCP			Result vs Forecast		
Year end 30 June	**1HFY21**	**1HFY22**	***Change***	**1HFY22e**	***Variance***	**Comment**
Total revenue (A$m)	**34.1**	**32.3**	*-5%*	**38.0**	*-15%*	**Miss driven by lower than forecast revenue in each product**
Total expenses (excl. D&A and int.)	**32.9**	**34.7**	*5%*	**36.1**	*-4%*	**Lower expenses than forecast but higher as % of revenue**
Expenses as % of revenue	*96.4%*	*107.3%*	*1095bps*	*95.0%*	*1234bps*	
Other income (e.g. forex gains/losses)	-3.0	2.2	*NM*	0.0	*NM*	Positive other income
EBITDA	**4.4**	**6.6**	*49%*	**8.7**	*-24%*	**Miss driven by miss at revenue and offset by lower expenses**
Depreciation	-0.4	-0.3	*-25%*	-0.3	*0%*	
Amortisation	-5.8	-6.5	*11%*	-6.5	*0%*	
EBIT	**-1.8**	**-0.2**	*NM*	**1.9**	*NM*	**Modest negative EBIT versus forecast positive EBIT**
Net interest income	0.4	0.8	*118%*	0.3	*>100%*	Much higher net interest income than forecast
Profit before tax	**-1.4**	**0.6**	*NM*	**2.2**	*-71%*	**Large miss driven by miss at EBITDA**
Income tax benefit/(expense)	1.5	1.2	*NM*	-0.6	*NM*	Income tax benefit rather than forecast income tax expense
NPAT	**0.1**	**1.8**	*1286%*	**1.7**	*8%*	**Beat driven by income tax benefit**
EBITDA margin	*13.0%*	*20.4%*	*742bps*	*22.8%*	*-234bps*	*EBITDA margin c.235bps below our forecast*
NPAT margin	*0.4%*	*5.5%*	*516bps*	*4.4%*	*117bps*	
Effective tax rate	*-109.3%*	*181.6%*	*NM*	*-25.0%*	*NM*	
Weighted average fully diluted shares	172.5m	172.9m	*0%*	172.5m	*0%*	
Diluted EPS	**0.07c**	**1.03c**	*1284%*	**0.96c**	*7%*	**7% beat in diluted EPS**
Interim dividend	0.00c	0.00c	*NM*	0.00c		No dividend consisent with our forecast

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The key take-outs are:

- **Revenue below our forecast**: Revenue fell 5% to $32.3m which was well below our forecast of $38.0m. The miss was driven by lower-than-expected revenue in each product segment (Collaborate, Infrastructure and Transact) as well as professional services (i.e. consulting).
- **EBITDA below our forecast**: EBITDA grew by 49% to $6.6m but was still well below our forecast of $8.7m. The miss was driven by the miss at revenue and also higher expenses as a % of revenue (though in absolute terms expenses were lower than our forecast). The miss was partially offset, however, by other income of $2.2m which we had not forecast and was driven by exchange rate movements.
- **NPAT close to in line**: NPAT of $1.8m was close to in line with our forecast of $1.7m and the miss at EBITDA – and EBIT and PBT – was offset by an income tax benefit of $1.2m rather than an income tax expense which we were forecasting.
- **Good cash flow**: Operating cash flow fell 23% to $8.7m but the cash flow conversion was good at 92% (and there was no debtor factoring). The net cash position improved from $5.5m at 30 June to $9.4m at 31 December. The company has undrawn debt facility of $14.4m.
- **No dividend but none expected**: IR did not declare an interim dividend but we did not expect any.

Earnings and Valuation Changes

EPS Downgrades

We have downgraded our EPS forecasts by 11%, 21% and 21% in FY22, FY23 and FY24. The downgrades have been driven by 7-8% reductions in our revenue forecasts and also reductions in our margin forecasts. We now forecast FY22 NPAT of $8.3m which is up on the FY21 NPAT of $7.9m so is consistent with the company's expectation of growth. Note our FY22 forecasts assume only modest income of $0.3m in 2HFY22 – compared to $2.2m in 1HFY22 – and also a tax expense in 2HFY22 similar in size to the tax benefit in 1HFY22 (so there is little net tax for the full year).

A summary of the changes in our key forecasts is shown below. We continue to forecast no dividends in FY22 but now also assume no dividends in FY23. We no assume a resumption of dividends in FY24.

Figure 2 - Change in key forecasts

Year end 30 June	2022e			2023e			2024e		
	Old	New	*Change*	Old	New	*Change*	Old	New	*Change*
Total revenue (A$m)	84.5	78.2	*-7.5%*	93.7	87.3	*-6.8%*	101.5	94.8	*-6.6%*
EBITDA	25.5	21.0	*-17.8%*	32.9	26.0	*-21.0%*	37.9	30.3	*-20.0%*
NPAT	9.3	8.3	*-10.9%*	14.1	11.1	*-21.3%*	17.0	13.5	*-20.5%*
Diluted EPS (Ac)	**5.4c**	**4.8c**	***-10.9%***	**8.2c**	**6.4c**	***-21.3%***	**9.8c**	**7.8c**	***-20.5%***
DPS (Ac)	0.0c	0.0c	*NM*	1.0c	0.0c	*-100.0%*	2.0c	1.0c	*-50.0%*

SOURCE: BELL POTTER SECURITIES ESTIMATES

33% Decrease in PT to $1.00

We have updated each valuation used in the determination of our price target for the earnings changes as well as market movements and time creep. We have also increased the discount in the relative valuations from 30% to 40% and the WACC in the DCF from 9.2% to 9.7% given the weaker-than-expected H1 result and increased skew in earnings to H2. We also do not anticipate much news flow in H2 and so there is a lack of apparent catalysts for the share price as well as a means of gaining better visibility on the H2 result.

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

Figure 3 - Change in valuations and impact on PT

	Old (as at 24-Nov-21)			New (as at 17-Feb-22)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
Methodology						
PE ratio	$1.28	40%	$0.51	$0.84	40%	$0.33
EV/EBITDA	$1.50	40%	$0.60	$1.03	40%	$0.41
DCF	$1.93	20%	$0.39	$1.26	20%	$0.25
Total			**$1.50**			**$1.00**

SOURCE: BELL POTTER SECURITIES ESTIMATES

The figure shows a relatively consistent decrease in each valuation ranging between 31-35%. The net result is a 33% decrease in our PT to $1.00 which is <15% premium to the share price so we maintain our HOLD recommendation.

Integrated Research

Company Description

Integrated Research (IR) is a leading global provider of experience management solutions for business-critical technology environments. The company offers three key solution suites - Collaborate, Transact and Infrastructure - that are powered by the hybrid-cloud Prognosis platform. Their solutions enable performance management, analytics, and business insights, and are used by many of the world's largest organisations including major stock exchanges, banks and telecommunication companies.

Investment Thesis

We maintain our HOLD recommendation on IR. Our investment thesis is based on:

- **Valuation**: Our 12 month price target for IR is $1.00. The price target is generated from a blend of three valuation methodologies we apply to the company: PE ratio, EV/EBITDA and DCF. The price target is a 13% premium to the current share price and the total expected return is the same given there is no forecast dividend yield.
- **High level of recurring revenue**: IR generates most of its revenue through licence and maintenance fees which combined represent >80% total revenue. The maintenance fees (c.20% of total revenue) are by nature highly recurring but the licence fees (c.60% of total revenue) are also highly recurring as the licences are typically sold on a fixed term and the company has a very high renewal rate (>95%).
- **Tier one global customers**: IR is a truly global company (>95% of total revenue is generated outside of Australia) and has a tier one customer base including many of the world's largest organisations. Companies that use IR's software include nine of the top ten US banks, six of the top ten automotive companies, seven of the ten biggest telcos, and six of the top ten financial services companies globally.

Key Risks

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

- **Technology risk**: IR is a technology company that designs, develops and distributes software. The risk with any such company is that the software does not perform to the clients' expectations or is flawed in some way. Such an occurrence would negatively impact the company's reputation and provide downside risk to our estimates.
- **Competition risk**: IR operates in a competitive market and there is the risk of aggressive or irrational behaviour from one or more competitors who could force down prices and reduce operating margins across the entire market. There is also the risk that a competitor comes out with a superior product to the rest of the market and increases its market share at the expense of IR and other participants.
- **Key product risk**: IR has one key product – Prognosis – and so has key product risk if demand or the outlook for that product changes or, worse, the product becomes superseded or obsolete. IR aims to mitigate this risk by regularly updating the product and adding new functionality and features to the software (e.g. mobile access and interface, cloud-based delivery, etc.) as well as developing various versions for different platforms, vendors and applications. There is still, however, only one core product that drives the future performance and viability of the company.

Integrated Research
as at 17 February 2022

Recommendation	Hold
Price	$0.885
Target (12 months)	$1.00

Table 1 - Financial summary

Integrated Research (IRI)

Share price:	$0.885	Target price:	$1.00
No. of issued shares:	172.5m	Market cap:	$152.7m

Profit & Loss (A$m)

Year end 30 Jun	2020	2021	2022e	2023e	2024e
Total revenue	**110.9**	**78.5**	**78.2**	**87.3**	**94.8**
Change	*10%*	*-29%*	*0%*	*12%*	*9%*
Expenses (excl. D&A, int.)	**78.2**	**68.7**	**73.9**	**76.4**	**80.6**
% of revenue	*70.5%*	*87.5%*	*94.5%*	*87.5%*	*85.0%*
Other income (fx gains/losses)	-1.9	-1.3	2.5	0.0	0.0
EBITDA	**42.9**	**21.9**	**21.0**	**26.0**	**30.3**
Depreciation	-1.0	-0.8	-0.6	-0.4	-0.3
Amortisation	-11.1	-12.7	-13.6	-14.6	-15.7
EBIT	**30.9**	**8.5**	**6.8**	**10.9**	**14.2**
Net interest (expense)/revenue	0.6	0.8	1.3	1.4	1.7
Pre-tax profit	**31.5**	**9.3**	**8.1**	**12.4**	**15.9**
Income tax expense	-7.4	-1.4	0.2	-1.2	-2.4
NPAT	**24.1**	**7.9**	**8.3**	**11.1**	**13.5**
Change	*10%*	*-67%*	*4%*	*35%*	*21%*

Cash Flow (A$m)

Year end 30 Jun	2020	2021	2022e	2023e	2024e
EBITDA	42.9	21.9	21.0	26.0	30.3
Change in working capital	-12.6	2.4	-6.9	-7.0	-5.8
Gross cash flow	**30.3**	**24.3**	**14.1**	**19.0**	**24.5**
Tax paid	-6.2	-3.3	0.2	-1.2	-2.4
Operating cash flow	**24.2**	**21.1**	**14.3**	**17.8**	**22.1**
Payments for capitalised R&D	-14.0	-12.0	-12.5	-13.0	-13.5
Payments for PPE	-0.3	-0.3	-0.3	-0.4	-0.5
Payments for intangibles	-0.9	0.0	0.0	0.0	0.0
Divestment of assets	0.0	0.0	0.0	0.0	0.0
Interest received	1.0	1.4	1.3	1.4	1.7
Investing cash flow	**-14.2**	**-10.8**	**-11.5**	**-11.9**	**-12.3**
Proceeds from borrowings	14.0	14.5	0.0	0.0	0.0
Repayment of borrowings	-9.0	-12.8	-2.5	-2.5	-1.5
Proceeds from issue of shares	0.0	0.0	0.0	0.0	0.0
Dividends paid	-12.5	-6.4	0.0	0.0	-0.9
Financing cash flows	**-9.7**	**-7.0**	**-2.5**	**-2.5**	**-2.4**
Net change in cash	**0.2**	**3.2**	**0.3**	**3.3**	**7.4**
Cash at start of period	9.3	9.7	12.1	12.5	15.8
Exchange rate impact	0.2	-0.8	0.0	0.0	0.0
Cash at end of period	**9.7**	**12.1**	**12.5**	**15.8**	**23.3**

Balance Sheet (A$m)

Year end 30 Jun	2020	2021	2022e	2023e	2024e
Cash	9.7	12.1	12.5	15.8	23.3
Current receivables	57.9	51.9	56.7	63.3	68.7
Other current assets	3.0	4.0	4.0	4.0	4.0
Non-current receivables	29.4	27.6	29.3	32.7	35.6
Financial assets	0.2	0.2	0.2	0.2	0.2
PPE	8.3	7.3	6.9	6.9	7.1
Deferred tax assets	1.4	1.2	1.2	1.2	1.2
Intangibles - Goodwill	3.6	3.3	3.3	3.3	3.3
Intangibles - Other	25.4	26.7	25.6	23.9	21.7
Total assets	**139.8**	**135.1**	**140.5**	**152.1**	**165.8**
Payables	10.2	10.2	9.8	10.9	11.9
Current borrowings	0.0	0.0	0.0	0.0	0.0
Current provisions	3.9	4.0	4.0	4.0	4.0
Current tax liabilities	2.2	0.1	0.1	0.1	0.1
Current deferred revenue	20.8	15.5	15.6	17.5	19.0
Deferred tax liabilities	6.5	7.0	7.0	7.0	7.0
Non-current borrowings	5.0	6.7	4.2	1.7	0.2
Non-current provisions	0.7	0.7	0.7	0.7	0.7
Non-current deferred revenue	1.6	0.9	0.8	0.9	0.9
Total liabilities	**57.3**	**51.7**	**48.9**	**49.4**	**50.4**
Issued capital	1.7	1.7	1.7	1.7	1.7
Reserves	5.1	4.4	4.4	4.4	4.4
Retained earnings/(losses)	75.8	77.3	85.5	96.6	109.3
Total shareholders' equity	**82.5**	**83.3**	**91.6**	**102.7**	**115.4**

Valuation data

Year end 30 Jun	2020	2021	2022e	2023e	2024e
NPAT (A$m)	24.1	7.9	8.3	11.1	13.5
Diluted EPS (cps)	**13.9**	**4.6**	**4.8**	**6.4**	**7.8**
Change	*10%*	*-67%*	*4%*	*34%*	*21%*
P/E ratio (x)	**6.3**	**19.3**	**18.5**	**13.8**	**11.4**
CFPS (cps)	14.0	12.2	8.3	10.3	12.8
Price/CF (x)	**6.3**	**7.2**	**10.7**	**8.6**	**6.9**
DPS (cps)	7.3	0.0	0.0	0.0	1.0
Yield	**8.2%**	**0.0%**	**0.0%**	**0.0%**	**1.1%**
Franking	100%	0%	0%	100%	100%
EV/Revenue (x)	1.3	1.9	1.8	1.6	1.4
EV/EBITDA (x)	**3.4**	**6.7**	**6.9**	**5.3**	**4.3**
NTA per share (cps)	31.1	31.0	36.4	43.7	52.2
Price/NTA (x)	**2.8**	**2.9**	**2.4**	**2.0**	**1.7**

Performance ratios

Year end 30 Jun	2020	2021	2022e	2023e	2024e
EBITDA margin	**38.7%**	**27.9%**	**26.8%**	**29.8%**	**31.9%**
Return on equity	**29.1%**	**9.5%**	**9.0%**	**10.8%**	**11.7%**
ROIC	44.6%	10.9%	8.4%	12.7%	15.7%
Payout ratio	51.8%	0.0%	0.0%	0.0%	12.8%
Effective tax rate	-23.6%	-14.7%	2.5%	-10.0%	-15.0%

Leverage ratios

Year end 30 Jun	2020	2021	2022e	2023e	2024e
Net debt/(cash) (A$m)	-4.7	-5.5	-8.3	-14.2	-23.1
Net debt/equity	**NM**	**NM**	**NM**	**NM**	**NM**
Net debt/EBITDA (x)	NM	NM	NM	NM	NM
Net interest cover (x)	NM	NM	NM	NM	NM

Segmentals (A$m)

Year end 30 Jun	2020	2021	2022e	2023e	2024e
Revenue by product					
Collaborate	59.8	44.0	45.1	50.7	57.1
Infrastructure	28.7	15.9	15.1	16.6	15.8
Transact	13.8	10.2	10.2	12.0	13.8
Professional Services	8.6	8.4	7.7	7.9	8.1
Total revenue	**110.9**	**78.5**	**78.2**	**87.3**	**94.8**
Revenue by fees					
Licence fees	72.1	47.4	47.0	51.9	53.5
Maintenance fees	23.9	18.1	17.6	17.5	16.6
Saas fees	0.7	0.3	1.6	5.5	11.9
Consulting fees	8.6	8.4	7.7	7.9	8.1
Testing solution services	5.5	4.3	4.3	4.6	4.7
Total revenue	**110.9**	**78.5**	**78.2**	**87.3**	**94.8**
% breakdown by fees					
Licence fees	*65%*	*60%*	*60%*	*59%*	*56%*
Maintenance fees	*22%*	*23%*	*23%*	*20%*	*18%*
SaaS fees	*1%*	*0%*	*2%*	*6%*	*13%*
Consulting fees	*8%*	*11%*	*10%*	*9%*	*9%*
Testing solution services	*5%*	*6%*	*6%*	*5%*	*5%*
Total	***100%***	***100%***	***100%***	***100%***	***100%***

Interims (A$m)

Year end 30 Jun	1HFY21	2HFY21	1HFY22	2HFY22e
Total revenue (A$m)	**34.1**	**44.4**	**32.3**	**45.9**
EBITDA	**4.4**	**17.5**	**6.6**	**14.4**
Depreciation	-0.4	-0.4	-0.3	-0.3
Amortisation	-5.8	-6.9	-6.5	-7.1
EBIT	**-1.8**	**10.2**	**-0.2**	**7.0**
Net interest (expense)/revenue	0.4	0.5	0.8	0.5
Pre-tax profit	**-1.4**	**10.7**	**0.6**	**7.4**
Income tax expense	1.5	-2.9	1.2	-1.0
NPAT	**0.1**	**7.8**	**1.8**	**6.5**

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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