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Technology One (TNE)

SaaS ARR growth likely to be the highlight

Recommendation

Buy (unchanged)

Price

\$9.95

Target (12 months)

\$12.50 (previously \$14.00)

GICS Sector

Software and Services

Expected Return

Capital growth	25.6%
Dividend yield	1.5%
Total expected return	27.2%

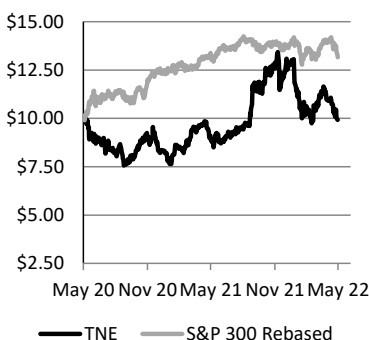
Company Data & Ratios

Enterprise value	\$3,084m
Market cap	\$3,215m
Issued capital	323.1m
Free float	85%
Avg. daily val. (52wk)	\$11.4m
12 month price range	\$8.50 - \$13.60

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	11.24	10.86	9.34
Absolute (%)	-11.65	-8.56	6.32
Rel market (%)	-5.67	-7.85	6.95

Absolute Price



SOURCE: IRESS

Expecting another solid result

Technology One is scheduled to report its 1HFY22 result on Tuesday, 24th May and we anticipate a solid result with forecast low double digit revenue and PBT growth. In our view, however, the key highlight will be the level of SaaS ARR growth which we expect to be strong given the level of SaaS flips are likely to be accelerating. We forecast SaaS ARR growth of 38% to c.\$215m and, furthermore, forecast total ARR growth of 18% to c.\$275m. One offsetting impact, however, of the expected accelerating SaaS flips is the level of on premise initial licence fees is likely to fall materially – we forecast a 44% fall to \$2.0m – and while this is a headwind for earnings we believe it is positive overall that these licence fees are rapidly diminishing. We also expect Technology One to provide FY22 guidance at the release of the interim result and expect the usual 10-15% growth in PBT with the likelihood this will be towards the upper end despite the rapid decline of on premise initial licence fees.

No change in forecasts

There is no change in our forecasts and we wait for the release of the 1HFY22 result before looking to reassess. We already forecast strong PBT growth of 16% in FY22 which is slightly above the top end of the 10-15% growth we expect the company to provide as FY22 guidance. The key swing factor this year is likely to be the level of on premise initial licence fees and if, for instance, Technology One is still able to generate a result towards the top end of the usual 10-15% growth range despite a material fall in these licence fees then this will further increase the quality of the result.

Investment view: PT down 11% to \$12.50, Maintain BUY

While there is no change in our forecasts we have updated each valuation used in the determination of our price target for market movements and time creep. There are no changes in the key assumptions we apply which are a 15% discount in the relative valuations and an 8.5% WACC and 5.0% terminal growth rate in the DCF. The net result is an 11% decrease in our PT to \$12.50 which has all been driven by a reduction in the relative valuations. We maintain our BUY recommendation.

Earnings Forecast

Year end 30 September	2021	2022e	2023e	2024e
Total revenue (A\$m)	311.8	350.2	384.5	431.0
EBITDA (A\$m)	124.9	150.4	179.2	210.3
NPAT (A\$m)	72.7	85.3	99.0	116.0
EPS (diluted) (cps)	22.5	26.3	30.4	35.4
EPS growth (%)	15%	17%	16%	17%
PER (x)	44.2	37.9	32.8	28.1
Price/CF (x)	27.9	25.2	21.4	18.3
EV/EBITDA (x)	24.7	20.4	16.9	14.2
Dividend (€ps)	13.9	15.3	17.6	20.2
Yield (%)	1.4%	1.5%	1.8%	2.0%
ROE (%)	38.2%	36.5%	34.5%	33.0%
Franking (%)	60.0%	60.0%	75.0%	75.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

1HFY22 Preview

Expecting another Solid Result

A summary of our P&L forecast for the 1HFY22 result is shown below.

Figure 1 - Forecast 1HFY22 P&L			
Year end 30 September	1HFY21	1HFY22e	Change
Total revenue (A\$m)	144.7	160.4	11%
Interest revenue	0.1	0.1	-5%
Revenue excluding interest	144.5	160.2	11%
Expenses (excl. R&D)	-78.7	-83.4	6%
<i>Expenses as % of revenue</i>	<i>-54.4%</i>	<i>-52.1%</i>	<i>239bps</i>
R&D expense	-16.2	-17.9	11%
<i>R&D as % of revenue</i>	<i>11.2%</i>	<i>11.2%</i>	<i>-1bps</i>
EBITDA	49.7	58.9	19%
Depreciation	-1.8	-1.7	-5%
Amortisation	-10.0	-14.7	48%
EBIT	37.9	42.5	12%
Net interest (expense)/income	-0.6	-0.6	0%
Profit before tax	37.3	41.9	12%
Tax expense	-9.1	-10.3	13%
NPAT	28.2	31.6	12%
<i>EBITDA margin</i>	<i>34.3%</i>	<i>36.8%</i>	<i>241bps</i>
<i>EBIT margin</i>	<i>26.2%</i>	<i>26.5%</i>	<i>31bps</i>
<i>PBT margin</i>	<i>25.8%</i>	<i>26.1%</i>	<i>35bps</i>
<i>NPAT margin</i>	<i>19.5%</i>	<i>19.7%</i>	<i>23bps</i>
<i>Effective tax rate</i>	<i>-24.4%</i>	<i>-24.5%</i>	<i>-13bps</i>
Basic EPS (cps)	8.79	9.81	12%
Diluted EPS (cps)	8.75	9.74	11%
Interim dividend (cps)	3.82	4.20	10%
<i>Franking</i>	<i>60.0%</i>	<i>60.0%</i>	
<i>Payout ratio</i>	<i>43.4%</i>	<i>42.8%</i>	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The key take-outs are:

- Forecasting low double digit growth:** We forecast low double digit growth in both revenue (up 11%) and PBT (up 12%). Note our revenue forecast of \$160m assumes a 1H/2H split of 46%/54% (consistent with both FY21 and FY20) and our PBT forecast of \$41.9m assumes a 1H/2H split of 37%/63% (slightly lower than the FY21 split of 38%/62% but higher than the underlying 30%/70% split in FY20).
- Forecasting 35% growth in SaaS fees:** The key driver of our forecast 11% growth in revenue is a 35% increase in SaaS fees to \$93m. This more than offsets forecast material falls in both on premise initial licence fees (down 44%) and on premise annual licence fees (down 14%) and continues the trend of SaaS fees becoming an increasingly larger percentage of total revenue.
- Forecast strong growth in both SaaS and total ARR:** While not shown in the figure above, we forecast 38% growth in SaaS ARR to \$215m and 18% growth in total ARR to \$275m. These forecasts imply a 23% decline in non-SaaS ARR to \$60m.

Earnings and Valuation Changes

No Change in Forecasts

There is no change in our forecasts and we wait for the release of the 1HFY22 result before looking to reassess. We already forecast strong PBT growth of 16% in FY22 which is slightly above the top end of the 10-15% growth we expect the company to provide as FY22 guidance. The key swing factor this year is likely to be the level of on premise initial licence fees and if, for instance, Technology One is still able to generate a result towards the top end of the usual 10-15% growth range despite a material fall in these licence fees then this will further increase the quality of the result.

A summary of our key forecasts is shown below. Note we forecast higher PBT growth of c.17% in both FY23 and FY24 as we expect the headwind from declining on premise initial licence fees to be less in these periods as they become more negligible. The only notable headwind in these periods is expected to be the increasing amortisation.

Figure 2 - Key forecasts						
Year end 30 Septemer	FY22e	Change	FY23e	Change	FY24e	Change
Total revenue (A\$m)	350.2	12%	384.5	10%	431.0	12%
EBITDA	150.4	20%	179.2	19%	210.3	17%
PBT	113.0	16%	132.1	17%	154.6	17%
NPAT	85.3	17%	99.0	16%	116.0	17%
Diluted EPS	26.3c	17%	30.4c	16%	35.4c	17%
DPS	15.3c	10%	17.6c	15%	20.2c	15%

SOURCE: BELL POTTER SECURITIES ESTIMATES

11% Decrease in PT to \$12.50

While there is no change in our forecasts we have updated each valuation used in the determination of our price target for market movements and time creep. There are no changes in the key assumptions we apply which are a 15% discount in the relative valuations and an 8.5% WACC and 5.0% terminal growth rate in the DCF.

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

Methodology	Old (as at 21-Mar-22)			New (as at 10-May-22)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
PE ratio	\$13.99	40%	\$5.60	\$12.09	40%	\$4.83
EV/EBITDA	\$13.70	40%	\$5.48	\$11.77	40%	\$4.71
DCF	\$14.63	20%	\$2.93	\$14.79	20%	\$2.96
Total		100%	\$14.00		100%	\$12.50

SOURCE: BELL POTTER SECURITIES ESTIMATES

The figure shows a double digit percentage decrease in each relative valuation but a modest low single digit percentage increase in the DCF. The net result is an 11% decrease in the PT to \$12.50 which is >20% premium to the share price so we maintain our BUY recommendation.

Technology One

Company Description

Technology One is a SaaS company that provides ERP (enterprise resource planning) software. The company develops, markets, sells, implements and supports its own enterprise software for each customer which is highly configurable but not customised.

Technology One was formed in 1987 and head office is in Brisbane, Queensland. The company markets its software in Australia, New Zealand, Malaysia and the UK and has in excess of 1,200 customers across these regions.

Investment Thesis

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

- **Valuation:** Our price target for Technology One is \$12.50 which is a 26% premium to the current share price. The price target is generated from a blend of the three valuation methodologies we apply to the company: PE, EV/EBITDA and DCF.
- **PEG ratio of 2-3x:** We forecast double digit underlying EPS growth of in each of the next three years which in our view justifies a PEG ratio of b/w 2-3x in these periods.
- **Potential to lift growth target:** Technology One has had an annual growth target of 10-15% growth in NPAT for a decade but we believe there is potential for the company to lift this annual target to 15-20% at some stage in the next few years.
- **Reasonable yield:** The forecast yield for Technology One is reasonable between 1-2% or more which assumes a payout ratio of b/w 55-60%. In our view this a reasonable yield for a company with such high forecast growth.

Key Risks

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

- **Switch to SaaS:** Like many software companies, Technology One is currently transitioning from an on premise to off-premise delivery model for its software. The company already has around half of its customers on the TechnologyOne SaaS platform (i.e. off premise) but there is still half of its customers still to be transitioned and this shift carries risk.
- **Competitive threat:** Technology One is one of several enterprise developers and vendors globally and its key competitors are large, global software companies such as Oracle, SAP, Workday and Infor. The size of these competitors presents a competitive threat to Technology One with the large marketing and R&D budgets of these companies and also the global presence and support provided
- **UK performance:** Technology One expanded into the UK market in 2006 and has recorded a loss in that market almost every year since. The business recorded a modest profit in FY16 but then slid back into a loss in FY17 and the loss then increased further in FY18. There are signs the business is turning around and it did report a modest profit again in FY20 but the company has yet to indicate when it expects the business to generate reasonable returns.

Technology One as at 10 May 2022

Recommendation

Buy

Price

\$9.95

Target (12 months)

\$12.50

Table 1 - Financial summary

Technology One (TNE)						Share price:	\$9.95	Target price:	\$12.50		
						No. of issued shares:	323.1m	Market cap:	\$3,215m		
Profit & Loss (A\$m)						Valuation data					
Year end 30 Sep	2020	2021	2022e	2023e	2024e	Year end 30 Sep	2020	2021	2022e	2023e	2024e
Total revenue	298.7	311.8	350.2	384.5	431.0	Net profit (A\$m)	62.9	72.7	85.3	99.0	116.0
Change	4%	4%	12%	10%	12%	Diluted EPS (c)	19.6	22.5	26.3	30.4	35.4
EBITDAR	133.3	160.1	189.0	220.8	254.9	Change	7%	15%	17%	16%	17%
R&D expense	-31.0	-35.1	-38.7	-41.6	-44.7	P/E ratio (x)	50.7	44.2	37.9	32.8	28.1
EBITDA	102.3	124.9	150.4	179.2	210.3	CFPS (c)	32.3	35.6	39.5	46.6	54.5
Depreciation	-3.9	-3.3	-3.5	-3.6	-3.7	Price/CF (x)	30.9	27.9	25.2	21.4	18.3
Amortisation	-14.7	-22.5	-32.6	-42.4	-50.9	DPS (c)	12.9	13.9	15.3	17.6	20.2
Forex	0.0	0.0	0.0	0.0	0.0	Yield (%)	1.3%	1.4%	1.5%	1.8%	2.0%
EBIT	83.6	99.1	114.3	133.2	155.7	Franking (%)	60%	60%	60%	75%	75%
Net interest (expense)/income	-1.1	-1.3	-1.2	-1.1	-1.1	EV/Revenue (x)	10.3	9.9	8.7	7.9	6.9
Profit before tax	82.5	97.8	113.0	132.1	154.6	EV/EBITDA (x)	30.2	24.7	20.4	16.9	14.2
Tax expense	-19.5	-25.2	-27.7	-33.0	-38.7	NTA per share (c)	13.1	11.7	17.5	27.7	42.9
NPAT	62.9	72.7	85.3	99.0	116.0	Price/NTA (x)	76.2	85.1	56.8	35.9	23.2
Cash Flow (A\$m)						Performance ratios					
Year end 30 Sep	2020	2021	2022e	2023e	2024e	Year end 30 Sep	2020	2021	2022e	2023e	2024e
EBITDA	102.3	124.9	150.4	179.2	210.3	EBITDAR/sales (%)	44.6%	51.3%	53.9%	57.4%	59.1%
Change in working capital	16.1	-0.9	0.0	-1.4	-1.9	EBITDA/sales (%)	34.2%	40.0%	42.9%	46.6%	48.7%
Gross operating cash flow	118.4	124.0	150.4	177.8	208.4	PBT/sales (%)	27.6%	31.4%	32.3%	34.3%	35.8%
Net interest	-1.1	-1.3	-1.2	-1.1	-1.1	Return on assets (%)	16.7%	16.0%	17.3%	18.1%	18.8%
Tax paid	-13.7	-7.8	-20.8	-24.8	-29.0	Return on equity (%)	44.3%	38.2%	36.5%	34.5%	33.0%
Other	0.0	0.0	0.0	0.0	0.0	ROIC (%)	NM	NM	>100%	>100%	>100%
Net operating cash flow	103.5	115.0	128.4	151.9	178.3	Payout ratio (%)	65.2%	61.4%	57.8%	57.5%	56.7%
Payments for PPE	-2.0	-1.7	-2.0	-2.5	-2.5	Effective tax rate (%)	-23.7%	-25.7%	-24.5%	-25.0%	-25.0%
Payments for intangibles	-42.9	-51.3	-57.5	-62.5	-65.0	Leverage ratios					
Payments for acquisitions	-0.2	-11.6	-6.0	-5.3	0.0	Year end 30 Sep	2020	2021	2022e	2023e	2024e
Net investing cash flows	-45.1	-64.5	-65.5	-70.3	-67.5	Net debt/(cash) (\$m)	-125.2	-131.4	-151.9	-184.8	-233.8
Proceeds from options exercise	5.2	10.6	2.5	2.5	2.5	Net debt/equity (%)	NM	NM	NM	NM	NM
Repayment of borrowings	0.0	0.0	0.0	0.0	0.0	Gearing (%)	NM	NM	NM	NM	NM
Dividends paid	-39.0	-42.5	-46.0	-51.4	-59.4	Net debt/EBITDA (x)	NM	NM	NM	NM	NM
Net financing cash flows	-38.3	-32.9	-48.5	-53.9	-61.9	Segmentals					
Net change in cash	20.2	17.6	14.4	27.7	49.0	Year end 30 Sep	2020	2021	2022e	2023e	2024e
Cash at end of period	125.2	142.9	157.3	185.0	234.0	Revenue (A\$m)					
Balance Sheet (A\$m)						SaaS fees	106.2	151.1	200.1	257.7	328.5
Year end 30 Sep	2020	2021	2022e	2023e	2024e	On Premise - Initial licences	27.3	16.8	11.7	7.0	3.5
Cash	125.2	142.9	157.3	185.0	234.0	On Premise - Annual licences	102.3	79.0	75.0	56.3	35.2
Prepayments	10.9	13.4	13.4	13.4	13.4	Consulting	62.5	64.5	62.9	63.2	63.5
Receivables	37.4	50.6	52.6	57.7	64.7	Other	0.8	0.7	0.7	0.7	0.7
Income tax receivable	8.1	0.0	0.0	0.0	0.0	Total revenue incl. interest	299.0	312.0	350.5	384.9	431.4
Other current assets	25.4	27.9	27.9	27.9	27.9	Interest revenue	0.4	0.2	0.3	0.4	0.4
PPE	32.8	28.3	26.8	25.7	24.5	Total revenue excl. interest	298.7	311.8	350.2	384.5	431.0
Intangibles - Goodwill	33.3	56.2	56.2	56.2	56.2	Interims					
Intangibles - Other	67.3	96.4	121.3	141.4	155.5	Year end 30 Sep	1HFY21	2HFY21	1HFY22e	2HFY22e	
Other receivables	0.0	0.0	0.0	0.0	0.0	Total revenue (A\$m)	144.5	167.3	160.2	190.0	
Contract acquisition assets	7.0	12.6	12.6	12.6	12.6	Growth	5%	4%	11%	14%	
Deferred tax assets	28.6	26.3	26.3	26.3	26.3	EBITDAR	65.8	94.3	76.8	112.2	
Total assets	375.9	454.7	494.5	546.4	615.3	R&D expense	-16.2	-19.0	-17.9	-20.8	
Payables	37.1	36.6	38.6	42.3	47.5	EBITDA	49.7	75.3	58.9	91.4	
Current provisions	20.5	21.2	21.2	21.2	21.2	Depreciation	-1.8	-1.5	-1.7	-1.7	
Unearned revenue	144.1	160.0	160.0	160.0	160.0	Amortisation	-10.0	-12.5	-14.7	-17.9	
Current borrowings	0.0	3.8	3.8	0.0	0.0	Forex	0.0	0.0	0.0	0.0	
Non-current provisions	2.4	2.1	2.1	2.1	2.1	EBIT	37.9	61.2	42.5	71.8	
Non-current borrowings	0.0	7.6	1.6	0.1	0.1	Net interest expense/income	-0.6	-0.7	-0.6	-0.6	
Other non-current liabilities	27.3	27.2	27.2	27.2	27.2	Pre-tax profit	37.3	60.6	41.9	71.1	
Total liabilities	233.7	264.5	260.5	259.0	264.1	Tax expense	-9.1	-16.1	-10.3	-17.4	
Shareholders' equity	40.6	51.6	54.1	56.6	59.1	NPAT	28.2	44.5	31.6	53.7	
Reserves	63.5	72.7	74.6	77.9	82.6						
Retained earnings	38.1	65.9	105.2	152.9	209.4						
Total shareholders' equity	142.2	190.2	234.0	287.4	351.1						

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

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