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Technology One (TNE)

Raise high the roof beam carpenters

Recommendation

Buy (unchanged)

Price

\$11.61

Target (12 months)

\$13.50 (previously \$12.50)

GICS Sector

Software and Services

Expected Return

Capital growth	16.3%
Dividend yield	1.2%
Total expected return	17.5%

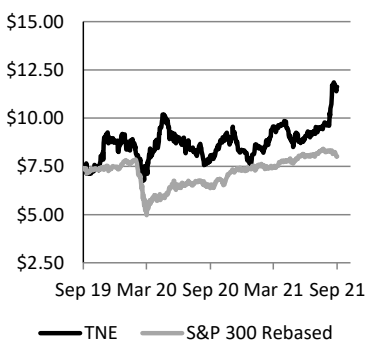
Company Data & Ratios

Enterprise value	\$3,634m
Market cap	\$3,734m
Issued capital	321.6m
Free float	85%
Avg. daily val. (52wk)	\$12.0m
12 month price range	\$7.60 - \$11.89

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	9.75	8.78	7.70
Absolute (%)	19.28	32.46	51.04
Rel market (%)	22.10	33.75	27.47

Absolute Price



SOURCE: IRESS

Forecasts updated for acquisition

We have updated our forecasts for the recently announced acquisition of Scientia. The impact is no change in our FY21 forecasts – consistent with the company saying the acquisition would be “earnings neutral” this year – and modest EPS upgrades of c.2% in both FY22 and FY23. Note we assume the acquisition is completed on or around 30 September – so does not contribute this year but contributes for a full 12 months in FY22 – and has relatively flat revenue around £11-12m or c.A\$21m in FY22 before modest growth thereafter. Also note we expect most of the Scientia revenue to be in ‘On premise – Annual Licenses’ at this stage though, consistent with what Technology One is doing, we expect most of this to flip to ‘SaaS fees’ over the next few years.

Investment view: PT up 8% to \$13.50, Maintain BUY

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. There are no changes in the key assumptions we apply which are a 10% discount in the relative valuations and an 8.5% WACC and 5.0% terminal growth rate in the DCF. The net result is an 8% increase in our PT to \$13.50 which is >15% premium to the share price so we maintain our BUY recommendation.

Result in November could be a catalyst

Technology One has a September year end so will report its FY21 result in late November. The full year result tends to be a catalyst for the share price – and we expect no different this year – as the second half result tends to be stronger both in terms of earnings and cash flow. We forecast a result slightly above the middle of the guidance range but do not rule out a result closer to the top end given the good 1HFY21 result and positive outlook for 2HFY21. We also see the potential for strong SaaS ARR growth above the 35% target provided by the company at the 1HFY21 result. The one potential negative, however, is another sell down by the co-founders post result though we would only expect this to be several million shares in total.

Earnings Forecast

Year end 30 September	2020	2021e	2022e	2023e
Total revenue (A\$m)	298.7	314.8	359.4	394.3
EBITDA (A\$m)	102.3	124.3	151.3	180.4
NPAT (A\$m)	62.9	73.8	85.3	99.0
EPS (diluted) (cps)	19.6	22.9	26.2	30.4
EPS growth (%)	7%	17%	15%	16%
PER (x)	59.2	50.8	44.2	38.2
Price/CF (x)	36.0	37.1	29.3	24.6
EV/EBITDA (x)	35.3	29.0	23.7	19.7
Dividend (€ps)	12.9	14.2	16.3	18.7
Yield (%)	1.1%	1.2%	1.4%	1.6%
ROE (%)	44.3%	43.5%	40.3%	37.8%
Franking (%)	60.0%	60.0%	60.0%	75.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Earnings and Valuation Changes

Forecasts Updated for Acquisition

We have updated our forecasts for the recently announced acquisition of Scientia. The impact is no change in our FY21 forecasts – consistent with the company saying the acquisition would be “earnings neutral” this year – and modest EPS upgrades of c.2% in both FY22 and FY23. Note we assume the acquisition is completed on or around 30 September – so does not contribute this year but contributes for a full 12 months in FY22 – and has relatively flat revenue around £11-12m or c.A\$21m in FY22 before modest growth thereafter. Also note we expect most of the Scientia revenue to be in ‘On premise – Annual Licenses’ at this stage though, consistent with what Technology One is doing, we expect most of this to flip to ‘SaaS fees’ over the next few years.

A summary of the changes in our key forecasts is shown below. Note there is no change in our dividend forecasts given the only modest change in our EPS forecasts.

Figure 1 - Change in key forecasts

Year end 30 September	FY21e			FY22e			FY23e		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue excl. interest (A\$m)	314.8	314.8	0.0%	338.1	359.4	6.3%	371.6	394.3	6.1%
EBITDA	124.3	124.3	0.0%	147.1	151.3	2.9%	174.9	180.4	3.1%
PBT	97.1	97.1	0.0%	111.0	112.9	1.7%	129.5	132.0	1.9%
NPAT	73.8	73.8	0.0%	83.8	85.3	1.7%	97.1	99.0	1.9%
Diluted EPS	22.9c	22.9c	0.0%	25.8c	26.2c	1.7%	29.8c	30.4c	1.9%
DPS	14.2c	14.2c	0.0%	16.3c	16.3c	0.0%	18.7c	18.7c	0.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

8% Increase in PT to \$13.50

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. There are no changes in the key assumptions we apply which are a 10% 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 PT calculation is shown below.

Figure 2 - Change in valuations and impact on PT

Methodology	Old (as at 7-Sep-21)			New (as at 22-Sep-21)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
PE ratio	\$13.11	40%	\$5.24	\$14.13	40%	\$5.65
EV/EBITDA	\$12.00	40%	\$4.80	\$13.18	40%	\$5.27
DCF	\$12.27	20%	\$2.45	\$12.86	20%	\$2.57
Total		100%	\$12.50		100%	\$13.50

SOURCE: BELL POTTER SECURITIES ESTIMATES

The figure shows a mid to high single digit percentage increase in each valuation. The net result is an 8% increase in our PT to \$13.50 which is >15% 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 \$13.50 which is a 16% 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 around 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 60-65%. 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 22 September 2021

Recommendation

Buy

Price

\$11.61

Target (12 months)

\$13.50

Table 1 - Financial summary

Technology One (TNE)	Share price:	\$11.61	Target price:	\$13.50
	No. of issued shares:	321.6m	Market cap:	\$3,734m

Profit & Loss (A\$m)						Valuation data					
Year end 30 Sep	2019	2020	2021e	2022e	2023e	Year end 30 Sep	2019	2020	2021e	2022e	2023e
Total revenue	285.8	298.7	314.8	359.4	394.3	Net profit (A\$m)	58.5	62.9	73.8	85.3	99.0
Change	13%	4%	5%	14%	10%	Diluted EPS (c)	18.3	19.6	22.9	26.2	30.4
EBITDAR	109.9	133.3	157.6	187.1	218.9	Change	60%	7%	17%	15%	16%
R&D expense	-28.0	-31.0	-33.3	-35.8	-38.5	P/E ratio (x)	63.5	59.2	50.8	44.2	38.2
EBITDA	81.9	102.3	124.3	151.3	180.4	CFPS (c)	24.0	32.3	31.3	39.6	47.3
Depreciation	-3.7	-3.8	-3.7	-3.9	-4.0	Price/CF (x)	48.3	36.0	37.1	29.3	24.6
Amortisation	-2.4	-14.8	-22.3	-33.4	-43.4	DPS (c)	11.9	12.9	14.2	16.3	18.7
Forex	0.0	0.0	0.0	0.0	0.0	Yield (%)	1.0%	1.1%	1.2%	1.4%	1.6%
EBIT	75.8	83.6	98.3	114.0	133.0	Franking (%)	64%	60%	60%	60%	75%
Net interest (expense)/income	0.6	-1.1	-1.2	-1.1	-1.0	EV/Revenue (x)	12.7	12.1	11.5	10.0	9.0
Profit before tax	76.4	82.5	97.1	112.9	132.0	EV/EBITDA (x)	44.3	35.3	29.0	23.7	19.7
Tax expense	-17.9	-19.5	-23.3	-27.7	-33.0	NTA per share (c)	11.9	13.1	10.3	15.7	25.1
NPAT	58.5	62.9	73.8	85.3	99.0	Price/NTA (x)	97.6	88.9	112.8	73.8	46.3

Cash Flow (A\$m)						Performance ratios					
Year end 30 Sep	2019	2020	2021e	2022e	2023e	Year end 30 Sep	2019	2020	2021e	2022e	2023e
EBITDA	81.9	102.3	124.3	151.3	180.4	EBITDAR/sales (%)	38.4%	44.6%	50.0%	52.0%	55.5%
Change in working capital	5.9	16.1	-4.5	-0.7	-0.5	EBITDA/sales (%)	28.6%	34.2%	39.4%	42.0%	45.7%
Gross operating cash flow	87.8	118.4	119.8	150.6	179.9	PBT/sales (%)	26.7%	27.6%	30.8%	31.4%	33.4%
Net interest	0.6	-1.1	-1.2	-1.1	-1.0	Return on assets (%)	18.4%	16.7%	17.8%	18.5%	19.2%
Tax paid	-11.5	-13.7	-17.5	-20.7	-24.8	Return on equity (%)	54.7%	44.3%	43.5%	40.3%	37.8%
Other	0.0	0.0	0.0	0.0	0.0	ROIC (%)	NM	NM	NM	>100%	>100%
Net operating cash flow	76.8	103.5	101.2	128.8	154.1	Payout ratio (%)	64.7%	65.2%	61.5%	61.6%	61.3%
Payments for PPE	-2.4	-2.0	-1.5	-2.0	-2.5	Effective tax rate (%)	-23.5%	-23.7%	-24.0%	-24.5%	-25.0%
Payments for intangibles	-35.9	-42.9	-47.5	-52.5	-57.5						
Payments for acquisitions	-4.1	-0.2	-12.0	-6.0	-6.0						
Net investing cash flows	-42.3	-45.1	-61.0	-60.5	-66.0						
Proceeds from options exercise	2.1	5.2	10.0	2.5	2.5						
Repayment of borrowings	0.0	0.0	0.0	0.0	0.0						
Dividends paid	-35.9	-39.0	-42.2	-47.4	-54.8						
Net financing cash flows	-33.8	-38.3	-37.2	-49.9	-57.3						
Net change in cash	0.7	20.2	2.9	18.3	30.9						
Cash at end of period	105.0	125.2	128.2	146.5	177.4						

Leverage ratios					
Year end 30 Sep	2019	2020	2021e	2022e	2023e
Net debt/(cash) (\$m)	-105.0	-125.2	-128.2	-146.5	-177.4
Net debt/equity (%)	NM	NM	NM	NM	NM
Gearing (%)	NM	NM	NM	NM	NM
Net debt/EBITDA (x)	NM	NM	NM	NM	NM

Segmentals					
Year end 30 Sep	2019	2020	2021e	2022e	2023e
Revenue (A\$m)					
SaaS fees	81.5	106.2	148.6	196.9	251.1
On Premise - Initial licences	40.6	27.3	19.8	14.9	10.0
On Premise - Annual licences	101.3	102.3	83.1	84.1	69.4
Consulting	61.6	62.5	62.8	63.1	63.4
Other	1.4	0.8	0.8	0.8	0.8
Total revenue incl. interest	286.4	299.0	315.1	359.8	394.8
Interest revenue	0.6	0.4	0.3	0.4	0.5
Total revenue excl. interest	285.8	298.7	314.8	359.4	394.3

Interims					
Year end 30 Sep	1HFY20	2HFY20	1HFY21	2HFY21e	
Total revenue (A\$m)	138.2	160.5	144.5	170.3	
Growth	7%	2%	5%	6%	
EBITDAR	49.9	83.3	65.8	91.8	
R&D expense	-15.1	-15.9	-16.2	-17.2	
EBITDA	34.8	67.4	49.7	74.6	
Depreciation	-1.9	-1.9	-1.8	-1.9	
Amortisation	-6.5	-8.4	-10.0	-12.3	
Forex	0.0	0.0	0.0	0.0	
EBIT	26.4	57.2	37.9	60.4	
Net interest expense/income	-0.5	-0.6	-0.6	-0.6	
Pre-tax profit	25.9	56.5	37.3	59.8	
Tax expense	-6.9	-12.6	-9.1	-14.2	
NPAT	19.1	43.9	28.2	45.6	

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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