EXPERT SYSTEM

FY2018 Earnings (+)

(Company press release)

Substantial improvement in margins

ES released its FY2018 earnings yesterday after trading, overall above the consensus and our expectations.

H2 sales amounted to €15.8m (-10.5% YoY), below our expectations (-2.7%) and consensus (-5.4%), resulting in lower seasonality (H2 accounting for 55% of FY2018 sales vs 68% in 2017). FY2018 sales reached €28.7m (+ 9.8% YoY), below our expectations (-1.5%) and consensus (-3.1%). The shift towards a recurring license sales model is accelerating, accounting for 72% of the total licenses sold in 2018 (vs 41% in 2017). As envisaged in the Group's strategic plan, the professional services division should ultimately account for a smaller share of total revenues (lower margins and more WC consuming). Geographically, we are seeing strong momentum in the US, UK (+64% YoY), and Spain (+95% YoY), promising markets for the Group.

EBITDA experienced a strong growth (+343% YoY) to reach €4.6m, above our estimates (+13.8%) and consensus (+0.8%), favoured by both (i) the shift which is taking place at the sales level, and (ii) the significant share of fixed costs, ultimately leading to a substantial increase of EBITDA margin to stand at 16.2% (vs 4.0% in 2017).

NI came out above both our expectations and consensus at -€3.8m (vs -€8.3m in 2017) materializing an increase in the net margin to reach -13.2% (vs -31.9% in 2017).

ND stood at €12.4m (+40.6% YoY), leading to a net leverage ratio of 2.7x (vs 8.4x in 2017 purely attributable to the substantial increase in EBITDA). ND increased mainly due to the increase in WC (+27.6% YoY), which grew at a faster pace than the growth in sales. More specifically, the account receivables grew by +27.5% YoY to represent 55% of sales in 2018 (47% in 2017). An effort regarding the WC management must be done, the company should make an effort in terms of pricing power to bolster the cash conversion. The reorganization of the sales channel with an indirect share called to be more meaningful should help in that respect.

We intend to be careful in our approach and our estimates (unchanged), even if we are convinced of the legitimacy of ES in its market. ES is suffering from a substantial undervaluation, when applying a 30% discount (place of listing, size, liquidity) on the trading multiples, the stock is currently trading at 1.9x 2019E Sales (vs 3.9x peers) and 8.6x 2019E EBITDA (vs 21.5x peers) for similar profitability and superior technology. We upgrade our price target to €2.00/share resulting from the improvement of the trading multiples.

Buy, TP of €2.00 (vs €1.78)- Pierre Buon : + 33 1 55 35 69 40

Market Data	
Industry	Artificial intelligence
Share Price (€)	1,7
Market Cap (€M)	59,7
Bloomberg	EXSY IM
Market Segment	FTSE AIM Italia

Ownership structure	
Management	27,0%
Free float	73,0%

€M (31/12)	2018a	2019e	2020e	2021e
Sales (€M)	28,7	33,2	37,8	43,1
Growth	*9,8%*	*15,5%*	*14,0%*	*14,0%*
EBITDA	4,6	7,4	9,5	10,9
Marge	*16,2%*	*22,3%*	*25,1%*	*25,3%*
Net income	-3,8	-2,1	1,0	2,3
EPS (€)	-0,11	-0,06	0,03	0,06
EPS growth	*n.m.*	*n.m.*	*n.m.*	*n.m.*
Dividend	0,00	0,00	0,00	0,00
Yield (%)	*0,0%*	*0,0%*	*0,0%*	*0,0%*
FCF	n/a	0,4	1,8	2,6
ROCE	n/a	-1,4%	8,2%	11,7%
EV/Sales (x)		1,9	1,7	1,5
EV/EBITDA (x)		8,6	6,7	5,9
PE (x)		n.s.	61,9	26,3
Net Debt	12,4	20,0	19,9	19,0
Gearing	*80%*	*150%*	*139%*	*114%*

Midcap Partners estimates

Upcoming event : H1 2019 Earnings - N/A

TOP Peers	Market Cap (M)	EV/Sales 2019E	EV/Sales 2020E	EV/EBITDA 2019E	EV/EBITDA 2020E
Iflytek Co., Ltd.	75 185	6,3	5,3	12,7	11,2
Nuance Communications, Inc.	4 761	10,3	8,5	17,8	15,2
Sidetrade SA	82	21,2	11,2	32,1	19,1

Source: FACTSET

Disclaimer

This document may refer to valuation methods defined as follows:

1 - DCF method: discounting future cash flows generated by the business's operations. Cash flows are determined using the analyst's financial forecasts and models. The discount rate used is the weighted average cost of capital, defined as the weighted average cost of the company's borrowings and the theoretical cost of its equity as estimated by the analyst.
2 - Comparables method: application of stock-market valuation multiples, or multiples observed for recent transactions. These multiples may be used as benchmarks and applied to the company's financial aggregates to determine its valuation. The analyst builds the sample according to the company's characteristics (size, growth, profitability, etc). The analyst may also apply a premium/discount based on his perception of the company's characteristics.
3 - Asset-based method: estimation of the value of the equity on the basis of the revalued and corrected assets comprising the fair value of the liability.
4 - Discounted dividend method: discounted future value of estimated dividend flows. The discounting rate taken is general the cost of capital.
5 - The sum of the parts: this method consists in estimating a company's various activities by using the most appropriate evaluation method for each of them, then by adding them together.

Rating structure:

Buy: expected over-performance 10% greater than the market within 6 – 12 months
Hold: expected performance of between -10% and +10% compared to the market within 6 – 12 months
Sell: expected under-performance 10% greater than the market within 6 – 12 months

Company	Closing price (€)	Rating	Warning
AST GROUPE	4.8	Buy	D,G
EXPERT SYSTEM	1.665	Buy	G
GROUPE CRIT	55.5	Buy	Nil
GUERBET	49.7	Hold	Nil

A LOUIS CAPITAL MARKETS – MCP or any corporate entity related to it holding more than 5% of the total shares issued by the issuer;
B The issuer holds more than 5% of the total shares issued by LOUIS CAPITAL MARKETS - MCP or any corporate entity related to it;
C LOUIS CAPITAL MARKETS - MCP, alone or with other corporate entities, is related to the issuer by other significant financial interests;
D LOUIS CAPITAL MARKETS - MCP or any corporate entity related holding a contract or providing liquidity with which it entered into a liquidity agreement with regard to the issuer's financial instruments;
E LOUIS CAPITAL MARKETS – MCP or any corporate entity related to it operated, during the past 12 months, in its capacity as leader or leader associated with an offer concerning the issuer's financial instruments made available to the public
F LOUIS CAPITAL MARKETS – MCP or any corporate entity related to it is a party in any other agreement with the issuer concerning the provision of investment services relating to the corporate activity, provided that this does not result in the disclosure of confidential commercial information and that the agreement was in force during the last 12 months or gave rise to payment of, or a promise to pay, remuneration during the same period;
G LOUIS CAPITAL MARKETS – MCP and the issuer agreed that the former should provide the latter with a service to produce and circulate the investment recommendation on the said issuer;

Stock rating distribution
At March 2019 the stock rating distribution issued by the LOUIS CAPITAL MARKETS - MCP Midcap research team is as follows:

Rating	Midcap Partners coverage universe	of which Investment banking services*
Buy	74%	85%
Hold	25%	15%
Sell	1%	0%

* Investment banking services provided by Midcap Partners in the previous 12 months

The reference prices used in this document are closing prices. Any opinion given in this document reflects our current judgement and may be changed without any prior warning. LOUIS CAPITAL MARKETS - MCP has adopted effective administrative and organisational methods, including the ""information barriers"", to guard against and to avoid conflicts of interest with regard to the investment recommendations. The remuneration of the financial analysts involved in drafting the recommendation is not tied to