

Lleida.net

BUY

The digital economy is driving its growth momentum

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Lleida.Net growth continues to be driven by the increasing digitalization of commercial transactions and regulatory oversight requiring trusted third parties to oversee them. In 2017, sales rose 23% to almost €10 million with a particularly strong performance coming from the certification and ID validation software that grew 32% to €2.6 million.

The new European Directive on Data Protection coming into effect in 2018 will require companies to seek explicit consent from consumers to remain in their databases. Lack of implementation could result in fines of up to €20 million, which in our view will drive companies to invest in compliance.

Sales of certified messaging services and data validation software will continue to drive cash flow growth in 2018. We expect sales in 2018 and 2019 to reach €4.2 million and €5.5 million respectively. Sales growth within these divisions has now averaged some 50% per year, over the past 3 years, a reflection of Lleida.net product development success.

We expect Lleida.net to generate a free-cash flow of €1.2 million during 2018, which could lead to a drop in Net Debt to €1.5 million, from €2.4 million in 2017. Based on our forecasts for 2018, the stock is still trading on a Free-Cash Flow yield of 9%, an EV/Ebitda (ex- capitalizations) of 11x and a PE of 21x.

The stock has bounced off its lows of €0.51 per share to the current €0.80, as the political uncertainty in Spain has progressively diminished. We still maintain our 12 month target price of €1.13 which would place the stock at a EV to Sales multiple of 2x which is where we think it should be given its growth profile and profit margins.

Equities

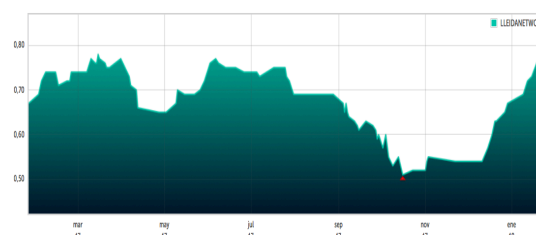
Spain Telecom/Software Services

Price: €0.80
RIC: LLN.MC

Trading Data

52 week range (€):	0.51 - 0.80
Mkt Cap (€ millions):	12.8
No. Shares (millions):	16.04
Avg Daily vol (LTM):	5,322

Share Price Chart (LTM)



(€ millions)	2016a	2017e	2018f	2019f
Turnover	8,1	9,9	11,7	13,1
Ebitda	0,1	0,6	1,3	2,1
Net Profit	-1,4	0,1	0,6	1,1
EPS	-0,09	0,00	0,04	0,07
Net Debt	2,4	2,4	1,5	0,5
EV/Ebitda	121	25,8	11,1	6,5
P/E	-	246,9	20,8	11,8
FCY	n.m.	3%	9%	13%

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Outlook for 2018

We expect Lleida.net to remain essentially cash generative and growth driven company in 2018.

This year is going to be dominated by its international expansion following a number of key hires of business development and sales to deepen Lleida.net exposure to the rest of Europe, Latin America and Africa. The hires were brought in during 2016 and early 2017, which means they are expected to bring the product of their development work mainly in 2018.

(1) Software Services Outlook

We have raised our Software Services revenues estimates to an increase of 58% (vs. 36% previously) in 2018 versus growth of 27% in 2017.

Within the European context there is an increased awareness of legal security issues in an increasingly digitalized economic environment. Lleida.net has a unique product offering in certified messaging with its own family of patents already approved in the most important jurisdictions around the world.

The regulators, namely data protection agencies, have now stepped in with a more rigorous data protection law that will come into effect in May of this year (stemming from a European Directive) that will force large consumer oriented business to put in place more rigorous compliance mechanisms.

Consumers will now have to give a clear and explicit consent for their data to be in hands of companies operating in the European Union. The consumer will be able to denounce non-compliance from companies with the added incentive that some or all of the proceeds arising from any fines going to the consumer.

We expect these drivers to have a distinct positive influence on the company's growth prospects.

(2) SMS divisions outlook

On the Telecom side, the company's strategy is expected to continue to shift from an emphasis on SMS Customer Solutions to the greater potential of SMS Interconnection Solutions (wholesale).

We are raising our 2018 sales (and sales growth projection) on SMS Wholesale from €4.7 million (+12% growth) to €5.0 million (+14% growth). Instead, we are lowering our sales and sales growth forecasts for the SMS Customer Solutions division from €3.0 million (+3% growth) to €2.4 million (-16% growth).

Lleida.net has built a powerful and efficient global interconnection network, which is competitive and can be operated with a relatively low cost base. This means that the company is expected to continue to grow by generating volume increases of traffic despite the lower margins (half or less that of the SMS Customer Solutions), with the same cost base.

The more customer driven and less scalable SMS Customer Solutions require a dedicated commercial sales force and its gradually becoming less interesting in the presence of the higher margin software services products. During 2017, this division shrank to almost the same size of the Software Solutions division but with approximately half the gross margin (the company does not disclose the number, so its only an estimate).

We have also made some additional adjustments to our forecasts to reflect some of the changing trends seen during the last quarter.

Our total sales and sales growth forecasts for 2018 are now €11.7 million (+ 18% growth) versus our previous €11.5 million (+ 15% growth). These changes in sales projections and sales mix actually result in no change in our gross profit forecasts for 2018, which remain at €6.2 million (+21% growth). For 2019 we have raised our Gross Profit forecast slightly to €7.3 million versus €7.1 million previously, pointing towards an 18% increase year on year.

Our cash operating cost projections have increased slightly to €4.9 million from €4.7 million mainly as a result of the new hires and some overdue upward salary revisions. Our estimates point towards an average company cost of the expected 59 employees to be working for Lleida.net in 2018 to be around €45,000. As a result we now have a slightly lower Ebitda (ex-capitalizations) of €1.3 million versus our previous forecast of €1.5 million.

We have adjusted downwards our Net Profit forecasts for 2018 and 2019 mostly on the back of a lower capitalization of R&D expenses, a non-cash item. Our new Net Profit numbers are €0.6 million (€1.1 million) for 2018 and €1.1 million (€1.2 million) for 2019. The reason being depreciation costs are now expected to rise to €1.2 million (€1.1 million) and the capitalization of R&D costs are now expected to be just under €0.6 million versus our prior estimate of €0.8 million.

Given that it is mostly attributable to non-cash items, the impact on the perceived valuation of Lleida.net should be negligible. Our Net Profit forecasts for 2019 remain almost unchanged at €1.1 million (vs. €1.2 million previously) on the back of slightly better operating profit estimates.

On the Balance Sheet side, we continue to expect a reduction in the Net Debt position of the company as our projected €1.2 million of free cash flow is to be invested in a €0.9 million reduction in Net Debt and the remaining €0.3 million in Working Capital. The company does not typically invest in Fixed Assets, so none are projected for 2018 or 2019. Investments in intangible assets are accounted for under the Capitalization of R&D costs in the profit and loss account and incorporated in our free cash flow calculations.

Profit and Loss (consolidated)

(€ millions)	2016	2017	2018f	2019f
Sales by division				
Software Services	1,9	2,7	4,2	5,5
SMS Solutions	3,3	2,8	2,4	2,6
ICX	2,8	4,4	5,0	4,9
Turnover	8,1	9,9	11,7	13,1
Cost of sales	-3,9	-4,7	-5,5	-5,7
Gross Profit*	4,1	5,2	6,2	7,3
% y-o-y growth		25	21	18
Gross Margin	51%	52%	53%	56%
Capitalized costs (R&D)*	0,9	0,8	0,6	0,6
Personnel Expenses	-2,0	-2,5	-2,7	-2,8
Other SG&A	-2,0	-2,1	-2,3	-2,5
Depreciation	-1,1	-1,1	-1,2	-1,1
Other	0,0	0,0	0,0	0,0
Total Operating Costs	-5,2	-5,7	-6,1	-6,4
% y-o-y growth		9	8	4
Operating Income	-0,1	0,4	0,7	1,6
Operating Margin	-1%	4%	6%	12%
Ebitda	1,0	1,4	1,9	2,7
Ebitda Margin	13%	15%	16%	20%
Ebitda (ex-capitalizations)	0,1	0,6	1,3	2,1
Ebitda Margin	2%	6%	11%	16%
Financial Income	0,0	0,0	0,0	0,0
Financial Costs	-0,2	-0,1	-0,1	-0,1
Extraordinaries	-1,1	-0,1	0,0	0,0
Financial Results	-1,3	-0,3	-0,1	-0,1
Profit Before Tax	-1,4	0,1	0,6	1,5
Tax	0,0	0,0	0,0	-0,3
Net Income	-1,4	0,1	0,6	1,2
Cash Flow	-1,2	0,4	1,2	1,7

Balance Sheet (consolidated)

(€ millions)	2016e	2017f	2018f	2019f
Fixed Assets	4,3	4,1	3,6	3,2
Intangible Assets	3,6	3,5	2,9	2,5
Tangible Assets	0,5	0,5	0,5	0,5
Investments in Group Companies	0,0	0,0	0,0	0,0
Other Investments	0,0	0,0	0,0	0,0
Deferred Assets	0,1	0,1	0,1	0,2
Current Assets	5,2	4,3	4,9	5,5
Inventory	0,0	0,0	0,0	0,0
Debtors	2,3	2,6	3,1	3,6
Investments in Group Companies	0,0	0,0	0,0	0,0
Short Term Investments	1,3	0,9	0,9	0,9
Short Term Accruals	0,2	0,2	0,2	0,3
Cash	1,5	0,7	0,7	0,7
Assets	9,6	8,5	8,5	8,7
Shareholders Funds	2,8	2,9	3,5	4,7
<i>Capital</i>	0,3	0,3	0,3	0,3
<i>Share Premium</i>	5,2	5,2	5,2	5,2
<i>Reserves</i>	-0,5	-1,9	-1,8	-1,2
<i>Repurchase of share capital</i>	-0,9	-0,9	-0,9	-0,9
<i>Profit and Loss account</i>	-1,4	0,1	0,6	1,2
Long Term Debt	1,9	1,2	1,2	0,6
Current Liabilities	4,7	4,5	3,8	3,4
Short Term Debt	3,2	2,8	1,9	1,3
Creditors	1,5	1,7	1,9	2,1
Liabilities	9,6	8,5	8,5	8,7
(€ millions)	2016e	2017f	2018f	2019f
Working Capital	0,8	0,9	1,2	1,5
Debtor Turnover (days)	52	89	88	94
Creditor Turnover (days)	34	61	63	67
Financial Debt	-5,1	-4,0	-3,1	-1,9
Cash	2,7	1,5	1,6	1,6
Net Debt	2,4	2,4	1,5	0,2

Sum of the parts valuation

Sector	Division	DCF (€)	Year	P/Sales
Software	Cert. & ID Validation	12.891.571	2017	4,8
			2018	3,1
Telecommunications	SMS	3.324.672	2017	1,2
			2018	1,4
	ICX	4.360.418	2017	1,0
			2018	0,9
	Sum of Parts	20.576.661		
	Net Debt	2.414.000		
	Equity Valuation	18.162.661		
	Per share	1,13		
	Share Price	0,80		
	Upside	41%		

Comparable Valuations

	Price	Mkt Cap.	Net Debt			EV		
			2016	2017e	2018e	2016	2017e	2018e
	(€)	(€ m)	(€ m)	(€ m)	(€ m)	(€ m)	(€ m)	(€ m)
Altia	17,20	118,3	-11,5	-16,0	-19,3	106,8	102,3	99,0
Catenon	0,60	11,2	4,5	4,7	5,0	15,7	15,9	16,2
Commcenter	1,32	8,7	14,0	11,3	10,4	22,8	20,0	19,1
Eurona	1,79	75,5	93,5	83,7	89,6	169,0	159,2	165,1
FacePhi	1,14	15,1	1,5	1,5	1,6	16,6	16,6	16,7
Gigas	3,56	15,2	1,9	2,6	3,2	17,1	17,9	18,4
Lleida.Net	0,80	12,8	2,4	2,4	1,6	15,2	15,3	14,4
ThinkSmart	1,49	8,5	4,5	5,2	5,4	13,0	13,7	13,9
Voz Telecom	1,89	8,5	0,8	1,0	0,8	9,3	9,5	9,2
Total		273,9	111,5	96,4	98,2	385,4	370,3	372,1

	Turnover			Ebitda			Net Profit			Cash Flow		
	2017e (€ m)	2018e (€ m)	2019e (€ m)	2017e (€ m)	2018e (€ m)	2019e (€ m)	2017e (€ m)	2018e (€ m)	2019e (€ m)	2017e (€ m)	2018e (€ m)	2019e (€ m)
Altia	57,4	59,7	62,1	8,6	9,2	9,9	6,0	6,5	7,0	7,1	7,6	8,1
Catenon	13,7	15,0	16,5	0,8	1,2	1,6	-0,1	0,0	0,2	0,5	1,0	1,3
Commcenter	52,5	54,7	56,8	1,1	1,2	1,4	-0,7	-0,6	-0,6	0,9	1,0	1,1
Eurona	169,6	179,7	188,7	9,6	10,6	11,5	-7,0	-6,8	-6,4	5,1	5,9	6,6
FacePhi	2,7	3,2	3,9	0,4	0,6	0,9	0,4	0,6	0,8	0,3	0,5	0,7
Gigas	6,0	6,9	7,6	0,3	0,5	0,7	-0,4	-0,2	-0,1	0,3	0,5	0,6
Lleida.Net	9,9	11,7	13,1	0,6	1,3	2,1	0,1	0,6	1,1	0,3	1,2	1,7
ThinkSmart	19,9	23,8	28,8	-0,7	0,5	1,8	-0,6	0,5	1,8	-1,1	0,1	1,5
Voz Telecom	9,9	10,5	11,3	0,0	0,0	0,2	-1,2	-1,2	-1,1	-0,2	-0,2	0,0
	341,6	365,3	388,8	20,7	25,2	30,0	-3,6	-0,7	2,8	13,2	17,5	21,6

	Turnover growth			Ebitda growth			Net Profit growth			Cash Flow Growth		
	2017e (€ m)	2018e (€ m)	2019e (€ m)	2017e (€ m)	2018e (€ m)	2019e (€ m)	2017e (€ m)	2018e (€ m)	2019e (€ m)	2017e (€ m)	2018e (€ m)	2019e (€ m)
Altia	-14%	4%	4%	-8%	8%	8%	-5%	8%	8%	-4%	8%	7%
Catenon	-3%	10%	10%	-	47%	28%	-96%	-82%	-	-	82%	32%
Commcenter	-6%	4%	4%	-	12%	11%	-57%	-6%	-7%	-	12%	11%
Eurona	5%	6%	5%	162%	10%	8%	-41%	-3%	-7%	-	16%	12%
FacePhi	35%	20%	20%	-	50%	49%	-	46%	45%	-	56%	53%
Gigas	25%	15%	10%	-	95%	40%	-47%	-42%	-59%	-	75%	36%
Lleida.Net	23%	18%	12%	370%	121%	57%	-	1086%	76%	-	330%	39%
ThinkSmart	26%	20%	21%	-57%	-	295%	-63%	-	239%	-48%	-	1162%
Voz Telecom	5%	7%	7%	-96%	295%	357%	38%	-4%	-8%	-	13%	-76%
	11%	7%	6%	116%	22%	19%	-77%	-80%	-	647%	33%	23%

	EV/sales			EV/Ebitda			P/E			FCY		
	2017e (x)	2018e (x)	2019e (x)	2017e (x)	2018e (x)	2019e (x)	2017e (x)	2018e (x)	2019e (x)	2017e (x)	2018e (x)	2019e (x)
Altia	1,8	1,7	1,5	11,9	10,7	9,6	19,8	18,3	16,9	6%	6%	7%
Catenon	1,2	1,1	1,0	19,0	13,2	10,3	-	-	46,6	5%	9%	11%
Commcenter	0,4	0,3	0,3	18,3	15,6	13,1	-	-	-	10%	11%	13%
Eurona	0,9	0,9	0,9	16,5	15,5	14,8	-	-	-	7%	8%	9%
FacePhi	6,1	5,2	4,4	40,1	26,9	18,3	38,0	26,1	18,0	2%	3%	5%
Gigas	3,0	2,6	2,4	69,6	36,8	26,5	-	-	-	2%	3%	4%
Lleida.Net	1,5	1,3	1,2	25,8	11,1	6,5	246,9	20,8	11,8	2%	9%	13%
ThinkSmart	0,6	0,5	0,4	-	30,6	7,0	-	14,4	4,2	-13%	1%	18%
Voz Telecom	1,0	0,9	0,8	1108,2	273,2	56,1	-	-	-	-2%	-2%	0%
	1,1	1,0	1,0	17,9	14,7	12,3	-	-384,2	97,8	5%	6%	8%

Review of consolidated 4Q17 results

4Q17 has been the 6th consecutive quarter of free cash flow generation for Lleida.net since it became a publicly listed company in 2015. The company reported cash flow of some €147k in 4Q17 versus €247k in 4Q16.

Total sales rose by 17% to €2.7 million during the quarter, driven by the strong performance (+63%) of the Wholesale SMS side of the business. The software services side (certified communications and ID Validation) and SMS Solutions fell by 4% and 12% respectively, relative to last year.

The expected seasonal upswing during 4Q17 was softer than expected on the customer side of Lleida.net. This was partly attributable to the uncertainty generated by political events in Spain, as the consumers behind Lleida.net customers became more cautious during the quarter. Broadly speaking, it is likely they were less prone to obtain new credit cards, change their utility or mobile phone providers, which represent the largest source of revenues for the certified communications and ID validation.

The customer driven SMS Solutions divisions continues to be under pressure on the margin side and it's becoming less attractive a product relative to the higher margin software products. The commercial focus is now being placed on the higher margin products.

Despite the increase in sales during the quarter, the reported gross profit remained broadly the same at €1.4 million, relative to 4Q16. The reason being the Wholesale SMS product carries a smaller margin than all other divisions, which was reflected in the gross margin decline to 51% in 4Q17 from 60% in 4Q16.

Part of the success this quarter is based on the fact that Lleida.net continues to leverage on the interconnection platform developed over the years together with a management system that enables to monitor a very detailed P&L for every SMS sent or received on a daily basis. It's basically a sophisticated SMS trading platform for which they are prepared to profitably capture an ever-growing slice of the global SMS market.

Operating income rose to €133k in 4Q17 versus €26k mainly on the back of a lower depreciation and amortization numbers combined with a slightly larger capitalization of R&D expenses. Excluding the non-cash items the operational cash flow, or Ebitda, went from €279k in 4Q16 to €176k in 4Q17. Other non-operating items came in of €51k broadly similar to 4Q16.

Only the financial debt position of the Balance Sheet has been reported in last week's release. The net debt of the company has remained stable relative to 2016 at €2.4 million, broadly a reflection that the positive cash flow generated of €347k during the year has been invested in financing the working capital associated to the rate of sales growth of the business.

Consolidated quarterly operating results

(€ '000)	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17
Software Services	343	422	559	656	675	584	699	649
SMS Solutions	661	716	719	795	711	768	649	699
ICX	691	748	815	830	838	1.077	1.126	1.353
Other	-8	53	30	24	19	25	8	0
Total	1.687	1.939	2.123	2.305	2.243	2.454	2.482	2.701
Turnover	1.687	1.939	2.123	2.305	2.243	2.454	2.482	2.701
Cost of sales	-950	-1.179	-858	-923	-938	-1.240	-1.236	-1.328
Gross Profit	737	760	1.265	1.382	1.305	1.214	1.246	1.373
<i>Gross Margin</i>	44%	39%	60%	60%	58%	49%	50%	51%
Capitalized costs (R&D)*	280	257	194	188	184	203	222	240
Personnel Expenses	-468	-487	-488	-543	-600	-617	-618	-647
Other SG&A	-445	-513	-438	-555	-564	-565	-403	-561
Depreciation	-305	-303	-267	-267	-251	-271	-273	-283
Amortization	0	-481	0	-174	0	0	0	0
Other	0	0	0	-5	5	2	2	11
Total Operating Costs	-1.218	-1.784	-1.193	-1.544	-1.410	-1.451	-1.292	-1.480
<i>% y-o-y growth</i>								
Operating Income	-201	-767	266	26	79	-34	176	133
<i>Operating Margin</i>	-12%	-40%	13%	1%	4%	-1%	7%	5%
Ebitda **	-176	-240	339	279	146	34	227	176
<i>Ebitda Margin</i>	-10%	-12%	16%	12%	7%	1%	9%	7%
Extraordinaries	-100	-382	-85	0	-67	0	-21	0
Financial Costs	-58	-37	-44	-37	-36	-19	-35	-18
FX	0	0	0	-6	0	-97	24	-33
Financial Results	-158	-419	-129	-43	-103	-116	-32	-51
Profit Before Tax	-359	-1.186	137	-17	-24	-150	144	82
Cash Flow	-334	-659	210	247	38	13	169	147

* Excluded from Ebitda calculation

** Ebitda with no exceptional items and no R&D capitalization