

EXPERT SYSTEM	<i>Italy</i>	<i>FTSE AIM Italia</i>	<i>Engineering</i>
Rating: BUY	Target Price: Euro 2,06 (prev € 2,1)	Update	Risk: Medium

Stock performance	1M	3M	6M	1Y
absolute	-4,39%	-10,28%	9,27%	19,43%
to FTSE AIM Italia	-1,24%	-2,64%	22,89%	29,71%
to FTSE STAR Italia	-0,80%	-5,36%	17,25%	26,64%
to FTSE All-Share	-0,19%	-5,26%	13,96%	29,66%
to EUROSTOXX	-0,31%	-4,42%	14,38%	21,44%
to MSCI World Index	-1,17%	-4,60%	16,32%	17,93%

Stock Data

Price	€ 1,56
Target price	€ 2,06
Upside/(Downside) potential	€ 0,32
Bloomberg Code	EXSEIMEQUITY
Market Cap (€mln)	55,9
EV (€mln)	68,3
Free Float	74,78%
Share Outstanding	35.720.711
52-week high	€ 1,84
52-week low	€ 1,12
Average daily volumes (1m)	314.348

Key Financials (€/mln)	FY18A	FY19E	FY20E	FY21E
Sales	28,7	33,9	39,7	46,5
EBITDA	4,6	7,7	10,1	12,7
EBIT	-3,2	-0,5	1,4	3,7
Net Profit	-3,8	-2,0	1,9	3,5
EPS (€)	-0,11	-0,06	0,05	0,10
EBITDA margin	16,2%	22,6%	25,3%	27,3%
EBIT margin	-13,2%	-6,0%	4,7%	7,5%

Main Ratios	FY18A	FY19E	FY20E	FY21E
EV/EBITDA (x)	14,7	8,9	6,8	5,4
EV/EBIT (x)	-21,2	-126,6	50,6	18,5
P/E (x)	-14,8	-27,4	30,2	16,0

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Stocks performance relative to FTSE AIM Italia

FY18A Results and 2019-2022F Estimates

FY2018 revenues increased by 12,1% YoY to €28,7 mln (€25,6 mln in 2017) and value of production reached €35,5 mln with an 8,2% increase YoY (€ 32,8 mln in 2017). Expert System has been expanding and diversifying its customer base on a global scale, with Insurance & Banking, Governments/Intelligence and Media representing the sectors that contributed circa 70% to the 2018 total revenues. The Ebitda increased by +343% YoY to € 4,6 mln (€ 1 mln in 2017). This stunning improvement is due to the mix of the increase of the average revenue value per client and to cost efficiencies in all business areas of the Group. A negative net income of € 3,8 mln compared to a negative € 8,3 mln in 2017 reflects the roll-out of Expert System's new strategy. Due to the positive results of FY2018 and to the confirmation by the management of the Strategic Guidelines for 2019 we confirm our estimates for the FY19-2022F.

Valuation Update

We have evaluated Expert System through the DCF and multiple methods. Each valuation methodology is able to capturing one or more aspects of a company's life: economic equity, cash flow and a comparison of listed company operating in the same sector. DCF equity value results of €88,1 million. Multiple method results of 58,9 million (net of 25% discount to take account of lower liquidity). The average equity value of € 73.5 million is our target price: €2.06 (previous TP €2,1). Unchanged our BUY rating and our medium risk

1. Economics & Financials

Table 1 – Economics & Financials

CONSOLIDATED INCOME STATEMENT (€/mIn)	FY17A	FY18A	FY19E	FY20E	FY21E
Sales	25,60	28,70	33,94	39,71	46,46
Other Revenues	0,35	0,38	0,50	0,50	0,50
Value of Production	32,81	35,50	40,42	45,27	50,70
Total Costs	31,76	30,86	32,76	35,22	38,00
EBITDA	1,05	4,64	7,66	10,05	12,70
<i>EBITDA Margin</i>	<i>4,1%</i>	<i>16,2%</i>	<i>22,6%</i>	<i>25,3%</i>	<i>27,3%</i>
D&A	7,54	7,87	8,20	8,70	9,00
EBIT	-6,50	-3,23	-0,54	1,35	3,70
<i>EBIT Margin</i>	<i>-19,8%</i>	<i>-9,1%</i>	<i>-1,3%</i>	<i>3,0%</i>	<i>7,3%</i>
Financial Management	-2,19	0,10	-0,50	-0,30	-0,20
EBT	-8,69	-3,13	-1,04	1,05	3,50
Taxes	-0,35	0,65	1,00	-0,80	0,00
Net Profit	-8,34	-3,78	-2,04	1,85	3,50
CONSOLIDATED BALANCE SHEET (€/mIn)	FY17A	FY18A	FY19E	FY20E	FY21E
Total Assets	21,56	20,02	18,50	17,00	16,50
Account receivable	12,38	15,79	18,00	21,00	24,50
Inventories	0,10	0,11	0,11	0,12	0,13
Account payable	3,09	3,04	3,40	3,80	4,20
Operating Working Capital	9,39	12,86	14,71	17,32	20,43
Other Receivable	6,60	5,90	7,00	8,20	9,80
Other Payable	7,44	7,79	8,60	9,30	10,10
Net Working Capital	8,55	10,97	13,11	16,22	20,13
Total Provisions	2,05	3,51	4,63	6,64	10,55
NET INVESTED CAPITAL	28,07	27,48	26,98	26,58	26,08
Equity	19,28	15,08	15,08	15,08	15,08
Cash and cash equivalent	-11,79	-4,81	-3,00	-3,50	-3,00
Short-Term Financial debt	5,89	2,41	2,00	3,00	2,00
ML Term Financial Debt	14,68	14,81	12,90	12,00	12,00
Net Financial Position	8,79	12,40	11,90	11,50	11,00
TOTAL SOURCES	28,07	27,48	26,98	26,58	26,08
CONSOLIDATED CASH FLOW (€/mIn)	FY18A	FY19E	FY20E	FY21E	
EBIT	(3,23)	(0,54)	1,35	3,70	
Taxes	0,65	1,00	(0,80)	0,00	
NOPAT	(3,88)	(1,54)	2,15	3,70	
D&A	7,87	8,20	8,70	9,00	
Change in receivable	(3,41)	(2,21)	(3,00)	(3,50)	
Change in inventories	(0,01)	(0,00)	(0,01)	(0,01)	
Change in payable	(0,05)	0,36	0,40	0,40	
Change in OWC	(3,47)	(1,85)	(2,61)	(3,11)	
Other Changes	1,05	(0,29)	(0,50)	(0,80)	
Change in Provision	1,46	1,13	2,01	3,91	
OPERATING CASH FLOW	3,03	5,65	9,75	12,70	
Investments	(6,32)	(6,69)	(7,20)	(8,50)	
FREE CASH FLOW	(3,29)	(1,04)	2,55	4,20	
Financial Management	0,10	(0,50)	(0,30)	(0,20)	
Change in Payable to Banks	(3,36)	(2,32)	0,10	(1,00)	
Change in Equity	10,16	3,35	(2,75)	(3,50)	
FREE CASH FLOW TO EQUITY (FCFE)	3,61	(0,51)	(0,40)	(0,50)	

Source: Expert System and Integræ SIM estimates

1.1 FY18A results

FY2018 results were positive and consistent with our estimates and in line with the Strategic Guidelines released by the Company last year.

Table 2 – FY18 – Actual vs Forecast

FY2018 (€/mln)	Sales	EBITDA	EBITDA %	EBIT	Net Profit	NFP
Actual	28,7	4,6	16,0%	-3,2	-3,8	-12,4
Forecast	29,0	4,3	11,9%	-3,3	-4,0	-13,6
Change	-1,0%	7,0%	34,7%	-3,0%	-5,0%	8,8%

Source: Expert System and Integrae SIM

FY2018 revenues increased by 12,1% YoY to €28,7 mln (€25,6 mln in 2017) and value of production reached €35,5 mln with an 8,2% increase YoY (€ 32,8 mln in 2017). Expert System has been expanding and diversifying its customer base on a global scale, with Insurance & Banking, Governments/Intelligence and Media representing the sectors that contributed circa 70% to the 2018 total revenues. The breakdown of sales by region, as illustrated in the chart below, reflects revenues generated outside the domestic market of 56%.

Chart 1 – Sales Breakdown by Region FY18A

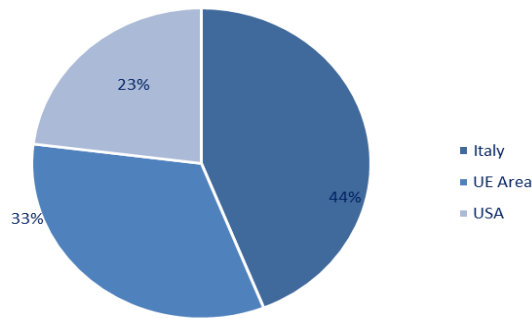
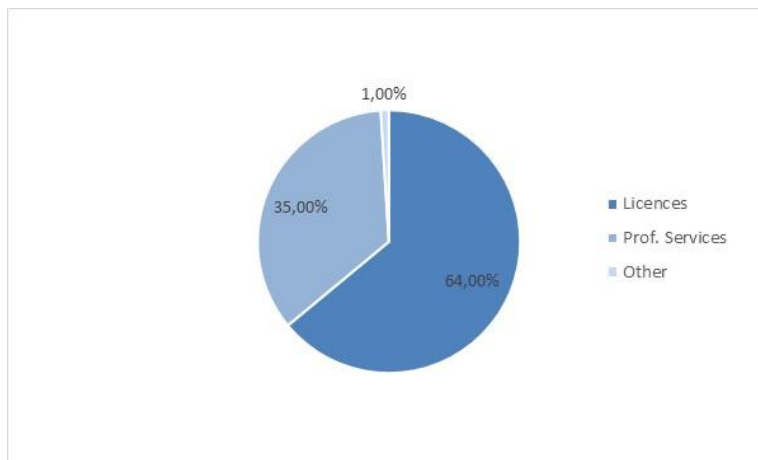
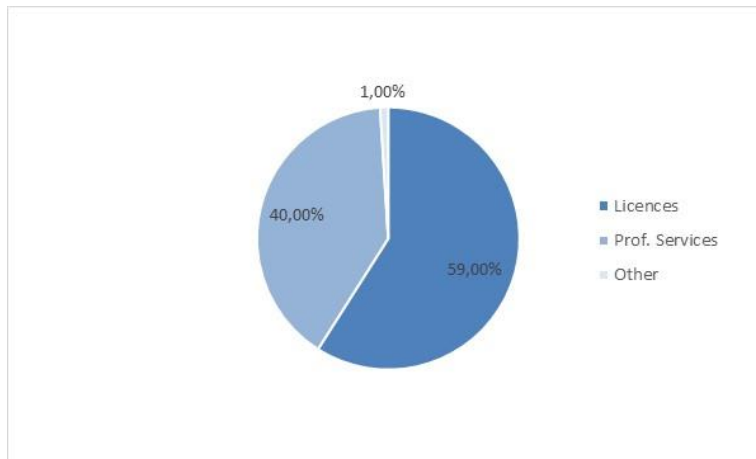


Chart 2 – Sales Breakdown by Revenue type - FY18A

Revenues 2017



Revenues 2018



Source: Expert System

The US is still the biggest market in the semantic analysis and experienced a sales growth of +66%. Also United Kingdom and Spain had a remarkable growth (respectively +64% and +66% YoY).

In order to increase its market share and reduce the exposure to seasonal business cycles, Expert System has pushed the transition to the perpetual license model to an offering of recurring yearly licenses, which give a more predictable stream of revenues. FY 2018 represented a tipping point with recurring licenses reaching 72% of total licenses sold, up from 41% in 2017. Consequently perpetual licenses went from 59% of total licenses sold in 2017 to 28% in 2018.

Other key drivers in the sales growth are related to (i) the introduction of indirect sale distribution channel via key partnerships with system integrators and big consulting firms and (ii) to re-targeting the customer policy towards long-term strategic clients, as large multinationals with larger AI budgets and which are more keen to technological innovations

The Ebitda increased by +343% YoY to € 4,6 mln (€ 1 mln in 2017). This stunning improvement is due to the mix of the increase of the average revenue value per client and to cost efficiencies in all business areas of the Group - especially in the Professional Services division – and lower cost of employees.

The Ebit improved to - € 3,2 mln from - € 6.5 million in 2017 after depreciation and provisions for € 7.9 million due to higher investments in technological development, as well as amortization consolidation difference coming from the acquisition for € 2.3 million.

A negative net income of € 3,8 mln compared to a negative € 8,3 mln in 2017 reflects the roll-out of Expert System’s new strategy.

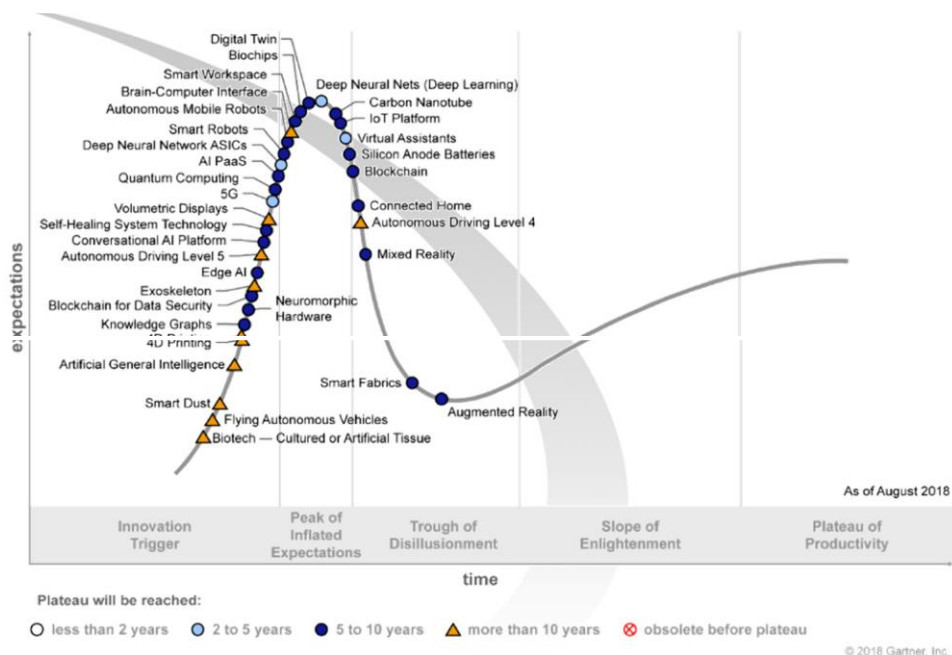
The net financial position soared to € 12,4 mln from €8,8 mln in 2017 mainly due to the increase of € 2,6 mln in Net Working Capital. In the short term the shift from a perpetual license model to a recurring license one impacts on the working Capital. This does not represent an issue for the Company as the clients default rate is nearly close to zero.

1.2 Estimates FY19E – FY21E

During the presentation to the financial community held on April 2nd 2019, the top management confirmed the Strategic Guidelines for 2019 and reiterated its commitment to pursue the defined strategic goals over the coming years, with a great focus on organic growth and on increasing the Ebitda. The commercial strategy will continue to aim towards a presence of products and customers characterized by a wide potential for development, in particular in the insurance sector where Expert System already successfully implemented projects and case histories. The key strategic drivers will be: (i) extension in existing markets with the current offering, mainly in USA - with a new sales team for the corporate market focused on insurance and banking – and in Germany and France; (ii) a new sales team will be implemented for the UK market; (iii) push on indirect sales channel with a reinforced team and specific investments in various countries, (iv) strategic partnerships with leading RPA vendors to enable the next step in robotic process automation that leverage the full power of Cogito for specific direct and indirect vertical markets, e.g insurance; (v) target and upsell across countries in large multinational clients so to implement successful stories and to implement new use cases. In terms of product innovation the release of the new version of Cogito Intelligence Platform covers new use cases, it's more flexible and cloud ready. Cogito 14.3 includes also knowledge graphs improvements enhanced machine learning workflow and RPA integration.

Thanks to its unique expertise and offering, Expert System has been included simultaneously in the "Magic Quadrant for Insight Engines" by Gartner and in the Big Data Analytics Platforms of the Forrester Wave.

Another market recognition of the solid R&D and innovative methodology applied by Expert System is the inclusion of the “Knowledge Graph” technology – which represents the basis of Cogito – in the Gartner Hype Cycle, precisely as an innovation trigger in the next 5 to 10 years.



Source: Gartner

The mix among market development, the aim of increasing average revenues per client thanks to the more appropriate cross-selling and up-selling strategies and the cost rationalization policy should allow Expert System to improve cash generation and marginality in the coming years, after a period of great expansion, which has allowed the company to position itself among the international leaders in artificial intelligence applied to cognitive calculation.

As per FY2018 results Expert System we confirm our previous estimates for 2019E-2021E assuming the increase of revenues generated by recurring license sales (versus perpetual licenses) and the continuous optimization of resources so to maximize margins and project profitability

2. Valuation

The results of the DCF method are a function of estimate and variables, including business visibility. Visibility that, in the case of Expert System, allows you to extend the time horizon up to 2021F when the profitability of the projects and the impact of acquisitions will be fully visible. For this reason, thanks to the DCF method we can address some aspects of the business that the ratio analysis would not be able to assess.

2.1 DCF Method

Table 3 – WACC

WACC		6,42%
Risk Free Rate	2,00% α (specific risk)	2,50%
Market Premium	9,02% Beta Adjusted	0,85
D/E (average)	100,00% Beta Relevered	1,46
Ke	12,13% Kd	1,00%

Source: Integrae SIM

Table 4 – DCF Valuation

DCF Equity Value		88,1
FCFO actualized	12,8	13%
TV actualized DCF	87,7	87%
Enterprise Value	100,5	100%
NFP (FY18A)	12,4	

Source: Integrae SIM

Considering the above data and assumptions, we expect an Expert System **equity value of € 88,1 mln.**

Table 5 – Equity Value - Sensitivity analysis

€/mIn	WACC							
	4,7%	5,2%	5,7%	6,2%	6,7%	7,2%	7,7%	
2,5%	213,4	174,5	147,5	127,6	112,5	100,4	90,7	
2,0%	174,7	147,7	127,8	112,6	100,6	90,9	82,8	
Growth rate (g)	1,5%	147,9	128,0	112,8	100,8	91,0	83,0	76,1
	1,0%	128,3	113,1	101,0	91,2	83,1	76,3	70,5
	0,5%	113,3	101,2	91,4	83,3	76,5	70,7	65,6
	0,0%	101,4	91,6	83,5	76,7	70,9	65,8	61,4
	-0,5%	91,9	83,7	76,9	71,0	66,0	61,5	57,6

Source: Integrae SIM

2.2 Market multiples

The panel includes peer companies with higher market capitalization. The same panel has been adopted to calculate Beta for the DCF valuation.

Table 6 – Peers main ratios

FY2018	Expert System	Ellie Mae Inc.	Imperva Inc.**	Splunk Inc.	Proofpoint Inc.	Qualys Inc.	Adobe Systems Inc.	salesforce.com, inc.	Open Text Corporation	Alphabet Inc.	Oracle Corporation	Peer Median
Country	Italy	USA	USA	USA	USA	USA	USA	USA	Canada	USA	USA	-
Mkt Cap (€/mIn)	3.857	3.464	N/A	19.439	6.791	3.240	131.588	124.401	13.860	843.380	184.758	19.439
EV (€/mIn)	3.971	2.825	N/A	16.356	5.854	2.636	118.138	109.905	11.018	660.211	179.373,2	16.356
Growth YoY												
Net Sales		15%	22%	38%	38%	21%	24%	25%	23%	23%	6%	23%
Ebitda		-6%	96%	-41%	-119%	37%	28%	42%	38%	7%	9%	18%
Ebit		-74%	80%	-35%	-85%	35%	31%	108%	43%	1%	8%	19%
Net Income		-57%	N/A	-45%	-49%	42%	53%	11%	-76%	143%	-59%	-45%
Profitability												
ROE		3%	-9%	-21%	-26%	16%	29%	4%	7%	19%	30%	5%
ROI		3%	-9%	-13%	-18%	15%	22%	4%	6%	14%	12%	5%
ROIC		1%	-4%	-12%	-20%	14%	23%	4%	10%	15%	14%	7%
ROCE		3%	-9%	-21%	-26%	16%	29%	4%	7%	19%	30%	5%
ROA		3%	-5%	-8%	-9%	10%	16%	2%	3%	14%	9%	3%
EBITDA %		17%	-1%	-11%	-4%	28%	35%	11%	34%	26%	41%	22%
EBIT %		2%	-4%	-14%	-14%	18%	31%	4%	18%	19%	34%	11%
Net Income %		5%	7%	-15%	-14%	21%	29%	3%	9%	22%	10%	8%
Dividend Yield		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2%	2%
EPS		0,66	0,68	-1,89	-1,99	1,47	5,28	0,50	0,91	44,22	0,9	80%
Capital Structure												
Debt/Asset		0,00 x	0,00 x	0,36 x	0,00 x	0,00 x	0,22 x	0,08 x	0,34 x	0,02 x	0,44 x	5%
Debt/Equity		0,00 x	0,00 x	1,07 x	0,00 x	0,00 x	0,44 x	0,17 x	0,70 x	0,02 x	1,31 x	9%
Interest Coverage		N/A	N/A	-5,99 x	-7,18 x	292,80 x	31,83 x	5,22 x	N/A	230,89 x	6,76 x	676%
NFP/EBITDA		-2,20 x	91,16 x	1,19 x	6,58 x	-0,50 x	0,78 x	-0,68 x	2,01 x	-0,36 x	2,37 x	98%
Equity/Asset		0,88 x	0,60 x	0,34 x	0,42 x	0,61 x	0,50 x	0,47 x	0,48 x	0,76 x	0,34 x	49%
Asset Utilization												
Quick ratio		4,22 x	2,62 x	3,09 x	0,71 x	1,85 x	1,06 x	0,84 x	1,18 x	3,75 x	3,78 x	223%
Fixed Asset Turnover		2,28 x	14,51 x	11,30 x	9,94 x	4,65 x	8,98 x	5,64 x	11,45 x	2,68 x	6,55 x	776%
Asset Turnover		0,55 x	0,63 x	0,54 x	0,64 x	0,50 x	0,54 x	0,53 x	0,37 x	0,64 x	0,32 x	54%

Source: Bloomberg

Table 8 – Market Multiples

Company name	EV/EBITDA (x)			EV/EBIT (x)			P/E (x)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Open Text Corporation	9,8	9,5	N/A	10,8	10,7	N/A	12,0	11,4	N/A
Blackbaud Inc.	19,4	18,2	15,3	22,7	20,9	18,2	32,8	29,4	25,0
Nuance Communications Inc.	11,4	10,3	10,7	12,9	12,1	11,0	14,1	13,3	11,5
SAP SE	13,0	11,9	10,9	14,4	13,0	11,7	19,6	17,5	15,6
ifytek Co., Ltd.	34,6	25,4	N/A	53,1	33,2	N/A	66,3	42,5	N/A
Cloudera Inc.	N/M	25,2	11,3	N/M	95,3	14,1	N/M	182,4	25,0
CommVault Systems Inc.	14,4	11,5	N/A	15,3	11,3	N/A	25,5	19,6	N/A
Microsoft Corporation	13,1	11,5	N/A	17,1	15,1	N/A	21,6	18,9	N/A
Alphabet Inc.	10,9	9,3	7,9	17,5	15,1	12,7	23,8	20,3	17,7
Sidetrade SA	26,6	16,5	N/A	38,4	21,6	N/A	49,9	28,0	N/A
Peer Median	13,1	11,7	10,9	17,1	15,1	12,7	23,8	20,0	17,7

Source: Infionals

Table 9 – Market Multiples Valuation

€/mln	2019E	2020E	2021E
Enterprise Value (EV)			
EV/EBITDA	100,6	117,4	139,0
EV/EBIT		20,3	47,2
P/E		36,9	62,1
Equity Value			
EV/EBITDA	88,7	105,9	128,0
EV/EBIT			36,2
P/E		36,9	62,1
Equity Value post 25% discount			
EV/EBITDA	66,6	79,4	96,0
EV/EBIT			27,1
P/E		27,6	46,6
Average	66,6	53,5	56,5

Source: Integrae SIM

The Expert System's equity value calculated using multiples methodology is € 78,5 mln. We then applied a 25% discount to take account of lower liquidity, expecting an average value of € 58,9 mln.

2.3 Equity Value

Table 10 – Equity Value

Average Equity Value (€/mln)	73,5
Equity Value DCF (€/mln)	88,1
Equity Value multiples (€/mln)	58,9
Target Price (€)	2,06

Source: Integrae SIM

The average equity value to € 73,5 million. Our target price is €2,06 per share (previous TP € 2,1). Thus, we do not change our BUY rating and our medium risk.

Table 11 – Implied valuation multiples

Multiples	FY19E	FY20E	FY21E
EV/EBITDA	11,0x	8,3x	6,5x
EV/EBIT	n.m.	62,1x	22,4x
P/E	n.m.	45,3x	23,7x

Source: Integrae SIM

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The table below, shows INTEGRÆ SIM's recommendation, target price and risk issued during the last 12 months:

Date	Price	Recommendation	Target Price	Risk	Comment
02/10/2018	1.27	Buy	2.1	Medium	Update

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Equity Total Return (ETR) for different risk categories			
Rating	Low Risk	Medium Risk	High Risk
BUY	ETR >= 7.5%	ETR >= 10%	ETR >= 15%
HOLD	-5% < ETR < 7.5%	-5% < ETR < 10%	0% < ETR < 15%
SELL	ETR <= -5%	ETR <= -5%	ETR <= 0%
U.R.	Rating e/o target price Under Review		
N.R.	Stock Not Rated		

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