

3 October 2023

## AROBS Transilvania Software

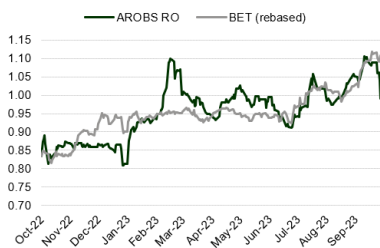
## BUY

BBG Ticker	AROBS RO
Market Cap (USD mil)	183
Price	0.990
Price target	1.43
Upside	44.4%

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## AROBS Transilvania Software: focusing on growth and scale

Management's message, during the 2Q23 earnings call, is that its focus is on growth right now, with the reason being to achieve the necessary scale to attract – and retain – large customers and orders >EUR 100m. As we flagged in our recent [initiation report](#), these relationships tend to be sticky – a top-tier supplier is more difficult to replace – and generate higher margins over time. It is also where recent acquisitions have been focused and a guidepost for future M&A activity. This was part of the message regarding the planned capital increase, specifically that, despite its strong balance sheet (1H23 gearing at 0.2x), the flexibility of ready cash will allow management to close deals more quickly. However, the corollary to this is, while pursuing scale, driving up the EBITDA margins will be secondary for several quarters at least, in our view.

Our current forecasts (under IFRS) assume flattish earnings for 2023E; and, even for 2024E-onwards, EBITDA margins a couple of percentage points below the 2022 levels, i.e., c.20% for the reported EBITDA and 23-24% on an adjusted basis. However, this is par for the course for a roll-up strategy company; profitability only rebounds once businesses are fully integrated. For our investment case then, 1H23 does not alter our view and we continue to see AROBS as being in this smaller, but high potential niche in our regional markets.

The focus of yesterday's (2 October) earnings call was management's vision for scaling up the business and an explanation of how earnings have changed post the numerous (nine) acquisitions since June last year. The company did not update its earnings guidance, but made it clear where it differs from the April budget (most importantly, not reflecting deals that were in the works at the time and other accounting items, e.g., the amortisation of goodwill under local accounting standards).

### The key points include:

- Management is targeting a c.EUR 55m (c.RON 275m) budget for M&A, comprised of: 1) a share issue of c.EUR 40m, targeting new investors; and 2) additional shares to be issued subsequently, worth c.EUR 15m (valued at current levels). We note that, as of 25 September, the company has c.37m shares, or 4.25% of the current total, in treasury. Its targeted deal structure will be to pay 75% cash and the balance in new AROBS shares. The CEO and controlling (c.66.4%) shareholder, Voicu Oprean, will not, we understand, participate in the new capital raising.

- Post-M&A optimisation is a matter of one-to-two years. The degree of independence of new businesses also depends on the earn-outs awarded to sellers.

- Wage costs increased significantly in the period – and we note that the employee headcount grew by c.85%, or to c.1,200 versus end-June 2022 – albeit generally in line with revenues. Organic labour costs grew 69% yoy vs. 66% organic sales growth; acquired employee costs were +30% yoy vs. *pro-forma* revenues growth of 22%.

The underlying EBITDA was acceptable at both the "old" business and the new acquisitions, c.20% and c.22.5%, respectively. In contrast, the contribution from its "greenfield" businesses (primarily Integrated systems, launched from January) was negligible. Integrated systems is low margin, but important for public contracts and a foot in the door for higher profit software work.

### Pro-forma 1H22 revenues vs 1H23

RON m	Organic	M&A	Greenfield	Total
1H22 pro-forma revenues	96.3	42.2	26.5	165.1
<b>1H23 revenues</b>	<b>159.9</b>	<b>51.5</b>	<b>29.7</b>	<b>241.1</b>
YOY growth	66%	22%	12%	46%
<b>1H23 Adjusted EBITDA</b>	<b>32.2</b>	<b>11.6</b>	<b>0.5</b>	<b>44.3</b>
<i>Adjusted EBITDA margin</i>	20.1%	22.5%	1.7%	18.4%

Source: Company data, WOOD Research

- The amortisation of goodwill under local accounting standards increased to RON 7.4m in 1H23, versus RON 2.1m in the base period. Additionally, in 1H23, it includes RON 2.5m of provisions for unused holiday and bad debt; last year, these were only booked in 4Q.

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- The 3Q23 results, due out on 28 November, will be the last under Romanian accounting standards, before the company transitions fully to IFRS for its FY23E numbers

## 2Q23 earnings review

On 29 September, after the market closed, AROBS reported 2Q23 net profit, under Romanian accounting standards, of RON 3.2m (-76% yoy) on revenues of RON 109.8m (+68% yoy) and EBITDA of RON 11.8m (-25% yoy). The adjusted EBITDA – excluding the RON 6m cost of the employee share option plan – came in at RON 17.8m (-2% yoy) and the adjusted net profit, adjusted for the SOP and amortisation of goodwill, was RON 13.2m (-14% yoy).

Compared to 2Q22, the results were affected negatively by: 1) higher depreciation and amortisation (RON 6.2m vs. RON 0.8m, stemming from the recent acquisitions); and 2) the higher non-cash costs of the share option plan (+90% yoy).

On the top line, like-for-like revenues grew by 26% yoy, to RON 160m (66% of the total), while the businesses acquired after 2Q22 contributed RON 51.5m. Moreover, greenfield revenues, from the newly-established companies within the group, contributed another RON 29.7m. Revenues were supported by new software services contracts, the expansion of the collaboration with existing clients, and the increase, in 2023, of the hourly rates applied to services. In software products, the increase in turnover was determined by contracting new customers during this period.

On the costs side, in addition to the amortisation of goodwill for acquired businesses and the share option plan, there was a significant increase in third-party services, used specifically by the newly-acquired companies (a RON 17.9m impact in 1H). We note that, under IFRS (on which our estimates are based), the goodwill will not be amortised.

### AROBS: 2Q23 results

RON m	2Q23	1Q23	4Q22	3Q22	2Q22	qoq	yoy	1H23	1H22	yoy
Revenues	109.8	131.3	92.1	82.2	65.2	-16%	68%	241.1	126.7	90%
<b>Adjusted EBITDA</b>	<b>17.8</b>	<b>25.5</b>	<b>n.a.</b>	<b>n.a.</b>	<b>18.3</b>	<b>-30%</b>	<b>-2%</b>	<b>43.3</b>	<b>39.9</b>	<b>9%</b>
EBITDA	11.8	22.8	11.2	18.3	15.8	-48%	-25%	34.6	36.7	-6%
EBIT	5.6	17.3	5.4	12.1	15.0	-68%	-63%	22.9	33.6	-32%
Pretax profit	6.5	17.0	4.8	12.3	15.5	-62%	-58%	23.6	34.5	-32%
Net profit	3.2	13.3	4.9	9.5	13.0	-76%	-76%	16.4	28.7	-43%
<b>Adjusted net</b>	<b>13.2</b>	<b>19.3</b>	<b>n.a.</b>	<b>n.a.</b>	<b>15.4</b>	<b>-32%</b>	<b>-14%</b>	<b>32.5</b>	<b>32.2</b>	<b>1%</b>

Source: Company data, WOOD Research

Year	Sales	EBITDA	Net profit	EPS	EPS	P/E	EV/EBITDA	FCF yield	Div yield
	RON m	RON m	RON m	RON	% yoy	(x)	(x)	%	%
2021	186.6	56.8	45.8	0.10	n/a	9.2	5.9	10%	n.m.
2022	299.8	76.1	47.0	0.05	-49%	18.3	11.1	-6%	n.m.
2023E	446.5	104.5	48.5	0.05	5%	18.2	8.1	3%	n.m.
2024E	522.3	123.6	64.1	0.07	36%	13.4	6.1	8%	n.m.
2025E	579.7	140.7	78.2	0.09	22%	11.0	4.8	10%	n.m.

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