

22 November 2023

AROBS Transilvania Software

BUY

AROBS Transilvania Software: takeaways from the 3Q23 earnings call

BBG Ticker	AROBS RO
Market Cap (USD mil)	174
Price	0.912
Price target	1.43
Upside	56.8%

AROBS' 3Q23 results showed a marked qoq improvement in the adjusted EBITDA margin, to 19.9%, vs. 16.2%, as: 1) the impact of the strong growth in headcount and wage costs, in particular, abates gradually; and 2) the cost savings from integration replaces the M&A transaction related costs seen in 2H22-1H23. We also see it as positive that the acquired companies are generating similar adjusted EBITDA margins (19.1% in 9M23) as the organic business (a 9M23 margin of 20.1%), even before integrations (a process that, typically, requires at least 12 months). We continue to expect margins to return to our mid-20% target next year. In the meantime, AROBS will continue with its planned capital increase, which should help expand its shareholders' base to institutional investors (and likely include joining the benchmark BET indices). We are BUYers of the stock.

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Takeaways from the 3Q23 earnings call

- **Market environment:** the CEO reiterated that, in software services, 9M23 was challenging. Customers are more cautious about launching projects to which they are not fully committed already. Software products are faring better in this respect, as they are seen as a cost-saving tool (e.g., fleet management tools).

- **Personnel costs:** demand for higher wages peaked during 2022, although it is only visible in the 2023 numbers (moreover, by end-9M23, AROBS' headcount of 1,235 employees jumped by 60% vs. end-9M22). During 2023, wage expectations have come back down, which will become apparent in the FY24E numbers. The elimination of tax breaks for IT workers will add some costs in FY24E, but management is still estimating these costs (during the Q&A at the recent CMD, management suggested a "high single-digit RONm" impact).

- **Other operating costs** (+98% yoy, to RON 25.2m) were affected negatively by: 1) higher (inflation-linked) rents; and 2) a rebound in travel expenses, linked to higher marketing efforts, and off-site visits by operational teams.

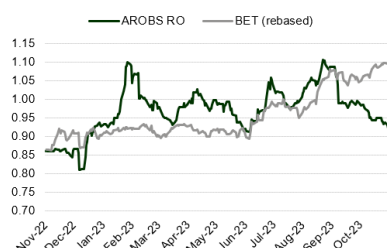
- ESOP costs have grown since 4Q23, as the programme now covers three companies, not just one.

- Organic growth +18% yoy in 9M23.

- On the back of its pending capital increase - planned for 1H24E – the company expects to boost its trading liquidity and enter the main BET index (as well as the BET-XT and the BET Plus). The timing of the index inclusion, of course, depends on the capital increase, but the aim is a listing with sufficient liquidity for institutional investors (today, retail represents nearly all of the free float).

- The acquired companies were bought at 4-8x EBITDA (AROBS trades at a reported 2023E EV/EBITDA of 8.0x).

- The revenues from the organic businesses (the group as of end-June 2022) generated 69% of the 9M23 revenues and 74% of the adjusted EBITDA. The businesses acquired since 3Q22 have contributed 24% to the top line and 25% of the adjusted EBITDA. The adjusted EBITDA of the former came in at 20.1%, and the latter at 19.1%. We calculate the 3Q23 margins for the organic and M&A businesses at 22.6% and 15%, respectively. The new Integrated Services (i.e., greenfield) generated 9% of sales but, with a 9M23 margin of just 1.4%, it was the biggest drag on the group's profitability; improving this is a focus for management in 2024E. On the bottom line, the adjusted net profit for the organic and M&A businesses was very similar, at c.15.5%. Again, we note the impact of the amortised goodwill on the M&A businesses' EBIT and net earnings (RON 11.6m), which will not be visible in the IFRS reporting.



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9M23 earnings from Organic, M&A and Greenfield businesses

RON m	Organic	M&A	Greenfield	Group
Turnover	235.7	82.5	31.7	349.8
Other operating income	4.3	2.2	0.0	6.5
Personnel expenses	119.0	50.7	1.5	171.2
Wages and taxes	105.7	48.8	1.5	156.0
ESOP	13.9	1.3	0.0	15.2
Other operating expenses	86.2	19.1	29.7	135.1
Amortisation and depreciation	5.6	12.7	0.0	18.3
of which goodwill	n.m.	11.6	n.m.	11.6
EBITDA	34.4	14.9	0.4	49.7
Adjusted EBITDA	48.3	16.2	0.4	65.0
Adj EBITDA margin	20.1%	19.1%	1.4%	18.2%
EBIT	29.1	2.2	0.4	31.7
Financial (income)/expense	-1.5	0.1	0.0	-1.4
Pretax profit	30.7	2.1	0.4	33.1
Net profit	22.2	0.0	0.3	22.5
Adjusted net profit	36.1	13.0	0.3	49.4
Adj Net margin	15.3%	15.7%	1.0%	14.1%

Source: Company data, WOOD Research

3Q23 earnings review

Last week (15 November), AROBS reported adjusted net profit of RON 16.9m (+10% yoy) on revenues of RON 108.7m (+32% yoy) and adjusted EBITDA of RON 21.6m (+12% yoy), or an adjusted net margin of 19.9% (vs. 23.5% in 3Q22). Excluding the adjustment for ESOP costs of RON 6.5m (vs. RON 4.2m in the base period), the reported EBITDA fell by 17% yoy, to RON 15.1m, and the net profit to RON 5.4m (-43% yoy). The latter, we note, under Romanian accounting standards, includes c. RON 3m of amortisation of goodwill for the acquired companies (RON 11.6m for 9M23), which will not be present when the company switches to IFRS reporting (i.e., comparable with our forecasts), starting with the FY24E numbers.

Compared to the dynamics in the first half of the year, when the reported opex (excluding depreciation) was 129% higher yoy, we saw another deceleration on the costs side of 5% qoq (vs. revenues -1% qoq). Excluding 1Q23, which had a very low qoq base, on one large government order, 3Q23 is the first quarter to see a material uptick in the adjusted EBITDA margin (+368bps qoq). The significant base effect, following the first consolidation of the former Enel business and Nordlogic in 3Q22, is beginning to moderate, and this will be even more visible in 4Q23E and 1Q24E, we believe.

Naturally, we are seeing a similar impact on the revenues lines; the growth in SW services revenues slowed to +32% yoy (at RON 88.5m) and to 24% yoy for SW products (RON 17.3m). Versus 2Q23, SW services and SW product revenues were -2.2% and +0.3%, respectively; this is normal seasonality, we believe, and we would expect a moderate qoq acceleration next quarter.

AROBS: 3Q23 results

RON m	3Q23	2Q23	1Q23	4Q22	3Q22	qoq	yoy	9M23	9M22	yoy
Revenues	108.7	109.8	131.3	92.1	82.2	-1%	32%	349.8	208.9	67%
Adjusted EBITDA	21.6	17.8	25.5	16.9	19.3	21%	12%	65.0	59.2	10%
Adj EBITDA margin	19.9%	16.2%	19.4%	18.4%	23.5%			18.6%	28.3%	
EBITDA	15.1	11.8	22.8	11.2	18.3	28%	-17%	49.7	54.9	-9%
EBIT	8.9	5.6	17.3	5.4	12.1	60%	-27%	31.7	45.7	-31%
Pretax profit	9.5	6.5	17.0	4.8	12.3	46%	-22%	33.1	46.7	-29%
Net profit	5.4	3.2	13.3	4.9	9.5	71%	-43%	21.9	38.2	-43%
Adjusted net	16.9	13.2	19.3	n.a.	15.4	28%	10%	49.4	47.6	4%

Source: Company data, WOOD Research

Year	Sales RON m	EBITDA RON m	Net profit RON m	EPS RON	EPS % yoy	P/E (x)	EV/EBITDA (x)	FCF yield %	Div yield %
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%	16.9	7.5	3%	n.m.
2024E	522.3	123.6	64.1	0.07	36%	12.4	5.6	8%	n.m.
2025E	579.7	140.7	78.2	0.09	22%	10.2	4.3	10%	n.m.

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