

04 September 2024

AROBS Transilvania Software (AROBS RO)

BUY

AROBS Transilvania Software: falling 1H24 automotive orders put spotlight on higher fixed cost base

AROBS RO	
Market Cap (USD mil)	169
Price	0.874
Price target	1.43
Upside (%)	63.6

Bram Buring, CFA

E-mail: bram.buring@wood.cz

Phone: +420 222 096 250



AROBS has posted disappointing 1H24 earnings, as falling orders for embedded software from automotive customers collided with sticky cash wage costs; while the 1H24 revenues contracted by 6% yoy, wages (excluding the employee share option scheme; ESOP) were 13% higher yoy. Wages now represent c.65% of the cash opex, vs. c.59% in 1H23 (the FY22 figure was c.46%). The company has announced remediating steps already, including headcount cuts in the software services segment and a 5-10% reduction in the pay for selected managers; these should bring a modicum of relief in 2H24E, as should the still ongoing integration of the companies acquired over the past couple of years. All this should better position the company for the uptick in 2H24E revenues that management still expects; for the moment, however, we believe that investors will want the proof that customers are reopening their wallets, before revisiting the story.

NEGATIVE

On 30 August, after the market closed, AROBS reported 2Q24 adjusted net profit of RON 2.4m (-71% yoy), on revenues of RON 101.2m (-6% yoy) and adjusted EBITDA of RON 13m (-44% yoy). In absolute terms, the biggest contribution to the 2Q24 RON 10.6m yoy contraction in the adjusted EBITDA was the RON 6.9m drop in revenues, follow by a RON 2.4m increase in cash costs excluding wages and, finally, a RON 1.3m increase in cash wages. For the whole of 1H24, the RON 16.5m yoy contraction in the adjusted EBITDA was led by lower revenues and higher cash wages – RON 12.6m and RON 13.2m, respectively – and a RON 9.3m reduction in other cash costs, especially third-party expenses, e.g., external software contractors.

In our view, the biggest structural issue for FY24E will be on the side of wage costs, which the company is addressing partly via the announced 5-10% reduction in the pay for selected managers – which should save c. RON 0.5m on a quarterly basis – and an unspecified headcount reduction in the software development bench (mostly junior staff). The company will be able to quantify the savings from the latter, according to management, once the budget for September-December has been finalised. Management is taking measured steps on the headcount front, as it is loath to lose development talent during what, in its telling, is a market trough, but it is prepared to cut deeper if the negative revenues trends continue.

The biggest issue in terms of the top line is falling revenues for software service, e.g., development, its largest segment. Segment revenues fell by 10% yoy, to RON 80m, in 2Q24 (vs. flat revenues in 1Q24) and were, overwhelmingly, driven by fewer contracts in its key business of embedded software for automotive manufacturers, especially related to electrification. The 1H24 organic revenues in the segment fell by 18% yoy, to RON 98.3m, while the acquired businesses, in total, grew by 21%, to RON 68.0m (these include embedded software development for non-automotive application, e.g., healthcare and marine).

Additionally, there was a 77% drop in the revenues from integrated services, mainly IT contracts for the public sector. Firstly, this was a timing issue – AROBS completed one big project in 1Q23 and booked revenues of RON 7.3m; however, since then, the quarterly revenues have been minimal (on average, c. RON 1.4m). The start of the biggest project on AROBS' books for FY24 has, moreover, been delayed, due to the timing of receiving EU funding. Management hopes to have this contract signed and delivered partially starting only in 4Q24E.

The software products segment performed in line with our expectations, growing by 11% yoy, in 2Q24, to RON 19.6m. Both the organic – e.g., fleet telematics or accounting software – and acquired businesses contributed to the growth, with the former up by RON 2.4m in 1H24, to RON 33.6m, and the latter RON 1.8m, to RON 4.2m.

04 September 2024

AROBS: 2Q24 results

RON m	2Q24	1Q24	2Q23	qoq	yoy	1H24	1H23	yoy
Revenues	101.2	105.0	108.2	-4%	-6%	206.3	218.8	-6%
Software services	80.0	86.4	88.6	-7%	-10%	166.4	175.9	-5%
Software products	19.6	18.2	17.7	8%	11%	37.8	33.6	12%
Integrated systems	1.7	0.4	1.9	311%	-11%	2.1	9.2	-77%
COGS	-74.8	-75.2	-75.8	0%	-1%	-150.0	-150.9	-1%
Gross profit	26.4	29.9	32.4	-12%	-19%	56.3	67.9	-17%
Gross margin	26.1%	28.5%	29.9%			27.3%	31.0%	
Adjusted EBITDA	13.4	20.6	24.0	-35%	-44%	34.1	50.6	-33%
Adj EBITDA margin	13.3%	19.6%	22.2%			16.5%	23.1%	
EBITDA	12.0	16.8	18.0	-28%	-33%	28.8	41.9	-31%
EBIT	4.1	9.7	11.0	-57%	-62%	13.8	28.7	-52%
Pre-tax profit	4.4	10.5	11.5	-58%	-62%	14.9	28.9	-48%
Net profit	2.4	8.0	8.4	-70%	-71%	10.5	22.2	-53%
Adjusted net	4.3	11.7	14.7	-63%	-70%	16.0	31.2	-49%

Source: Company data, WOOD Research; note: adjustments exclude the non-cash costs of the SOP and goodwill amortisation

Key takeaways from the 2Q24 earnings call

Regarding the FY24E guidance from April, the CEO said this may be updated – if necessary – during September (the 1H24 revenues and adjusted EBITDA came in at 42% and 37% of the FY24E guidance, respectively). The picture should be clearer, he explained, as discussions with customers resume after the summer break.

While the contracts from automakers for embedded software – related particularly to electrification – have contracted, management sees demand growth in embedded software in other areas, e.g., healthcare, for cybersecurity contracts and for AI products. Especially in cybersecurity, it is both getting incoming queries and reaching out to existing business partners

The CEO sees a pick-up in the contract talks for software services after the summer and, according to the head of the division, this should translate into revenues by the end of this year, or in early-2025E.

Infobest (software development based in Romania, but serving mostly the DACH markets) was consolidated for one month in 2Q24. In 2023, it generated revenues of EUR 4.8m (c. RON 24m), so it should contribute meaningfully to the top line in 2H24E.

AROBS will maintain the current higher level of S&M costs, including staffing, and key focus areas require more marketing. Specifically, in 2H, it wants to consolidate its presence in the US, starting with a VP of Sales position, and developing the sales team in the UK for Future Workforce (process automation).

The impact of the elimination of tax breaks for IT workers from January has increased AROBS' wage bill by 5-10% (so, by RON 6-12m in 1H24).

ESOP costs fell 20% in 1H24, to RON 7.0m; for FY24E, the CFO expects a reduction of 25% (our model includes a 27% drop).

M&A will focus on the SEE region, but also looking in the EU, the US and Türkiye.

Year	Sales RON m	Adj.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	46.9	0.05	-49%	18.3	11.1	-6%	n.m.
2023	427.7	92.7	32.1	0.04	-30%	27.3	9.7	-2%	n.m.
2024E	522.3	123.6	64.1	0.07	36%	11.9	5.4	8%	n.m.
2025E	579.7	140.7	78.2	0.09	22%	9.8	4.1	10%	n.m.
2026E	637.6	158.9	93.8	0.11	20%	8.2	3.0	11%	n.m.

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04 September 2024

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Czech Republic
namesti Republiky 1079/1a
Palladium
110 00 Praha 1
Tel +420 222 096 111
Fax +420 222 096 222

Poland
Centrum Marszałkowska
Marszałkowska 126/134, 7th Floor
00 008 Warszawa
Tel +48 22 222 1530
Fax +48 22 222 1531

UK
16 Berkeley Street
London W1J 8DZ
Tel: +44 20 3530 0691

Italy
Via Luigi Settembrini, 35
20124 Milan
Italy
Tel +39 02 36692 500
Fax +39 02 67910 761

<http://www.wood.com>
Bloomberg page WUCO

Research

Co-Head of Equities/Head of Research
Marta Jezewska-Wasilewska
+48 602 450 482
marta.jezewska-wasilewska@wood.com

Head of Consumer/Industrials
Lukasz Wachelko, CFA
+48 222 221 560
lukasz.wachelko@wood.com

Utilities/Mining/Pharma
Bram Buring, CFA
+420 222 096 250
bram.buring@wood.cz

Consumer
Dmitry Vlasov
+995 591 049 675
dmitry.vlasov@wood.com

Industrials/Utilities
Jakub Bronicki
+48 22 222 1546
jakub.bronicki@wood.com

Deputy Head of Research
Jakub Caithaml
+420 222 096 481
jakub.caithaml@wood.cz

Head of Polish Research
Maria Mickiewicz
+48 602 450 718
maria.mickiewicz@wood.com

Energy
Jonathan Lamb
+447949973325
jonathan.lamb@wood.com

Financials
Miguel Dias
+420 735 729 418
miguel.dias@wood.cz

Macroeconomics
Raffaella Tenconi
+44 7842 176 462
raffaella.tenconi@wood.com

Head of Financials
Can Demir
+44 7534 663 629
can.demir@wood.com

Macroeconomics
Alessio Chiesa
+44 751 770 6102
alessio.chiesa@wood.com

Real Estate
Peter Palovic
+420 737 597 120
peter.palovic@wood.cz

Head of Türkiye Research
Atinc Ozkan
+420 222 096 700
atinc.ozkan@wood.com

Head of TMT
Piotr Raciborski, CFA
+48 222 221 551
piotr.raciborski@wood.com

Türkiye
Can Yurtcan
+420 222 096 780
can.yurtcan@wood.com

Greece
George Grigoriou
+ 30 697 410 8565
george.grigoriou@wood.com

Sales

Co-Head of Equities
Jarek Tomczynski, CFA
+44 790 8158 953
jarek.tomczynski@wood.com

Ilgin Erdogan
+420 603 489 447
ilgin.erdogan@wood.cz

Piotr Kopec
+48 602 440 933
piotr.kopec@wood.com

Ioana Pop
+44 7507 146 696
ioana.pop@wood.com

Brasil Plural in association with WOOD & Co
Tatiana Sarandinaki
+1 732 322 7583
Tsarandinaki@wood.bplural.com

Constantinos Koufopoulos
+306975855517
costas.koufopoulos@wood.com

Sales Trading & Execution Service

Co-Head of Equities
Zuzana Mora
+420 733 142 865
zuzana.mora@wood.cz

Jan Koch
+48 603 206 101
jan.koch@wood.com

John Roberts
+44 203 530 0699
john.roberts@wood.com

Ermir Shkurti
+420 222 096 847
ermir.shkurti@wood.cz

Vladimir Vavra
+420 733 625 203
vladimir.vavra@wood.cz