Progressive EQUITY RESEARCH

THE PANOPLY

SOFTWARE AND COMPUTER SERVICES

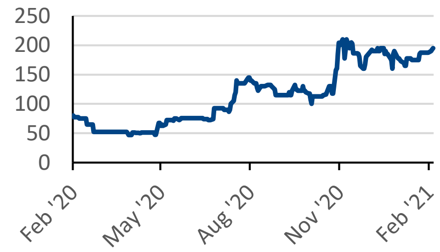
4 March 2021

TPX.L

195p

Market Cap: £135.7m

SHARE PRICE (p)



12m high/low	210p/47p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£(9.3)m *(at 28/02/21)*
Enterprise value	£145m
Index/market	AIM
Next news	Trading Update, Apr-21
Shares in Issue (m)	69.6
Chairman	Mark Smith
Chief Executive	Neal Gandhi
Finance Director	Oliver Rigby

COMPANY DESCRIPTION

The Panoply is a digitally-native technology services company, focused on digital transformation.

www.thepanoply.com

THE PANOPLY IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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A big deal in IT transformation

The Panoply has announced the (earnings enhancing) acquisition of Keep IT Simple Ltd ("KITS"), a profitable provider of high-value IT support and digital services to the Public and Private sectors. In our view the deal is both material and transformational. KITS is the Panoply's largest acquisition to date and brings new skills, scale and clients to the group. The acquisition also represents significant progress towards the group's commercial vision of £100m of annual run-rate revenue by March 2023. We upgrade forecasts following the announcement (FY 22E revenue +21%, adj. EBITDA +46%).

- **Deal details:** KITS delivered revenue of £9.7m and adjusted EBITDA of £2.7m for the twelve months ending December 2020. In addition, the business has £30.3m of contract backlog to be recognised between 2021 and 2024. The maximum consideration for the deal is £26m, payable £7.5m in cash and via the issuance of 10.3m new ordinary shares at 180p. In addition, it is expected that a further £4.9m consideration will be paid to the vendor from free cash on the KITS balance sheet. We note that post-completion, the group's net debt position will be £9.3m, comfortably below 1x proforma EBITDA.

- **A transformational acquisition:** KITS is The Panoply's largest acquisition to date, and in our view adds significant scale, skills and a high-quality client base to the group. KITS will enable the group to bid for multi-year projects several multiples larger in value than is currently the case and should also extend the average length of client relationships, thereby improving recurring revenue levels.

- **About KITS:** Formed in 2015, KITS works in partnership with its clients in both the private and public sectors to provision transformational IT support. The business focusses on the higher end of the technology services stack, typically delivering managed services and has expertise in service integration and management. The business has built a reputation in the public sector for transforming and running live and critical services such as payment platforms on behalf of clients such as the Rural Payments Agency and the Department for Environment, Food and Rural Affairs.

- **Accretive deal, forecasts increased:** For FY 22E, the first full year of consolidation, we upgrade revenue and adjusted EBITDA by 21% and 46% respectively.

* Indicates a pro forma figure, other data presented on a statutory basis. NB: EV calculations include forecast future share issuance.

FYE MAR (£M)	2019	2020	2021E	2022E	2023E
Revenue	22.1*	31.5	48.5	63.3	69.3
Adj EBITDA	2.1*	3.4	6.6	9.5	10.5
Adj PBT	0.3	2.9	5.6	8.3	9.2
Fully Adj EPS (p)	0.7	3.6	6.4	8.0	8.5
EV/Sales (x)	3.0x	4.6x	3.3x	2.7x	2.4x
EV/EBITDA (x)	31.5x	43.0x	24.4x	18.2x	16.2x
PER (x)	N/A	N/A	30.6x	24.5x	23.0x

Source: Company Information and Progressive Equity Research estimates.

Structure of the deal

The total consideration for the deal was £26m, payable £7.5m in cash and via the issuance of 10.3m new ordinary shares at 180p. In addition, a further £4.9m consideration will be paid to the vendor from free cash on the KITS balance sheet. The purchase price will be subject to a customary adjustment based on completion accounts.

In order to help fund the cash element, and to provide the group with additional resources for further acquisitions, the group has extended the existing Revolving Credit Facility with HSBC, which matures in June 2023, from £7.0m to £20.0m. £6.0m will be drawn down at completion to fund the acquisition, leaving £7.0m available for future acquisitions.

Up to £7m in value of the 10.3m shares issued as part of the deal are subject to clawback in the event that KITS does not achieve a revenue target of £26.8m in calendar 2022 or 2023.

We make four key observations on the deal structure:

- KITS is the largest deal to date for The Panoply. Consistent with previous acquisitions, share issuance will fund the majority of the consideration.
- HSBC has materially extended the RCF. In our view this represents a significant vote of confidence in The Panoply.
- Although all M&A involves a degree of execution risk - and this is the largest transaction undertaken by the group so far - we believe that The Panoply has demonstrated a strong track record of successful M&A, both in terms of target identification and post-merger integration. In addition, the £7.0m potential clawback represents a prudent approach to the future performance of KITS.
- Management's commercial vision for The Panoply is to achieve £100m and £12-14m adjusted EBITDA on a run-rate basis by 31 March 2023. Clearly the KITS acquisition represents significant progress towards this goal.

Dilution and sensitivity to deferred consideration

In the RNS of 11 February 2021, The Panoply confirmed the remaining value of acquisition consideration to be issued at £11.1m. Our EPS forecasts for the group are sensitive to the resulting share dilution from the acquisition consideration, so we take this opportunity to present our updated dilution model.

A quick recap on the acquisition model

The Panoply's acquisition model historically involved an initial consideration, a substantial element of which is usually paid via the issue of new ordinary shares, followed by a deferred consideration, which is based upon the post-acquisition financial performance of the acquisition. This majority of this element is also usually paid via share issuance, with the number of shares issued a function of 1) financial results delivered and 2) a pre-set share price formula. The latter involves a floor on the input share price.

For example, FutureGov (acquired July 2019) was acquired for of £6.06m in cash and a further 6.6m new ordinary shares as part of the initial consideration. In addition, a deferred consideration was also payable. Dilution from the deferred consideration for FutureGov is calculated by dividing the earn-out price payable (i.e. a multiple of future EBITDA in this particular example) by an input price per share in The Panoply Holdings plc which is the greater of 83.125 pence and the volume-weighted average mid-market price ("VWAP") over the 30 business days prior to the issue of the relevant Panoply Shares.

Note – as discussed on pages one and two of this report, the KITS transaction involved no deferred consideration.

An inverse relationship between the share price and dilution

Clearly there is an inverse relationship between the level of dilution and The Panoply's share price. A higher share price = less dilution (fewer shares issued) and vice-versa. With the majority of the group's acquisitions made to date using a similar methodology, future EPS dilution is therefore highly sensitive to the future share price, but with each transaction having specific financial terms.

In the RNS of 11 February 2021, the group confirmed the payment schedule for acquisition consideration payments. This is summarised in the following table, to which we have added our expectation of the relevant reporting period to the original table.

The Panoply – Values and timing of payment acquisition consideration

Value £000	Timing of payment of acquisition consideration	Assumed TPX reporting period
1,032	Within the next 6 months	H2 21E
7,285	Between 6 and 12 months	FY 22E
2,785	After 12 months	FY 23E onwards
11,102		

Source: Company data & Progressive Equity Research estimates

The group has £11.102m of acquisition consideration payments to make. These relate to eight of the twelve acquisitions made to date – the original four at IPO for which all deferred consideration will be paid by the end of FY 22E, Greenshoot Labs and Deeson, for which payments should be complete by end-FY 23E and FutureGov and Ameo, where deferred consideration could be paid during FY22E, FY 23E and FY 24E.

In the following table, we present a sensitivity analysis of the impact on adjusted EPS from a number of different prevailing share price scenarios, up to a theoretical future share price of 200p. We have applied the £11.102m from the previous table into an assumed schedule based upon previous company announcements. Our adjusted earnings estimates are obviously unaffected by variances in the number of shares, but clearly adjusted EPS is.

Although not shown in the table, we have used a calculation for the future adjusted share count to be consistent with the company's own methodology, as outlined on page 25 of the 2020 Annual report. This is based upon the sum of: 1) The weighted average number of shares for the period, 2) shares relating to future contingent consideration and 3) shares relating to Share-based payments (i.e. share options).

Note that 82p is the lower of the two prices mentioned in the amended Share Purchase Agreements ("SPA"s) as announced in the RNS of 08 September 2020. Previously we used this figure as our 'base' price when calculating the weighted average fully diluted number of shares to produce our EPS forecasts. With the current share price sitting around 180p, we no longer believe 82p represents a realistic view of potential dilution. Consequently, the EPS figures coloured blue in the table below (at 180p) are the same as our revised adjusted diluted EPS estimates presented elsewhere in this report.

Please note that we are not attempting to forecast future share price movements. The table simply reflects: 1) our view on estimates and 2) a view of the impact of dilution on our EPS estimates at various prevailing share prices.

The Panoply – impact on EPS of varying prevailing share prices

		FY 21E	FY 22E	FY 23E
Deferred consideration payable	***£m***	**1.032**	**7.285**	**2.485**
Adjusted earnings	**£m**	**4.960**	**6.986**	**7.539**
	Share Price			
Adjusted EPS (p)	*82*	*5.85*	*7.54*	*7.89*
including new deferred	160	6.32	7.92	8.41
consideration shares at:	170	6.35	7.94	8.44
	180	**6.38**	**7.97**	**8.47**
	190	6.41	7.99	8.50
	200	6.43	8.00	8.52
Delta vs 180p	*82*	-8%	-5%	-7%
	160	-1%	-1%	-1%
	170	0%	0%	0%
	180	**0%**	**0%**	**0%**
	190	0%	0%	0%
	200	1%	0%	1%

Source: Progressive Equity Research estimates

We acknowledge that there is a degree of simplification in the table as presented, since the dilution calculation is a based upon forecast future prevailing share prices and said prices are applied to the total deferred considerations anticipated for the respective financial years. The reality is that financial terms are different for each deal. Nevertheless, the table demonstrates the sensitivity of the future share issuance to the prevailing share price. To again use a hypothetical example, FY 23E adjusted EPS could be 7% lower if the prevailing share price is 82p than it would be if the shares stand at 180p.

Forecast revisions

Following the announcement, we make upward revisions to forecasts. These are summarised in the following table.

The Panoply – forecast revisions following KITS acquisition

	FY 21E			FY 22E			FY 23E		
£m unless stated	**Old**	**New**	**Change (%)**	**Old**	**New**	**Change (%)**	**Old**	**New**	**Change (%)**
Revenue	47.5	48.5	2.2%	52.3	63.3	21%	57.2	69.3	21%
Adj EBITDA	6.3	6.6	4.3%	6.5	9.5	46%	7.2	10.5	46%
Fully adj PBT	5.3	5.6	6.0%	5.8	8.3	41%	6.7	9.2	38%
Fully adj EPS (p)	5.8	6.4	9.5%	6.0	8.0	32%	6.8	8.5	25%

Source: Progressive Equity Research estimates

- We have made no changes to estimates of underlying performance of The Panoply's existing business from those published in our previous research note. *(See The Panoply: A step-change in reach into healthcare. PERL 04 February 2021).* However, as discussed in the previous section, our per-share calculations reflect the revised assumption on dilution from deferred consideration discussed on pages four and five)
- For the first full-year of consolidation – FY 22E, we forecast the deal to be earnings accretive, with 21%, 46% and 32% respective increases in revenue, adjusted EBITDA and adjusted EPS. For FY 23E, the same metrics increase by 21%, 46% and 25%
- The release confirms that as at 28 February 2021, assuming all payments in connection with the deal had been made at that date, the group retained cash reserves of approximately £3.6m, with a net debt position of £9.4m. On a pro-forma basis, net debt remains below 1x EBITDA. On our forecasts this will comfortably remain the case.
- The KITS deal contains a clawback provision, if the business does not deliver revenues of £26.8m in calendar 2022 or 2023. For prudence, we have assumed KITS delivers a lower level of revenue than the target. However, we have not forecast any clawback. If KITS delivers it targets then clearly our revenue (and profit) forecasts may be too conservative. However, if the targets are not met then the number of shares in issue may be reduced via the clawback, resulting in improved EPS.

Financial Summary: The Panoply

Year end: March (£m unless shown)

PROFIT & LOSS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue	22.1*	31.5	48.5	63.3	69.3
Adj EBITDA	2.1*	3.4	6.6	9.5	10.5
Adj EBIT	0.3	3.1	5.8	8.6	9.6
Adj PBT	0.3	2.9	5.6	8.3	9.2
Reported EPS (p)	(9.2)	(4.9)	6.0	8.0	8.2
Fully Adj EPS (p)	0.7	3.6	6.4	8.0	8.5
Dividend per share (p)	0.0	0.0	0.6	0.7	0.8
Adjusted share count (Dil. M)	36.8	74.8	77.7	87.7	89.0
Average Shares outstanding (Dil. M)	18.2	48.2	67.7	83.1	87.2

CASH FLOW & BALANCE SHEET	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Operating cash flow	(1.2)	2.7	4.7	9.9	10.5
Free Cash flow	(1.2)	2.5	2.5	6.5	6.8
FCF per share (p)	(1.8)	3.6	3.6	9.3	9.8
Acquisitions	1.4	(7.0)	(39.0)	(7.2)	(2.6)
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	5.4	0.0	28.0	7.2	2.6
Net cash flow	5.6	(1.0)	(8.5)	6.5	6.8
Overdrafts / borrowings	0.0	(5.0)	(11.0)	(11.0)	(11.0)
Cash & equivalents	5.7	4.6	2.0	8.5	15.3
Net (Debt)/Cash	5.7	(0.4)	(9.0)	(2.6)	4.3

NAV AND RETURNS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Net asset value	19.3	27.3	23.9	27.8	33.2
NAV/share (p)	52.3	36.5	30.7	31.6	37.3
Net Tangible Asset Value	0.3	0.3	0.1	(0.1)	(0.2)
NTAV/share (p)	0.8	0.4	0.1	(0.1)	(0.2)
Average equity	9.6	23.3	25.6	25.8	30.5
Post-tax ROE (%)	3.6%	1.5%	11.5%	21.7%	27.1%

METRICS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue growth		42.9%	53.8%	30.4%	9.6%
Adj EBITDA growth		61.9%	93.3%	45.2%	9.8%
Adj EBIT growth		1106.2%	88.1%	47.9%	11.0%
Adj PBT growth		N/A	91.1%	47.4%	11.5%
Adj EPS growth		N/A	N/A	24.8%	6.3%
Dividend growth		N/A	N/A	16.7%	14.3%
Adj EBIT margins		9.8%	12.0%	13.6%	13.8%

VALUATION	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EV/Sales (x)	3.0	4.6	3.3	2.7	2.4
EV/EBITDA (x)	31.5	43.0	24.4	18.2	16.2
EV/EBIT (x)	N/A	47.2	27.5	20.1	17.7
PER (x)	N/A	N/A	30.6	24.5	23.0
Dividend yield	N/A	N/A	0.3%	0.4%	0.4%
FCF yield		N/A	1.8%	4.8%	5.0%

Source: Company information and Progressive Equity Research estimates

* Indicates a pro forma figure, other data presented on a statutory basis. NB: EV calculations include forecast future share issuance.

Progressive EQUITY RESEARCH

4 March 2021

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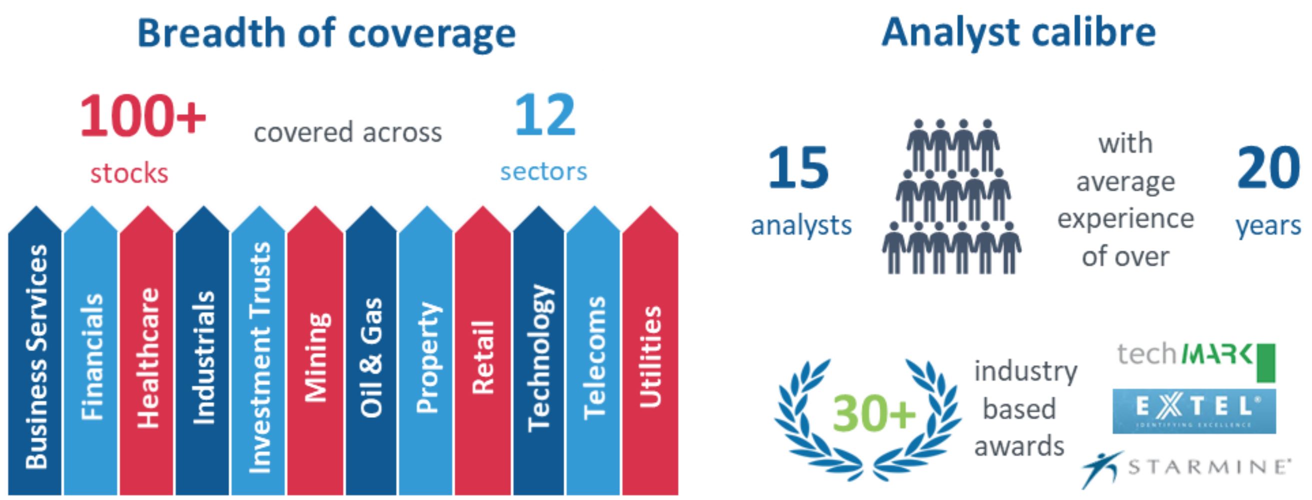

To arrange a meeting with the management team, or for further information about Progressive, please contact:
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