The Panoply

1st March 2021 (7.05)

For FCA purposes, this is a marketing communication

Executive summary

Price:	180p
Shares in issue:	78m
52 week high/ low:	200p/48p
Market cap:	£140m
Market:	AIM
Broker:	Dowgate/Stifel
Ticker:	TPX.L
Target price:	**275p**

Share Price Performance

BUY

Activities

The Panoply is a digitally-native technology services group focused on digital transformation. It provides services primarily to government, education, charities and industry.

Management

Mark Smith	Chairman
Neal Gandhi	Chief Executive
Oliver Rigby	CFO
Chris Sweetland	Non-Exec Director
Isabel Kelly	Non-Exec Director
Rachel Neaman	Non-Exec Director

Major shareholders

Neal Gandhi	14.1%
Oliver Rigby	7.6%
Octopus	3.3%
Canaccord	2.4%
Gresham House	2.4%
Rathbones	2.3%
Other employees	45.4%

Analyst

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Acquisition of Keep IT Simple

The Panoply has announced the acquisition of Keep IT Simple (KITS), a provider of high value IT support and transformation services to public and private sector clients. KITS has a strong client base, including the Rural Payments Agency and DEFRA, and provides managed services notably in service integration and management. The current strength of The Panoply is in discovery, alpha and beta stages of projects and KITS will add the capability to run high value, high value services thereby providing a complete end-to-end offering. The combination with KITS will extend the average duration of contracts, with the enlarged group generating a higher proportion of revenues on a recurring basis, in addition to enabling The Panoply to bid for materially larger, multi-year projects. The group is paying £26m (30% cash, 70% shares) with no earnout but a £7m clawback if very demanding revenue targets are not met in 2022/23. With a March year end, there is limited impact on our fiscal 2021 estimate, but for FY22 we raise our PBT forecast by +48% to £8.4m, while DCe EPS is enhanced by +30% to 8.7p. We view the combination with KITS as a perfect strategic and operational fit, while the financial benefits are compelling. We raise our target price to 275p (was 235p) and retain our Buy recommendation.

- **Keep IT Simple.** Founded by Grant Harris in 2015, KITS has built a reputation for transforming and running live and critical services such as payment platforms for clients including the Rural Payments Agency and Defra. The group generated revenues of £9.7m in the year to December 2020 and at the end of that year had a contract backlog of £30.4m for the period 2021-24. In 2020, the group generated EBITDA of £2.7m at a strong 28% margin.
- **Acquisition terms.** The Panoply is acquiring KITS for £26m, comprising 30% cash (£7.5m) and 70% shares (£18.5m, 10.3m new shares at 180p). There is no earnout, but the equity consideration is subject to clawback of up to £7m if very demanding revenue targets of £27m in December 2022/23 are not achieved. The group has extended its RCF from £7m to £20m and following completion leverage remains under 1x.
- **Forecasts.** The group guides to Revenues and EBITDA of not less than £48.5m and £6.6m, respectively, for the year to March 2021. We raise our forecasts to £49.0m/£6.7m which feeds through to an increase in PBT/EPS to £5.6m/7.3p. In the first full year of the transaction, we raise our PBT estimate by +48% to £8.4m (£5.7m). The acquisition enhances EPS by +30% to 8.7p on a Dowgate basis and 7.7p on The Panoply basis which fully dilutes for earnout shares at their floor value.

Financials (Pro-Forma)

Year to March £m	2019	2020	2021E	2022E
Revenues	22.1	31.5	49.0	65.5
Adjusted PBT		2.9	5.6	8.4
Adjusted EPS, p		5.1	7.3	8.7
EPS with max DC, p		3.6	5.8	7.7
DPS, p			0.6	0.8
Net cash/(debt)		(0.4)	(8.8)	(2.3)
P/E, x		35.1	24.8	20.6

Source: The Panoply, Dowgate Capital (forecast)

Keep IT Simple

Founded by Grant Harris in 2015, Keep IT Simple (KITS) is an ethical company that delivers highly technical, hands-on consultants and engineers that provide high quality IT Support and transformation services to public and private sector clients.

KITS embeds skilled resource into the operations of a client and through the adoption of modern, agile working practices that optimise architecture to open source and private cloud solutions, KITS is able to deliver a significantly improved result at greatly reduced cost compared with legacy proprietary systems.

KITS employs Enterprise, Solution, Infrastructure and Data architects who work with Programme managers comprising software development, system administration, database administration, network and security teams.

Accordingly, the group offers a comprehensive approach in the following areas –

- Strategic IT assessment
- Architectural design
- Transformation of IT platforms and environments
- Ongoing support and optimisation
- Migration from high-cost proprietary products to the use of open source and private/public cloud solutions.

KITS has expertise in transforming underperforming and expensive proprietary systems though rearchitecting, transforming, migrating and optimising performance.

The group provides a case study that in 2015 it was appointed by a UK government agency to transform a poorly performing system that cost £34m p/a.

KITS was appointed to address serious failings in the failed online system and over 18m resolved these issues in four key stages –

- Fix underlying performance issues.
- Implement improved environment infrastructure.
- Implement best practice support model.
- Consolidate hosting providers.

During this process of work, KITS performed seven data centre moves, reviewed and optimised software licences and platform maintenance (saving £10m p/a) and more than halving operational headcount by using automation, performance monitoring and environment cloning.

The new high performance, high capacity platform delivered a greatly improved result at an annual running cost of just £5.5m, an 85% reduction.

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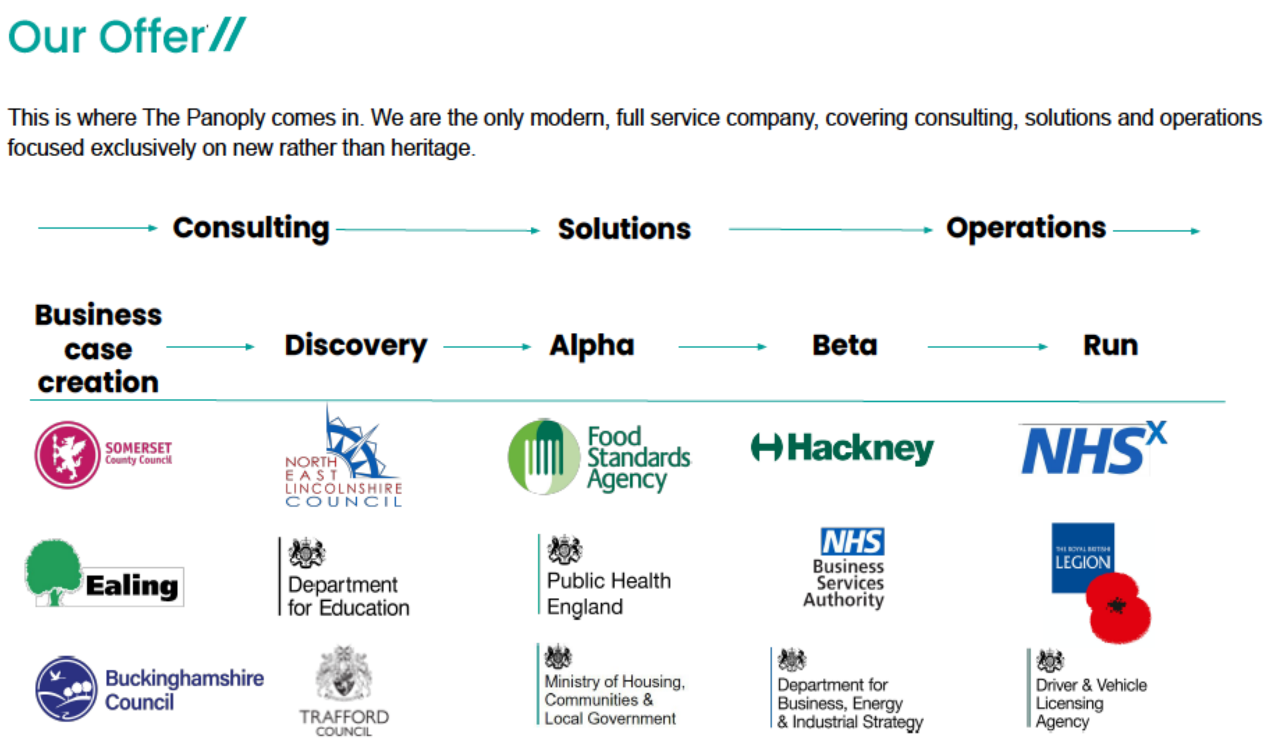
Strategic benefit

The Panoply has built its offering to become a modern, full service company that covers consulting, solutions and operations. As shown in the diagram below, the group is able to provide a full-service offering from Business Case Creation, then Discovery, through Alpha, and Beta and finally Run.

The Panoply offer



Source: The Panoply

The existing operations of The Panoply have focussed on Consulting and Solutions, while the addition of KITS will add considerable scale and capability in Operations to implement and then support the Run stage of a project, thereby offering a full end-to-end solution at scale.

We view KITS, which has built an impressive reputation for transforming and running live and critical services, for example payment platforms, for clients including the Rural Payments Agency and DEFRA, as a perfect fit with The Panoply.

The enlarged group will now be able to provide ongoing managed support services to clients which will enable it to secure additional contracts running high value, high profile services to public sector customers.

These contracts are typically of longer duration than those of the existing operations of The Panoply, which will provide an increased base of recurring revenues.

The Panoply believes that KITS will give the enlarged group access to key UK Government supplier frameworks, enabling it to bid for multi-year projects that are a multiple of the size of those that the group currently works on.

Financial & management structure

KITS generated revenues of £9.7m and EBITDA of £2.7m in 2020, which represents very strong growth from revenues and EBITDA of £10.9m and £3.3m for the 18m period to December 2019. At the end of December, KITS had a contract backlog of £30.4m for the period 2021-24, providing highly attractive revenue visibility.

The Panoply will acquire KITS for £26m, comprising £18.5m in new shares (10.3m at 180p) and £7.5m in cash. This represents a multiple of 2.6x historic revenues and just under 10x historic EBITDA, which we view as attractive given the growth profile of KITS and the scope for considerable revenue synergies.

As an indication of the confidence of vendor Grant Harris, founder of KITS, the consideration is subject to clawback of £7m of the equity part of the consideration if KITS does not hit extremely demanding revenue targets of £27m by the years to December 2022 or 2023.

The Panoply has extended its RCF with HSBC to £20m from £7m, of which £6m will be drawn down at completion. The remaining £7m will be available for future acquisitions.

We view the acquisition structure as highly attractive as the group has successfully moved away from its previous earnout-based model while ensuring financial alignment of The Panoply and KITS teams.

Following completion, leverage will remain below 1.0x based on pro forma results.

KITS will sit under the Foundry4 brand and will become the deep tech, engineering focused division of the group.

Grant Harris, Founder & CEO of KITS, will become Managing Director of the new Managed Services Division within Foundry4. The Panoply believes that there is considerable opportunity to add sales, bid management, HR, recruitment and financial support to KITS to facilitate further growth.

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Change to forecasts

As The Panoply has a March year end, the acquisition of KITS will have only a modest benefit this year, with the full benefit coming through in fiscal 2022.

The changes to our forecasts are illustrated in the table below.

Change to Forecasts

Year to March		2021E		2022E
£m	Old	New	Old	New
Revenues	48.0	49.0	54.5	65.5
Upgrade, %		*2*		*20*
EBITDA	6.4	6.7	6.8	9.8
Upgrade, %		*6*		*45*
Adjusted PBT	5.3	5.6	5.7	8.4
Upgrade, %		*6*		*48*
Adjusted EPS, p	6.9	7.3	6.8	8.7
Upgrade, %		*5*		*29*
EPS incl DC, p	5.5	5.8	5.9	7.7
Upgrade, %		*5*		*31*

Source: Dowgate Capital estimates

The Panoply indicates that following the acquisition, it expects Revenues and EBITDA to be not less than £48.5m and £6.6m, respectively, for the year to March 2021.

Including one month of trading from KITS leads us to upgrade our Revenue forecast to £49.0m (was £48.0m) and EBITDA to £6.7m (£6.4m). This flows through to an increase in our PBT forecast to £5.6m (£5.3m) while EPS increases +5% to 7.3p (6.9p) on a Dowgate basis and to 5.8p (5.5p) on The Panoply basis which is fully diluted for all earnout shares at their floor value.

We viewed our forecast for The Panoply on a standalone basis as conservative for fiscal 2022. At this stage, we also model KITS on a highly prudent basis and forecast £11m revenues and £3m EBITDA for March 2022, representing c10% growth over December 2020.

We raise our Revenue forecast by +20% to £65.5m (£54.5m) and EBITDA by +45% to £9.8m (£6.8m). This feeds through to an increase of PBT of +48% to £8.4m (£5.7m) while EPS is enhanced by +30% to 8.7p on a Dowgate basis and 7.7p on The Panoply basis.

Given that we view our underlying assumptions for both businesses as conservative and include no revenue synergies, we see considerable scope to increase our estimates over the next year as KITS beds in.

We believe The Panoply is very well positioned to achieve its financial objective of delivering £100m run-rate revenues and £12-14m EBITDA by March 2023.

Profit & Loss

Year to March £m	2020	2021E	2022E	2023E
Profit & Loss				
Revenues				
Group	**31.5**	**49.0**	**65.5**	**72.1**
Growth, %	43	56	34	10
Organic, %		24	10	10
EBITDA				
Operational EBITDA	5.7	8.7	11.9	13.0
Central costs	(1.9)	(2.0)	(2.1)	(2.2)
EBITDA	**3.8**	**6.7**	**9.8**	**10.8**
Margin, %	12.1	13.7	15.0	15.0
Adjusted Operating Profit	3.1	5.9	8.8	9.7
Operating margin	9.8	12.0	13.5	13.5
Net interest	(0.2)	(0.3)	(0.4)	(0.3)
Share Based Payments	(0.1)	(0.2)	(0.3)	(0.4)
Exceptional costs	(0.6)	(0.1)	--	--
Pre tax - Normalised	**2.9**	**5.6**	**8.4**	**9.4**
Pre tax - Headline	2.2	5.3	8.1	9.0
Tax - Normalised	(0.2)	(0.8)	(1.4)	(1.8)
Tax rate (%)	8	*15*	*17*	*19*
Attributable - Normalised	2.7	4.8	7.0	7.6
Attributable - Headline	2.2	4.5	6.8	7.3
Shares – average dil, m	52.1	65.5	80.3	83.6
Shares - incl max DC, m	74.8	81.4	91.0	91.0
Shares - period end dil, m	58.9	77.9	82.7	84.4
Dividends	--	(0.5)	(0.7)	(0.8)
Retained earnings	2.2	5.0	7.4	8.2
EPS - Normalised (p)	5.1	7.3	8.7	9.1
EPS – Incl max DC (p)	3.6	5.8	7.7	8.4
EPS – Headline (p)	4.2	6.9	8.4	8.8
DPS	--	0.6	0.8	1.0

Source: The Panoply, Dowgate Capital estimates post IFRS16

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Cash Flow & Balance Sheet

Year to March £m	2020	2021E	2022E	2023E
Cash flow				
Operating profit	3.1	5.9	8.8	9.7
Depreciation	0.7	0.8	1.0	1.1
Working capital	(0.6)	(2.0)	--	--
Other	(0.4)	(0.1)	--	--
Cash from operations	**2.8**	**4.6**	**9.8**	**10.8**
Interest	(0.2)	(0.3)	(0.4)	(0.3)
Taxation	--	(0.8)	(1.4)	(1.7)
Net cash from operating	**2.6**	**3.5**	**8.0**	**8.8**
Acquisitions	(7.0)	(38.9)	(7.2)	(2.6)
Capex & leases	(0.9)	(0.8)	(1.0)	(1.1)
Disposals	--	--	--	--
Other	--	--	--	--
Net cash in investing	**(7.9)**	**(39.7)**	**(8.2)**	**(3.7)**
Issue of shares	--	28.0	7.2	2.6
Dividends	--	(0.1)	(0.5)	(0.7)
Forex/other	(0.8)	(0.1)	--	--
Net cash from financing	**(0.8)**	**27.8**	**6.7**	**1.9**
Net flow	**(6.1)**	**(8.4)**	**6.5**	**7.0**
Balance sheet				
Closing net cash/debt	**(0.4)**	**(8.8)**	**(2.3)**	**4.7**
Deferred Consideration	(16.7)	(9.3)	(2.9)	--
Net cash/debt incl DC	(17.1)	(18.1)	(5.2)	4.7

Source: The Panoply, Dowgate Capital estimates post IFRS16

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- BUY is an expected return greater than 10%;
- HOLD is an expected return -10% to +10%;
- SELL is an expected return less than -10%.

Distribution of Investment Recommendations as per 31/12/2020

	Corporate No.	Corporate %	No.	%
Buy	162	100	162	100
Hold	0	0	0	0
Sell	0	0	0	0

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The company has seen a draft of the note and minor factual amendments have subsequently been made.

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