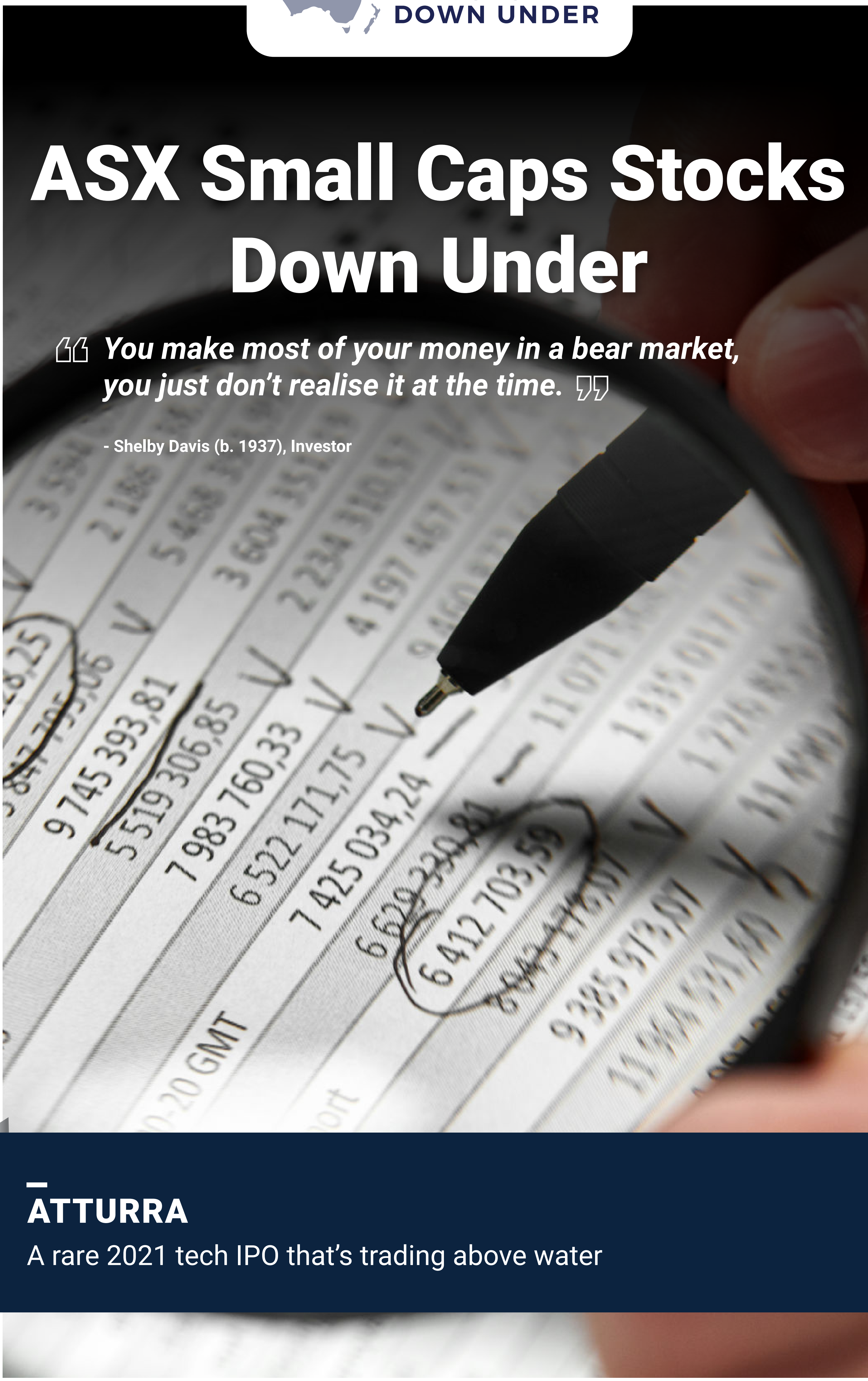
STOCKS DOWN UNDER

25 MARCH 2022

ASX Small Caps Stocks Down Under

> *You make most of your money in a bear market, you just don't realise it at the time.*

- Shelby Davis (b. 1937), Investor



ATTURRA

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Stocks Down Under rating: ★★★★

ASX: ATA
Market cap: A$136.4M

52-week range: A$0.48 / A$0.78
Share price: A$0.68

There are few tech IPOs since COVID-19 that are above water, but IT services provider Atturra (ASX: ATA) has been a notable exemption. It is not an unprofitable software stock, but rather a profitable IT services provider helping businesses bring their operations into the digital era. We believe it's a great space to be in, but also that this company could potentially be a takeover target, considering the M&A activity in this space.

Share price chart

Source: Tradingview

Meet Atturra

Atturra was founded in 2015 as a 'roll up' of five individual IT services brands. Over the next few years, Atturra completed further acquisitions and rebranded itself before listing on the ASX in December 2021 at 50 cents per share, raising $24.8m. It has almost always traded below its IPO price despite the Russia-Ukraine war and the sell-off in tech shares. The company provides end-to-end IT solutions, such as data and integration services, advisory and consulting, cloud services and business application services, like Enterprise Resource Planning solutions. Simply put, it helps its clients ensure their IT systems are up to date and will get the job done.

The most prominent client segments are the federal, local and state governments, accounting for 38% of its FY21 revenue. Other major client segments include education, defence, financial planning and utilities. Many of these segments either lack a dominant service provider or are difficult to service because of specific regulation, which represents a significant opportunity for Atturra, in our view.

In FY21, Atturra generated $98.3m in revenue, $8.4m EBIT and $5.6m in NPAT, which marked the second consecutive year it was profitable. The company is expecting further growth in FY22, having forecasted $126.7m in revenue, $11.5m EBIT and $8.6m NPAT on a pro forma basis, which would be 29%, 37% and 54% higher, respectively. Its top 20 clients generated 62% of its total FY21 revenue and 33% have had a commercial relationship with Atturra for over 5 years.

IT services spending a $37bn opportunity

IT services is a large market and expected to only grow bigger in the coming years. Research firms Gartner and Frost & Sullivan have estimated that enterprise IT spending globally was US$4.1 trillion in 2021 and will reach US$4.5 trillion in 2022. In Australia, 2021 spending was A$103bn in 2021, $37bn of which was for IT services. The latter figure is expected to grow at a CAGR of 4.1% over 2021-25.

Several factors are driving this, the most important of which are the increasing digitisation of the economy and increasing adoption of The Cloud. Enterprises must be nimble and agile to keep up with their customers' needs and government regulation, which IT service providers can help with. But as much as the sector is growing, the IT services market has high barriers to entry, which puts incumbents in pole position when it comes to winning new or repeat business.

Atturra's most prominent capability is Microsoft, which it has offered for five years and the company has been certified by Microsoft itself as a Gold Partner – recognising Atturra has best in class capability. Being a Gold Partner allows Atturra to pursue advanced Microsoft specialisations unavailable to the general markets. Another Atturra capability is TechnologyOne (ASX: TNE) which is also ASX listed. TechnologyOne powers over 73% of Australian councils and Atturra has claimed to be the largest independent provider of services supporting TechnologyOne applications. While Atturra offers several digital services, all are delivered to clients as a single holistic solution that can be flexibly integrated into their digital environment.

A potential M&A target?

Because the IT services industry is growing fast, it has seen its fair share of M&A deals. Empired (ASX: EPD) was the most recent example, bought out in November 2021 by global systems integrator Capgemini for $233m – a deal valuing the company at an FY21 EV/EBIT ratio of 16.7x. We covered Empired on April 20 last year and although we didn't see the takeover coming, we did think Empired was undervalued and would re-rate. Another was DWS which was acquired by Indian IT services giant HCL Technologies for $161.9m in a deal that valued its shares at 7.9x earnings.

We think Atturra could be a target. Its $111.5m EV values it at 9.7x FY22 EV/EBIT (pro forma). This is higher than the multiple of the HCL/DWS deal, but we would note that deal was completed over 18 months ago. Applying a multiple of 16.7x , the price the more recent Empired-Capgemini deal was completed at, derives an EV of $192.1m and a share price of $0.82 - a 20% premium to its current price.

A company with long term promise

Even if M&A lightning doesn't strike again, we like the long-term prospects of this company. It is true that while Atturra trades at a discount to Empired's takeover price, it is trading at a premium to Empired's EV/EBIT ratio before it was taken over – Empired traded at 4.9x for FY21 despite having lower revenue and EBIT in FY21 than Atturra (Empired recorded $186m and $22.6m respectively). But as we said last year, that company had been undervalued for a long time and we think that takeover deal has made investors realise not just that this industry is a great space to be in, but also that you don't have to be as big as Microsoft (NDQ: MSFT) to gain from it.

We think the performance of this company shows that the recent tech sell-off hasn't been against Tech per se but against unprofitable companies trading at hefty valuations. Atturra is a perfect example of this principle given its performance since listing. It has bucked the trend, is profitable and has gained since its IPO, but the valuation is still reasonable. There is a risk that investors could turn on the company if it doesn't deliver on its prospectus forecast in its FY22 results. The consequences of missing your first prospectus forecasts as newly listed company can be disastrous and difficult to recover from, just look at Nuix (ASX: NXL). However, Atturra's 1HY22 results showed it was on track to meet its forecasts, with a 44% gain in revenue to $61.9m, a 139% gain in underlying EBIT, to $6.4m, and a 40% jump in NPAT, to $3.4m. It also has a healthy balance sheet with $37.2m cash, which could enable further acquisitions.

We think Atturra has substantial scope for growth in an exciting industry and is reasonably priced for a company in its position. Therefore, it's four stars from us.

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