Progressive EQUITY RESEARCH

THE PANOPLY

SOFTWARE AND COMPUTER SERVICES

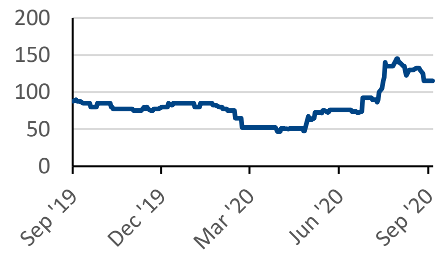
2 October 2020

TPX.L

115p

Market Cap: £77.4m

SHARE PRICE (p)



12m high/low	145p/47p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£3.0m *(at 08/09/20)*
Enterprise value	£74.4m
Index/market	AIM
Next news	Interims, Dec-20
Shares in Issue (m)	67.3
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

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Positive recent news flow

Recent news flow from The Panoply has, in our view, been very positive. Firstly, the group announced the earnings accretive acquisition of Difrent Ltd ("Difrent"), a profitable digital transformation consultancy to the Healthcare and Social Care verticals. Secondly, it confirmed the revision of a number of the Share Purchase Agreements ("SPAs") arising from certain historical acquisitions, which will reduce share dilution by 7.7m if the shares return to the 130p level as at the time of the announcement. Lastly, the AGM statement confirmed that H1 21E trading remains solid. We upgrade forecasts following the announcements, with the acquisition increasing adjusted EBITDA by 7% and 14% for FY 21E and FY 22E respectively.

- **A material acquisition, immediately earnings enhancing:** Difrent reported total revenues of £7.4m (+72% YoY) and EBITDA of £0.9m for the year ending March-20. The total initial consideration is £8.8m, payable £4.0m in cash and £4.8m in new ordinary shares. Further consideration may be payable at a rate of 0.66x revenue growth above £7.6m in the 12-month periods ending March-21E and March-22E.
- **A strategically sensible deal:** Difrent has a broad service offering and a strong roster of clients in health and social care. With both being core verticals for The Panoply, we believe the acquisition has strong industrial logic. Difrent's offering includes strategic consultancy, user centred design business analysis, business change, procurement and front and back end development. Key clients include NHSX, the Dept. of Health, and the DWP.
- **SPA amendments reduce dilution:** The group has revised a number of the SPAs arising from four of its recent acquisitions. As a result, if the shares return to the 130p level as at the time of the announcement, maximum expected dilution is reduced by 7.7m shares.
- **H1 21E trading remains robust:** The group's recent AGM statement confirmed that trading in the first two months of Q2 21E remained "strong" and signalled the Board's confidence that the FY 21E financial outcome will meet their recently upgraded expectations.
- **Forecasts increased:** Following the first two announcements, we make upward revisions to estimates. FY 21E and FY 22E adjusted EPS improves by 7% and 12% respectively, reflecting the acquisition, SPA changes and revised assumptions on future interest and tax charges.

* 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	43.0	52.3	57.2
Adj EBITDA	2.1*	3.4	5.1	6.2	7.1
Adj PBT	0.3	2.9	4.7	5.8	6.7
Fully Adj EPS (p)	0.7	3.6	5.2	6.0	6.8
EV/Sales (x)	1.7x	2.7x	2.2x	1.8x	1.6x
EV/EBITDA (x)	17.5x	25.4x	18.4x	15.1x	12.9x
PER (x)	N/A	N/A	22.0x	19.0x	16.9x

Source: Company Information and Progressive Equity Research estimates

Amendments to SPAs

In the FY 20A results announcement (released 30 July 2020), the group revealed its revised marketing strategy would place greater emphasis on two full-stack brands, FutureGov and Foundry 4. The former is the group's change-led brand, the latter the technology-led brand.

In order to accelerate the integration of four recent acquisitions into the group and the new full-stack brands, alongside the Difrent announcement, The Panoply also confirmed that it has revised a number of the SPAs arising from these acquisitions. The group has now made eleven acquisitions, and the four amended SPAs are presented in the following table, along with the nature of the amendment.

The Panoply – SPAs and amended SPAs

Subsidiary & date of acquisition	Previous deferred consideration	New deferred consideration
FutureGov Ltd (11 June 2019)	Calculation based upon FY 21E financial performance, payable in four tranches, 96% shares, 4% cash following the relevant reference period.	Fixed amount of £1.25m with respect to (w.r.t.) FY 21E financial performance. Of this, £121k to be paid in cash within ten days. Remainder via issue of new ordinary shares at the greater of 83.125p/share or the VWAP of TPX shares for 30 business days prior to the issue of the relevant shares
AMEO Professional Services Ltd (10 March 2020)	Calculations based upon financial performances in 1) the 17 months ending March 2021 and 2) the 12 months ending March 2022. Both payable post period ends.	Fixed amounts of: 1) £416k for the 17-month period ending March 2021 2) 890k for the 12-month period ending March 2022. Both payable via issue of new ordinary shares at the greater of 82p/share or the VWAP of TPX shares for 30 business days prior to the issue of the relevant shares
GreenShoot Labs (11 February 2019)	Calculations based upon financial performances in 1) 12-month period ending 31 March 2020 and 2) 12-month period ending March 2021. Payable post period end.	1) Fixed amount of £0.5m w.r.t the 12-month period ending 31 March 2020. 2) Calculation based on financial performance for the 12-month period ending March 2021 payable via the issue of new ordinary shares in The Panoply in one tranche
Deeson Group Holdings Ltd (18 December 2018)	Calculations based upon financial performances in 1) 12-month period ending September 2019 and 2) 12-month period ending September 2020. Payable post period end. Maximum possible deferred consideration capped at £3.6m.	Calculations based upon financial performances in: 1) 12-month period ending September 2019 and 2) 12-month period ending September 2020. Payable post period end. Maximum possible deferred consideration cap increased at £4.5m.

Source: Company Data

VWAP = Volume Weighted Average Price

As a result of the amendments, the total possible deferred consideration payable by the group is increased to £20.8m, with a maximum number of new shares to be issued of 26.4m. However, based upon the closing share price at the time of the announcement of 130p, the expected dilution would reduce to 18.7m new shares, compared to the revised reference prices in the SPAs.

Although no details are provided, the SPA announcement also reveals that both Ameo and FutureGov are trading in line with management's expectations.

Dilution and sensitivity to deferred consideration

The Panoply's acquisition model typically involves an initial consideration, the majority of which is usually paid via the issue of new ordinary shares, followed by a deferred consideration based upon the post-acquisition financial performance of the acquisition. This majority of this 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) is the group's largest acquisition to date. In addition to a payment of £6.06m in cash, the selling shareholders received 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 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.

Clearly there is an inverse relationship between the level of dilution and The Panoply's share price. A higher share price = fewer shares issued i.e. less dilution 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 share price, but with each transaction having specific financial terms.

In the RNS of 8 September 2020, the group confirmed the payment schedule for acquisition consideration payments. This is summarised in the following table, to which we have added 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**	**TPX reporting period**
4,219	Within the next 6 months	H2 21E
5,294	Between 6 and 12 months	H1 22E
4,776	After 12 months	H2 22E onwards
14,289		

Source: Company data & Progressive Equity Research estimates

The group has £14.289m of acquisition consideration payments to make. These relate to eight of the eleven 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. Note 74p is the base price at which the original four acquisitions were set and we have presented a number of additional scenarios up to a share price of 160p. The key input into the calculation is the "Deferred consideration payable" line. We have applied the £14.289m 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.

In the table below 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 SPAs (see the table on page 2 above) and we have used this as our 'base' price when calculating the weighted average fully diluted number of shares to produce our EPS forecasts and the other numbers in the table below. Consequently, the EPS figures coloured blue in the table below (at 82p) are the same as our revised adjusted diluted EPS estimates presented elsewhere in this report.

Please note that we are not forecasting future share price movements. The table simply reflects a prudent view on estimates with view of the impact of lower dilution on those estimates should a higher share price prevail (compared to our 'base' case) when calculating future share issues associated with the outstanding deferred consideration.

The Panoply – impact on EPS of varying prevailing share prices

		FY 21E	FY 22E	FY 23E
Deferred consideration payable	*GBP (000)*	*4,219*	*7,285*	*2,485*
Adjusted earnings (£m)		**4.204**	**5.075**	**5.930**
	Share Price			
Adjusted EPS (p)	74	*5.13*	*5.94*	*6.69*
including new deferred	**82**	**5.23**	**6.04**	**6.82**
consideration shares at:	110	5.49	6.29	7.16
	120	5.55	6.35	7.24
	130	5.61	6.41	7.32
	140	5.66	6.46	7.38
	150	5.71	6.50	7.44
	160	5.74	6.53	7.49
Delta vs 82p	*74*	-2%	-2%	-2%
	82	**0%**	**0%**	**0%**
	110	5%	4%	5%
	120	6%	5%	6%
	130	7%	6%	7%
	140	8%	7%	8%
	150	9%	8%	9%
	160	10%	8%	10%

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 10% higher based upon a prevailing share price of 160p versus the level reported at a prevailing share price of 82p.

Q2 21E Trading remains solid

The Panoply's recent AGM statement contains a number of highlights. We believe the core message is one of confidence in the outlook for the current year, and note the following:

- Building on the record performance heralded for Q1 21E[1], trading in the second quarter remains "strong".
- The Group has signed approximately £10m of new contract wins in the first two months of the current quarter, including three Local Authority wins in Cheshire and Chester
- The release signals the Board's confidence in the FY 21E financial outcome, with results expected to be in line with their recently upgraded expectations.
- The announcement also reiterates management's three-year commercial target to deliver £100m run rate revenue by 31 March 2023 with EBITDA of £12-14m. Although this appears a somewhat challenging target given our FY 21E forecasts of £42.6m and £5.0 respectively, note the target includes contributions from both organic growth and future acquisitions that are yet to be announced.

Forecast revisions

As summarised below, we make revisions to forecasts following the announcements.

The Panoply – forecast revisions

	FY 21E			FY 22E			FY 23E		§
£m unless stated	**Old**	**New**	**Chg (%)**	**Old**	**New**	**Chg (%)**	**Old**	**New**	**Chg (%)**
Revenue	39.8	43.0	8.0%	45.4	52.3	15.1%	49.9	57.2	14.6%
Adj EBITDA	4.7	5.1	6.9%	5.4	6.2	13.9%	6.2	7.1	13.9%
Fully adj PBT	4.6	4.7	1.8%	5.1	5.8	12.6%	5.6	6.7	19.8%
Fully adj EPS (p)	4.9	5.2	6.7%	5.4	6.0	11.9%	5.9	6.8	16.5%
Net (Debt) /cash	4.0	-1.1	n/m	8.0	3.2	-60%	12.0	8.3	-31%

Source: Progressive Equity Research estimates

- We have assumed six months' contribution to FY 21E financials from Difrent, with a full-year contribution being made from FY 22E onwards. We have also assumed a degree of integration costs during FY 21E.
- As a result of the Difrent acquisition, our FY 21E, FY 22E and FY23E revenue forecasts increase by 8%, 15% and 15% respectively. Adjusted EBITDA improves by 7%, 14% and 14% respectively for the same periods.
- The cash portion of the Difrent acquisition will be funded via the combination of: 1) an extension of the group's revolving credit facility with HSBC to £7m and 2) the group's existing cash resources. We note that the group's financial position remains solid following the acquisition, with cash less the consideration payment at £4m and a net debt position of £3m.
- Aside from the new contribution from Difrent, our operational forecasts for The Panoply are unchanged. Incorporating the SPA amendments discussed above, alongside revised assumptions on future depreciation, interest and tax charges generates a further aggregate boost to EPS. Our revised adjusted EPS calculations are 7%, 12% and 17% higher for FY 21E, FY 22E and FY23E respectively.

[1] For further commentary, see The Panoply: A strong start to FY 21E: PERL 21/07/20

Financial Summary: The Panoply

Year end: March (£m unless shown)

PROFIT & LOSS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue	22.1*	31.5	43.0	52.3	57.2
Adj EBITDA	2.1*	3.4	5.1	6.2	7.1
Adj EBIT	0.4	3.7	4.9	6.0	6.9
Adj PBT	0.3	2.9	4.7	5.8	6.7
Reported EPS (p)	(9.2)	(4.9)	2.9	3.8	4.4
Fully Adj EPS (p)	0.7	3.6	5.2	6.0	6.8
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Adjusted share count (Dil. M)	36.8	74.8	80.4	84.0	86.9
Average Shares outstanding (Dil. M)	18.2	48.2	63.8	77.6	85.0
CASH FLOW & BALANCE SHEET	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Operating cash flow	(1.2)	2.7	4.0	5.3	6.2
Free Cash flow	(1.2)	2.5	3.3	4.31	5.10
FCF per share (p)	(1.8)	3.7	4.9	6.4	7.6
Acquisitions	1.4	(7.0)	(2.0)	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	5.4	0.0	0.0	0.0	0.0
Net cash flow	5.6	(1.0)	1.3	2.3	3.1
Overdrafts / borrowings	0.0	(5.0)	(7.0)	(5.0)	(3.0)
Cash & equivalents	5.7	4.6	5.9	8.2	11.3
Net (Debt)/Cash	5.7	(0.4)	(1.1)	3.2	8.3
NAV AND RETURNS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Net asset value	19.3	27.3	30.8	34.2	39.4
NAV/share (p)	52.3	36.5	38.3	40.7	45.3
Net Tangible Asset Value	0.3	0.3	0.1	0.0	0.0
NTAV/share (p)	0.8	0.4	0.2	0.1	0.0
Average equity	9.6	23.3	29.0	32.5	36.8
Post-tax ROE (%)	3.6%	1.5%	10.1%	14.4%	15.7%
METRICS	**2019**	**2020**	**2021E**	**2022E**	**2023E**
Revenue growth		42.9%	36.5%	21.5%	9.5%
Adj EBITDA growth		61.9%	49.3%	21.9%	14.6%
Adj EBIT growth		934.2%	33.3%	22.5%	15.0%
Adj PBT growth		N/A	60.1%	22.8%	16.8%
Adj EPS growth		N/A	N/A	15.6%	12.9%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		11.7%	11.4%	11.5%	12.1%
VALUATION	**2019**	**2020**	**2021E**	**2022E**	**2023E**
EV/Sales (x)	1.7	2.7	2.2	1.8	1.6
EV/EBITDA (x)	17.5	25.4	18.4	15.1	12.9
EV/EBIT (x)	N/A	23.4	19.0	15.5	13.2
PER (x)	N/A	N/A	22.0	19.0	16.9
Dividend yield	N/A	N/A	N/A	N/A	0.0%
FCF yield		N/A	4.3%	5.6%	6.6%

*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

2 October 2020

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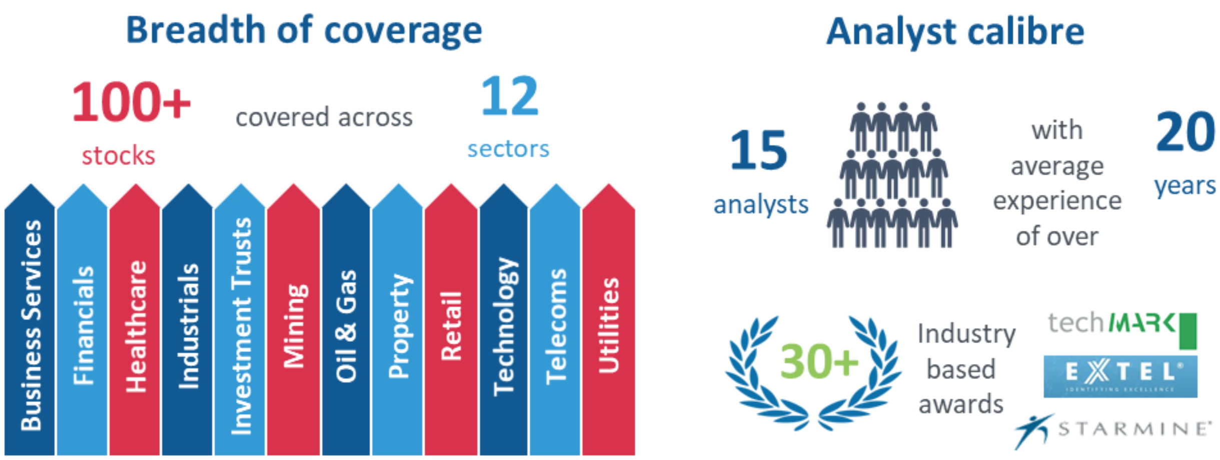

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