Review

Edison investment research

4 August 2009

Maxima Holdings

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
05/08	46.7	8.8	25.3	5.6	3.3	6.7
05/09	56.6	7.1	21.0	4.5	4.0	5.4
05/10e	58.0	6.2	16.3	4.0	5.2	4.8
05/11e	64.0	7.1	19.8	4.5	4.2	5.4

Note: * PBT and EPS (fully diluted) are normalised, excluding intangible amortisation.

Investment summary: Refocused strategy

Annual results broadly matched market expectations and reflect a strong bank of recurring revenues as well as the impact of robust underlying cash flow. The trading environment remains demanding, but a new management team and refocused strategy creates an opportunity to unlock the potential of the business model. The valuation remains attractive on a number of levels.

Annual results: In line with revised expectations

As a consequence of both underlying growth and the full year impact of acquisitions, revenues increased 21% to £56.6m – of which 56% are recurring. Normalised operating profits fell 27% to £7.1m reflecting a modest attrition of gross margins from 72% to 70% – a tougher pricing environment and the impact of acquisitions – as well as investment in the cost base to enhance the delivery infrastructure. Debt rose to £15.5m to reflect acquisition costs, but underlying cash flow remained positive. A dividend of 4.5p reflects optimism over the potential for the group going forward.

Forecasts and outlook: FY10 investment-FY11 rewards

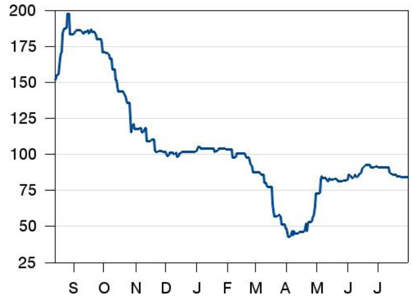
Results were broadly in line with the lower expectations established in March but forecasts now need to reflect the renewed investment in organic growth inspired by the new management team. Consequently we are now expecting normalised PBT in the current year of £6.2m compared to £6.8m previously. However, we are expecting the investment in the sales effort to reap rewards in FY11 when a return to FY09 profit levels should be achievable.

Valuation: Attractive on all metrics

New management have clearly recognised the need to refocus on organic growth given the acquisitive roll-up model may be temporarily suspended due to market conditions and the current debt/equity dynamics. This does highlight, however, the strong underlying cash generation of the business and the dividend paying potential. Meanwhile a P/E in low single digits is attractive in both an absolute sense and relative to a peer group. Once market conditions allow, Maxima should then be in a stronger position to deliver value from strategic deals particularly as an ability to de-leverage will boost balance sheet strength.

Price	84p
Market Cap	£21m

Share price graph



Share details

Code	MXM
Listing	AIM
Sector	Software & Computer Services
Shares in issue	25.3m

Price

52 week	High	Low
	197.5p	45.0p

Balance sheet as at 31 May 2009

Debt/Equity (%)	61.5
NAV per share (p)	100.4
Net borrowings (£m)	15.5

Business

Maxima is an integrated IT business systems and managed services company.

Valuation

	2009	2010e	2011e
P/E relative	49%	43%	41%
P/CF	2.7	2.7	2.5
EV/Sales	0.6	0.6	0.5
ROE	18%	18%	22%

Geography based on revenues FY09

UK	Europe	US	Other
87%	10%	3%	0%

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Maxima Holdings is a research client of Edison Investment Research Limited

Investment summary: Re-focused strategy

Company description: Industry consolidator but organic emphasis

Maxima has established critical mass and a broad footprint across the IT service sector by acquisitive growth in the last four years. The business is split into two parts: Maxima Business Solutions - a traditional installer of a range of industry specific business applications and Maxima Support Enablement Services providing IT managed and infrastructure services. We believe Maxima's full service offering business model is more suited than many of its peers to tougher times, given its high level of recurring revenues and broadly based customer profile.

Strategic shift to organic growth

The acquisitive roll-up model which has historically underpinned the Maxima strategy is inevitably somewhat on hold given the wider lack of appetite for debt, a share price which yields a low equity value and an absence of willing sellers. The new management team has recognised the challenges inherent in the current environment and sensibly shifted the focus to organic growth. This necessitates an investment in the sales effort and personnel – approximately £1m in FY10 – which should lead to substantial rewards in FY11. There is significant potential for Maxima to capture a greater share of the IT spend of a client base extending to 1,400 customers and through extending its reach, the overall impact on the top line should comfortably out-strip the attrition rate in the legacy solutions business.

Sensitivities: Tough trading environment creates margin pressure

The decline in gross margins in FY09 reflects the competitive impact of a tougher pricing environment and the impact of a slowing UK economy. However, Maxima is as well placed as any to win more business from its existing clients selling on both cost and service grounds and further investment in the delivery mechanisms should provide the spur. Maxima's track record of strong customer retention rates, high levels of recurring revenues, a diverse customer base and broad technology platform also give it some natural defensive qualities.

Valuation and outlook

The real and sentiment driven impact of forecasts which have slipped on a number of occasions, is reflected in a share price which, despite the recent bounce, still does not reflect the genuine value and potential of the business. Nonetheless, the market may soon start to give some credit to a new management team that has clearly recognised the challenges presented by the current environment. A shift in tack from acquisition to organic growth should emphasise the opportunity to boost the share of IT spend from the existing client base and some of this is reflected in a top line forecast of +10% in FY11. Meanwhile a P/E in low single digits allied to the rarity among smaller IT service and software stocks of dividend yield support, underpins an attractive long-term investment case.

Annual results

Against the backdrop of a challenging environment, Maxima has produced a creditable full year performance. Turnover and debt reflect the impact of acquisitions while profitability reveals the expected impact of a tougher pricing environment as well as investment in delivery mechanisms to support organic growth. Overall, the figures are broadly in line with market expectations.

Exhibit 1: Summary of annual results for the 12 months to 31 May 2009

£m	2009	2008	%
	12 months to 31 May	12 months to 31 May	
Turnover	56.6	46.7	+21
Gross margin (%)	70	72	-2pt
Operating profit (norm)	8.3	9.5	-13
Profit/(loss) before tax (norm)	7.1	8.8	-19
EPS normalised (p)	21.0	25.3	-16
Net debt	15.5	8.5	+82

Source: Maxima

Financial review

Revenues for the year to 31 May 2009 have increased from £46.7m to £56.6m. This growth principally reflects the acquisition of DXI Networks Limited in August 2008 as well as some underlying progress as evidenced by advances in the Business Intelligence arena – the latter partly offset by lower hardware sales and general pressure on consulting revenues. The tough trading environment was evident in a decline in gross margins from 72% to 70% which also reflected the higher proportion of slightly lower margin managed services following the DXI acquisition, which attract a slightly lower margin. As highlighted, recurring revenues stand at 56% in aggregate vs 52% in 2008 and are generated in both solutions and services.

Partly as a consequence of the gross margin decline, normalised operating profits fell 15% to £8.3m which also took into account an investment in infrastructure including the opening of the support centre at Chelmsford.

Significant non-cash items included the amortisation of intangibles of £4.0m (FY08 £3.4m), and a reappraisal of the value of acquired goodwill which led to an impairment provision of £8.4m. Exceptional items covered a provision of £0.6m for interest rate hedging arrangements to insulate against possible future rate rises, restructuring costs largely pertaining to senior management changes and a provision of £2.7m in respect of lease related and vacant property costs. Normalised EPS declined 16% to 21.2p and the total dividend recommended for FY09 was 4.5p.

A rise in group net debt to £15.5m largely reflects the acquisition of DXI Networks in July 2008 for a total cash cost of £8.5m including £2.0m of borrowings and £0.6m cash. Underlying cash generation was still strong with a £5.2m inflow from operations, notwithstanding the working capital impact of higher payables from DXI. Overall, the group still had £3.4m of headroom within its existing banking facilities at the year end.

Operating highlights

During FY09, the group achieved 87 new business wins including 10 MS Dynamics customers and 40 new customers using managed application and infrastructure services. Upselling to existing customers remains a core focus and significant contract extensions and upgrades included Mars, DVLA and Watson Wyatt.

The group received significant credit from some of its key business partners in the form of various awards for sales and support excellence, which included a Distributor of the Year Award from QAD, IBM Partner of the year in that category at the 2009 Oracle UK Partner Awards and being certified for Microsoft Dynamics Accreditation.

Exhibit 2 below highlights the divisional performance for Solutions and Managed Services and the impact of the DXI acquisition can be clearly seen in the growing proportionate contribution of Services which rose from 51% of group sales in FY08 to 57% in FY09. The historically lower margin of the DXI business though is partly evident in an operating margin for services of 12.6% compared to 17.2% in solutions.

Exhibit 2: Divisional performance

Note: * Add back of exceptionals and share-based amortisation to tally with group definition.

Year to 31 May	2008			2009		
Sales	H1	H2	Year	H1	H2	Year
Solutions	9,798	12,917	22,715	11,890	11,935	24,209
Managed Services	11,277	12,665	23,942	16,393	18,282	32,400
Group sales	21,075	25,582	46,657	28,283	30,217	56,609
Profits						
Solutions	2,119	2,588	4,707	1,867	2,295	4,162
Managed Services	1,806	2,885	4,691	2,098	1,997	4,095
Other *	64	216	280			
Group operating profit	3,989	5,689	9,678	3,965	4,292	8,257

Source: Maxima, Edison Investment Research

Strategy, forecasts and outlook

Having reduced estimates earlier this year to largely reflect a slowdown in the overall IT services market, results for FY09 came in broadly in line with expectations. However, with the new management team's focus on driving organic growth, an investment in the sales effort means FY10 operating profits will fall more than expected, although payback in FY11 should be rapid.

Exhibit 3: Changes to forecasts

	2010 New	2010 Old	2011
Sales	58.0	56.0	64.0
PBT (normalised)	6.2	6.6	7.1
EPS	16.3	19.1	19.8
DPS	4.0	4.4	4.5

Source: Edison Investment Research

Management changes underpin new strategy

The initial driver to significant changes in the composition of the senior management team came about with Mike Brooke's decision to step down as chairman, a position he had held since Maxima floated in 2004. This enabled former CEO and major shareholder Kelvin Harrison to move to chairman and paved the way for a search for a new CEO, which resulted in the appointment of Graham Kingsmill. Previously Graham had been chief executive of Netstore plc, an AIM listed – prior to its acquisition by 2e2 Group in 2008 – IT application management, hosting and security services business. Before this, Graham was MD of SAP in the UK and Ireland. In addition, a new CFO was appointed – David Memory – who also had previously worked at Netstore.

The strategic focus of the group has now shifted to organic growth rather than the historic pattern of an acquisitive 'roll-up' organisation. There have been a number of drivers for this, not least of which has been the impact of a different climate for acquisition opportunities; a depressed share price impacts the value of Maxima's paper currency, the environment is not conducive to taking on more debt and finally there are fewer willing sellers. In addition there is a genuine drive to sweat the assets of recently acquired businesses and capture more synergy benefits with respect to overheads.

There is still a medium-term objective to move the top line closer to £100m, but the time horizon has now moved out to 2012 and beyond and, providing conditions allow, this will see future strategy move back towards acquisition.

Exhibit 4: Acquisition history

Note: * Estimated; ** Net of acquired cash balances.

Acquisitions	Date	Division	Price** (£m)	Sales (£m)	EBIT (£m)	P/sales (x)	P/EBIT (x)
Ringwood	Aug-05	Solutions	2.9	3.2	0.0	0.4	100.0
Hanston	Sep-05	Managed Services	8.2	3.5	0.7	2.3	11.9
Seabrook	Jan-06	Solutions	0.5	0.6	0.1	0.5	5.3
QED	May-06	Managed Services	4.3	3.2	1.1	1.3	4.0
Cognition	Oct-06	Solutions	4.1	4.7	1.0	0.9	4.1
Intertech	Nov-06	Managed Services	3.7	3.0	0.0	1.2	11.5
Seven Three	Mar-07	Solutions	1.1	1.0	0.1	1.1	8.5
3net	May-07	Managed services	14.0	6.1	1.6	2.3	8.8
Centric	Jul-07	Managed Services	4.9	2.0	0.6	2.5	9.0
Eclectic	Dec 07	Solutions	3.0	4.3*	0.3*	0.7	10.0
DXI	July 08	Managed Services	8.5	14.1	1.3	0.6	6.8
						1.2	8.2

Source: Maxima, Edison Investment Research

Other elements to the fresh approach by management are likely to see a simplification of the product offering generally and an emphasis on four key partner aligned Business Solution Practices: Microsoft – Microsoft Dynamics AX and CRM combined with Maxima's own industry solution, MAXcel, addressing the construction and energy industries; SAP and Oracle – Business intelligence and performance capability into the financial services sector in particular; QAD and Specialist Solutions – targeting an extension of QAD ERP usage to the large Manufacturing and Consumer Products companies which comprise the majority of the QAD UK user base.

The overriding framework for future strategy is encapsulated in three ways: Extension – the demand for consultancy services and software to make existing IT systems be better and last longer; Expansion – Up-sell services and deepen the penetration of the existing client base; Partnerships – Providing sales support and enablement services to selected technology partners.

Forecasts and outlook

A focus on profitability, de-leveraging and investment are key as to how management views medium-term prospects and the latter in particular helps explain the adjustment to FY10 forecasts in Exhibit 3. An investment of c £1m during FY10 in the sales effort will depress short-term profitability but, as FY11 forecasts indicate, this could then enable double-digit sales growth to be achievable. In the short term, however, a lengthening in sales cycles due to the economic backdrop – as well as some margin pressure – makes for a challenging backdrop. Maxima is fortunate in that with over 50% of revenues recurring (ie support contracts with >1 year duration) it has some degree of visibility and high customer retention is evidence of the strength of the proposition. Maxima remains unique in the quoted UK sector with such a wide range of industry coverage and a broad technology platform.

Valuation

Peer group comparisons

Peer group comparisons are always somewhat problematic especially given Maxima's revenue mix makes it more comparable to the IT activities present within larger organisations such as Serco and Capita rather than some of the quoted peers. Nonetheless the companies highlighted below do have certain similarities to Maxima and it is clear that on any of the P/E, EV/sales or yield criteria, the company is not expensive on a relative basis. Maxima has the highest yield of the companies considered, a P/E at the lower end of the range and an EV/sales ratio slightly below the average.

Exhibit 5: Peer group comparison

Note: Prices as at 30 July 2009.

								Fiscal 2009	Calendar 2009	
Enterprise software services	Year end	Price (p)	Market cap (£m)	Sales growth (%)	Sales (£m)	PBT (£m)	EPS (p)	P/E (x)	EV/ Sales	Yield (%)
Maxima	May	84	25.1	21%	56.6	7.1	21.0	4.5	0.64	5.0%
Smaller companies										
K3	Dec	85	20.2	-1%	37.2	6.0	18.0	4.7	0.89	0.6%
Microgen	Dec	67	58.2	2%	33.5	6.7	5.7	11.9	1.41	2.2%
Morse	June	31	40.9	-16%	212.9	0.9	-2.2	42.3	0.24	0%
Sanderson	Sept	7.25	3.15	-5%	26.3	3.5	3.7	2.0	0.52	0.8%
Peer group Average								15.2	0.76	0.9%

Source: Edison Investment Research, Thomson

Rating based metrics, cash flow and dividends

Despite the recent bounce in the share price, Maxima's equity is still very lowly rated. While reflecting the disappointment of a retreat in estimates during the current year, an absolute P/E of around the 4x mark does not accurately reflect the potential to deliver organic growth or indeed the ability of the business to generate free cash flow. With respect to the latter, the company is expected to generate c £3m of net cash flow in each of the next three years and, from a de-leveraging perspective if nothing else, the equity story is interesting.

In the meantime, a yield of approximately 5% has both absolute and relative attractions and, given the longer-term growth ambitions, offers an appealing benchmark for valuation. Although sentiment has suffered during 2009, the impact of the strategic shift inspired by the new management team holds out the opportunity of a more rewarding FY10 for all stakeholders.

Exhibit 6: Company fact sheet

Operations

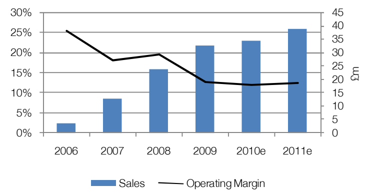
Maxima has eight UK offices and one in Ireland and one in India with c 450 staff servicing over 1,400 clients. In the past two years, it has bought five businesses to broaden its product and service offering and has integrated these businesses under the Maxima brand.

Performance

Maxima Support Enablement Services

This division provides services to customers with pre-installed business software. It provides a range of fully managed or on-demand support and consultancy services. Support for operating systems (Windows, Linux and Unix) and databases (Oracle, Microsoft, IBM and Computer Associates) make up the core of the business and networking and security infrastructure (Cisco). The acquisitions of Centric and now DXI provide communication technology and 24/7 helpdesk offerings. The Oracle-based application management business supports over 100 clients' databases, middleware and applications software and has 40 support contracts across a broad base of industries. It has 10 major Computer Associates mainframe clients, and about 100 Citrix-based platform clients.

Main competitors: 2e2, Computacenter, Capita.



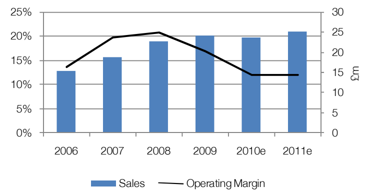
Maxima Business Solutions

Maxima Solutions delivers and supports a growing range of IT products. The division embraces the Information Management and Business Solutions practices of the group. In Business Solutions, its core expertise is in Enterprise Resource Planning (ERP) systems, where it specialises in the implementation and support of Microsoft Dynamics AX, SAP's Business One, QAD's MFG/PRO and its own proprietary systems. Its 'own-brand' solutions – I-CON360, IBS and Intellect – are mainly for mid-sized industrial clients, while the SAP offering encompasses the whole SME market. Maxima became an accredited SAP partner in 2003 and is now one of the largest of SAP's certified resellers in the UK. It started its relationship with Microsoft in 2007 and is now one of the top 10 UK sellers. It is the sole UK and Irish distribution partner for the QAD enterprise software solution MFG/PRO, a supply-chain management system. QAD is a leading ERP vendor specialising in the manufacturing sector.

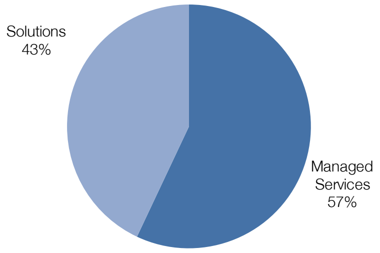
The division also has a range of product and sector expertises: Microsoft CRM (customer relationship management) applications and its own proprietary document management systems. Portals and information and ticketing systems for kiosks are also strong niches. As well as its strength in the manufacturing sector, document handling brings exposure to financial services and public sector customers.

With a balance of older legacy systems as well as newer platforms, the division relies heavily on repeat business from its installed customer base. Hence, operations are all strongly cash-generative.

Main competitors across different areas: Hitachi Consulting, K3, Sanderson.

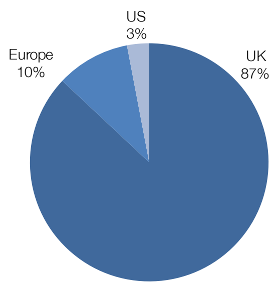


Divisional breakdown



Based on 2009 sales

Geographic breakdown



Based on 2009 sales

Source: Edison Investment Research

Exhibit 7: Financials

£'000s	2007	2008	2009	2010e	2011e
Year end 31 May	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	31,767	46,657	56,609	58,039	63,952
Cost of Sales	(7,838)	(13,240)	(17,192)	(17,412)	(19,185)
Gross Profit	23,929	33,417	39,417	40,627	44,766
EBITDA	6,498	10,012	8,877	7,665	8,568
Operating Profit (before GW after restr.)	6,165	9,535	8,257	7,015	7,918
Intangible amortisation (including share-based payments)	(1,560)	(3,547)	(4,124)	(4,250)	(4,250)
Exceptionals (other than restr.)	0	0	(12,065)	0	0
Other	0	0	(551)	0	0
Operating Profit	4,605	5,988	(8,483)	2,765	3,668
Net Interest	(423)	(780)	(1,149)	(800)	(799)
Profit Before Tax (norm)	5,742	8,755	7,108	6,215	7,119
Profit Before Tax (FRS 3)	4,182	5,208	(9,632)	1,965	2,869
Tax	(822)	(1,463)	400	(1,000)	(999)
Profit After Tax (norm)	4,445	6,396	5,331	4,152	5,058
Profit After Tax (FRS 3)	3,360	3,745	(9,232)	965	1,870
Average Number of Shares Outstanding (m)	17.5	24.9	25.1	25.3	25.3
EPS - normalised fully diluted (p)	24.8	25.3	21.0	16.3	19.8
EPS - FRS 3 (p)	19.2	15.1	(36.8)	3.8	7.4
Dividend per share	5.2	5.6	4.5	4.0	4.5
Gross Margin (%)	75.3%	71.6%	69.6%	70.0%	70.0%
EBITDA Margin (%)	20.5%	21.5%	15.7%	13.2%	13.4%
Operating Margin (before GW and except.) (%)	19.4%	20.4%	14.6%	12.1%	12.4%
BALANCE SHEET					
Fixed Assets	46,167	52,971	51,262	47,712	44,162
Intangible Assets	45,224	51,947	49,901	46,501	43,101
Tangible Assets	943	1,024	1,361	1,211	1,061
Investment in associates	0	0	0	0	0
Current Assets	14,120	17,511	17,189	17,523	17,913
Stocks	106	312	405	400	400
Debtors	8,900	10,521	10,816	10,800	10,800
Cash	2,861	4,202	2,421	2,421	2,421
Current Liabilities	(16,800)	(19,298)	(20,924)	(21,250)	(21,250)
Creditors	(16,100)	(18,544)	(19,828)	(20,450)	(20,450)
Short term borrowings	(700)	(754)	(1,096)	(800)	(800)
Long Term Liabilities	(12,085)	(15,678)	(22,351)	(21,497)	(18,078)
Long term borrowings	(8,766)	(12,063)	(16,812)	(14,402)	(10,983)
Other long term liabilities	(3,319)	(3,615)	(5,539)	(7,095)	(7,095)
Net Assets	31,402	35,506	25,176	22,487	22,747
CASH FLOW					
Operating Cash Flow	4,510	9,215	6,076	7,856	8,568
Net Interest	(423)	(644)	(1,076)	(800)	(799)
Tax	(2,203)	(1,861)	(2,049)	(2,000)	(2,000)
Capex	(278)	(816)	(1,005)	(1,000)	(1,000)
Acquisitions/disposals	(15,209)	(6,131)	(8,428)	0	0
Financing	10,853	(309)	1,015	0	0
Dividends	(734)	(1,347)	(1,405)	(1,350)	(1,350)
Net Cash Flow	(3,484)	(1,893)	(6,872)	2,706	3,419
Opening net debt/(cash)	3,121	6,605	8,615	15,487	12,781
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	0	0
Closing net debt/(cash)	6,605	8,498	15,487	12,781	9,362

Source: Company accounts, Edison Investment Research

Edison Investment Research

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