ISSUER RATING

BB+

Long-term Rating

Outlook: Stable

First rating date: 30/12/2020
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Rating Action and Rationale

- EthiFinance Ratings upgrades the rating of Izertis S.A. from 'BB' to 'BB+', changing the outlook from Positive to Stable.
- The rating is supported by the group's solid financial profile, including a controlled level of indebtedness (adjusted NFD/EBITDA <2.5x and adjusted FFO/NFD >30% on average) together with a high level of financial autonomy (equity/TFD >80% on average).
- However, the rating is constrained by the still modest current size of the company, which affects its competitive positioning, as well as by a lower interest coverage (EBITDA/interest ~5.5x) due to higher interest rates.
- The rating upgrade mainly results from a strengthened business profile based on the consolidation of competitive advantages together with greater operational diversification, following the acquisitions of recent years. All this while maintaining a balanced financial profile.
- In line with our methodology, the software services sector presents a medium ESG risk (sector heatmap score between 3.0 and 3.4) given its limited impact on the environment. This assessment has a neutral impact on the sector rating. The company's ESG policies are considered adequate (ESG score between 1 and 4), which also has a neutral effect on the rating.

Issuer Description

Izertis, S.A., founded in 1996, and its subsidiaries (hereinafter Izertis,'the company' or 'the group') operates in the technology consulting sector with the aim of facilitating the digital transformation of companies. The group has offices in nine countries, with projects in more than 50. For 2022 the company reported revenues of €88.4m (+36.0% YoY) with EBITDA of €12.1m (EBITDA margin of 13.6%) and an adjusted NFD/EBITDA ratio of 3.2x. First-half 2023, revenues amounted to €57.8m (+45.5% vs. 1H22) with EBITDA of €9.0m (EBITDA margin of 15.6%) and an adjusted NFD/EBITDA ratio of 3.5x. The group has been listed on Spain's BME Growth since November 2019, with a market capitalization of €208.8m as of 05/10/2023.

Fundamentals

Business Profile

Industry Risk Assesment

- **Sector with good growth prospects, in the process of consolidation. Low barriers to entry, with medium profitability levels and relatively low volatility.**

  The consultancy sector involves a large number of companies, the vast majority of which are small, although it is undergoing a continuing process of concentration in which large groups (controlling 40% of the sector's revenues) are acquiring smaller companies. High competitiveness is reflected in profitability margins (EBIT margins between 6% and 9%). Despite the current environment of economic and geopolitical uncertainty, the consultancy sector is assumed to have expanded in 2023 and has good growth prospects, driven by the profound transformation in which all industries are immersed. Although barriers to entry are considered low, given that high capital investment is not required, there is the need for expertise, as well as the ability to attract talent and adapt to possible technological disruptions that may arise in the market in a timely manner.

- **The sector has medium ESG exposure.**

  In general terms, there is limited use of natural resources in the provision of services, with a mostly indirect impact. Customer service is fundamental in this industry, so quality of service and price are key issues that can quickly affect reputation, sales and profitability. Finally, particular mention is made of liabilities arising from quality of information and ethical issues, although the associated financial impact is considered to be limited.

Company's competitive positioning

- **A specialist group which, despite its small size in terms of turnover, is consolidating its position as an integrator of technology consultancy services.**

  Izertis is one of the smaller of the leading groups in the market. This has drawbacks in terms of the credit rating but, together with its wide range of services, high specialization, and a flatter organizational structure compared to large multinational consultancy firms (more hierarchical and bureaucratic structures) does allow it flexibility in order to meet clients' needs. Izertis' alliances with benchmark technology companies, such as Microsoft, SAP, Salesforce and AWS, is also noteworthy, being a direct contact and technology advisor for customers that want to adapt any of these companies' software into their businesses, which helps attract and retain clients.

- **High concentration of revenues and EBITDA in Spain, although risk mitigated by wide range of services and high client diversification.**

  Although the generation of turnover and EBITDA is concentrated in the domestic market (88.0% and 89.8% of total respectively in 2022), the group's wide range of services offered mitigates the risk. Izertis combines services of a more traditional nature (management programmes, development of applications, etc.) with services linked to digital transformation (blockchain, artificial intelligence, data, etc.). This allows it to meet a larger number of clients' technological needs. In addition, the group has a wide diversification at the target industry level, not having a relevant dependence with any of them, as well as a diversified and quality customer portfolio. The top-20 clients represents 41.4% of turnover (2021: 39.1%), with the presence of groups of recognized prestige within different target industries.

Governance

- **Shareholding closely linked to day-to-day management through the founding partner and the management team.**

  D. Pablo Martín Rodríguez (founder, chairman and CEO) controls 52.20% of the shares. In spite of this showing a high concentration in the decision-making process, the long-term participation of the main shareholder and his presence in the day-to-day activities brings stability. We have a positive assessment of the company's management, given the track record of inorganic growth with a financing structure that has allowed the group to maintain stable and controlled metrics over time. We consider the management team to be qualified, with good experience in the sector. In addition, the listing on the BME Growth market since 2019 has facilitated a growing free-float of shares (up to 32.02% of the total as of June 2023) and could help with future fund-raising.

- **ESG policy rated neutral**.

  Although Izertis has a neutral ESG exposure (score of 2.45), we consider that the adaptation of strategies to ESG trends is still limited and may be exposed to risks that could affect revenues, earnings, cash flows, asset value, and/or reputation in the foreseeable future (up to 5 years). Izertis' ESG score is 51 out of 100. The governance assessment stands out (score of 63), marked by a qualified board of directors including the presence of independent members, together with the public disclosure of the group's policies (Code of Conduct and Anti-Corruption Policy) and the prioritization of ESG risks. Izertis' social (53) and environmental (33) scores are considered acceptable.

Financial Profile

Cash-flow and leverage

- **Growing FFO from the increase in EBITDA still insufficient to cover M&A, resulting in negative free cash flow.**

  The group achieved record EBITDA of €12.1m in 2022 (+53.6% YoY, with EBITDA margin of 13.6%) and is well on course to exceed it in 2023 (EBITDA of €9.0m in 1H23, EBITDA margin of 15.6%). Progress is being driven by the group's focus on providing higher value services to customers and generating higher profitability margins, as well as by the incorporation of acquired companies. Consequently, the capacity to generate growing cash flow from operations (FFO/EBITDA of 74.5% in 2022 and 76.8% in 1H23), has contributed to funding the group's ongoing inorganic growth plan. However, M&A has kept FCF negative in recent years (-€12.5m in 2022 and -€9.5m in 1H23), which has been mainly covered through new debt and capital increases.

- **Controlled indebtedness marked by the group's inorganic growth.**

  The group has been able to keep the debt ratio (adjusted NFD/EBITDA) under control despite an ongoing inorganic growth policy (6 companies acquired in 2022 and 2 in the first half of 2023), at 3.2x (2022) and 3.5x (June 2023). This has been thanks to the incorporation of companies that allow for higher operating cash flow generation, together with a balanced acquisition financing structure. However, Izertis' financial profile is impacted by the current environment of higher interest rates (Euribor). The group has seen the interest coverage ratio deteriorate significantly (6.3x in 2022 and 4.9x in 1H23).

Solvency

- **Good financial autonomy.**

  The level of financial autonomy (ratio of equity to adjusted total financial debt) is moderately high, standing at 65.4% in 2022 (+7.2pps vs 2021). This ratio benefited from the increase in equity (+44.2 YoY) via a capital increase (compensation of the amounts owed to the former owners of the companies acquired in 2021/22 for a total amount of €14.5m). The financial autonomy ratio continued to strengthen in 1H23, standing at 72.8%, thanks to the increase in equity (+19.7%) again as a result of the share capital increases (compensation of debt) and to a lesser extent by the capitalisation of higher earnings.

Liquidity

- **Adequate liquidity supported by recurrent generation of operating cash.**

  Despite significant capital expenditure in 2022 and 1H23, cash and cash equivalents remained strong and stable at €26.0m, demonstrating the group's ability to grow in a profitable and controlled manner. This, coupled with solid and recurring FFO (estimated at €13.6m in 2023) and undrawn financing facilities (as at June 2023 €6.2m), suggests that Izertis will not have difficulties in meeting its commitments in the short term (debt maturities of €28.6m <12 months). In addition, its solid financial profile provides the group with flexibility in the event of potential refinancing scenarios.

Modifiers

- **Controversies.**

  The company does not appear to present any controversies.

- **Country Risk**

  No country risk has been identified.

Main Financial Figures

Main financial figures. Thousands of €.	2020[4]	2021	2022	H1 2023	22vs21%
Revenues	50,741	65,046	88,432	57,803	36.0%
EBITDA	5,270	7,854	12,066	9,008	53.6%
EBITDA margin	10.4%	12.1%	13.6%	15.6%	1.6pp
EBIT	3,777	3,618	6,290	5,006	73.9%
EBIT margin	7.4%	5.6%	7.1%	8.7%	1.6pp
EBT	1,909	2,694	4,019	3,109	49.2%
Total Assets	63,208	103,039	144,625	159,401	40.4%
Equity	23,335	33,755	48,674	58,255	44.2%
Total Adjusted Financial Debt[1]	29,348	57,998	74,416	79,985	28.3%
Adjusted Net Financial Debt[1]	14,359	20,269	38,811	53,952	91.5%
Equity/Adjusted TFD	79.5%	58.2%	65.4%	72.8%	7.2pp
Adjusted NFD/EBITDA	2.7x	2.6x	3.2x	3.5x	0.6x
FFO	6,237	5,955	8,984	6,920	50.9%
FFO/Adjusted NFD	43.4%	29.4%	23.1%	25.7%	-6.2pp
EBITDA/Interest	8.7x	8.3x	6.3x	4.9x	-2.0x

[1]Debt adjusted by EthiFinance Ratings, includes lease liabilities of €3.8m (June 2023), €2.5m (2022), €2.4m (2021) and €2.6m (2020), as well as non-recourse factoring of €4.2m (June 2023), €4.8m (2022), €3.5m (2021) and €2.2m (2020). The net debt calculated by the company itself amounts to €31.5m, with a NFD/EBITDA ratio of 2.6x at the end of 2022 (2.9x at June 2023). [2] LTM EBITDA calculated by the company.[3]FFO annualized based on 1H23. [4]P&L figures at year-end 2020 have not been adjusted for IFRS 16 and are not 100% comparable.

Rating Sensitivity

Factors that could (individually or collectively) impact the rating:

- **Positive factors (↑).**

  More favourable economic environment. Improved debt levels (adjusted NFD/EBITDA below 2.0x and adjusted FFO/NFD above 40% and EBITDA/interest above 6.5x on average). Increased financial autonomy (Equity/TFD above 90% on average).

- **Negative factors (↓).**

  Worsening economic environment. Deterioration of ratios (adjusted NFD/EBITDA above 3.0x, adjusted FFO/NFD below 25% and EBITDA/interest below 5.0x on average) and Equity/TFD (below 75% on average).

Credit Rating

Credit Rating	
Business Risk Profile	**BB+**
Análisis Sectorial	*BBB-*
Industry's ESG	*Neutral*
Competitive Positioning	*BB-*
Governance	*BB+*
Financial Risk Profile	**BB+**
Cash flow and leverage	*BB+*
Solvency	*BBB-*
Company's ESG	Neutral
Anchor Rating	**BB+**
Modifiers	*No*
Rating	**BB+**

Regulatory Information

Sources of information

The credit rating assigned in this report has been requested by the rated entity, which has also taken part in the process. It is based on private information as well as public information. The main sources of information are:

- Annual Audit Reports.
- Corporate Website.
- Information published in the Official Bulletins.
- Rating book provided by the Company.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, EthiFinance Ratings assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies, and in accordance with the Corporate Rating Methodology that can be consulted on https://www.ethifinance.com/en/ratings/methodologies and according to the Long-term Corporate Rating scale available at https://www.ethifinance.com/en/ratings/ratingScale.
- EthiFinance Ratings publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.
- The issued credit rating has been notified to the rated entity, and has not been modified since.

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