PANMURE GORDON & CO

Founded 1876

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Equity Research

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FLASH

DATALEX

Standout beneficiary of accelerating industry shifts

BUY

(Remains Unchanged)

Target Price: €2.50

Share Price: €2.00

(Price at close 20 August 2015)

Stock Codes	DLE.L / DLE ID
Market Cap	€149m
Last Published Research:	19 December 2014

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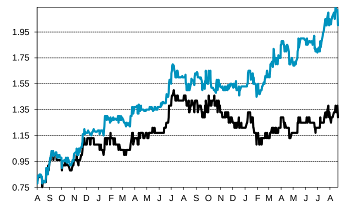
Absolute & Relative Performance



— Absolute

— Relative to ISEQ SE OVERALL (ISEQ)

***Source** Datastream*

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DLE reports H1 FY15 results on August 26th. The focus will be for evidence of (1) consistency; (2) visibility on the revenue growth trajectory over the next 18 months; (3) continued strong momentum on multiple levels to demonstrate the scalability of the DLE model; (4) the building of new capabilities; (5) commentary on new airline client pipeline and go-lives; and (6) a reiteration of an expected 20%-25% growth in adjusted EBITDA in FY15. The potent combination of (1) high revenue visibility; (2) the free cash flow and dividend story for FY15-17; (3) the truly differentiated business model strength which has made DLE a market leader in the fast-growing travel retail technology space; and (4) the uniqueness of DLE as a strategic asset, merits high valuation ratios. We see the strong multi-year share price outperformance continuing, therefore we retain our Buy and target price of €2.50.

- **Continued confidence, consistency and momentum –** We remain confident in the high visibility of DLE's model and momentum in DLE's core focus area, as well as the company's very initial steps/progress in adjacent travel technology verticals such as payments and big data. DLE's category leadership, domain expertise, and market-leading omni-channel offering, in contrast to point/single channel/inflexible solutions offered by many of its competitors, positions DLE well to capture more than its fair share of the market growth. A significant new client, JetBlue, has just gone live, whilst another, Swiss International Airlines, is scheduled to go live on the DLE platform in H2 FY15, all proof of increased momentum, whilst the pipeline of new, high-quality airline clients remains promising.
- **Vast potential of DLE's core proposition and the wider e-commerce optionality –** Investors increasingly grasp the significant opportunity represented by DLE's key product offering; the core digital commerce platform which delivers omni-channel retail capabilities to airlines that allows them to dynamically price and sell all of their products – from the core air fare to all other products/services (such as baggage, seats, meals, hotels, car rentals). This is particularly valuable to airlines given the increasing importance of ancillary revenues as the single most essential lever to improve airline profitability.
- **Attractive financial model –** DLE's medium-term attractive financial/operational dynamics driving rising returns are based on (1) a highly visible, predictable and recurring transaction-based and volume-driven revenue stream; (2) well-invested product offering positioned to leverage growth in volumes due to highly scalable infrastructure; and (3) strong free cash flow generation reflecting low capital intensity and working capital needs.

continued

Year End Date	Sales ($m)	PBTA ($m)	EPS (¢)	DPS ord (¢)	P/E (x)	EV/EBITDA (x)	Yield (%)
2014A	41.4	6.4	3.5	2.0	64.2	20.1	0.8
2015E	45.9	7.1	4.8	3.0	46.8	15.5	1.3
2016E	51.4	9.4	7.7	3.3	29.4	12.0	1.5
2017E	58.0	12.3	9.5	3.6	23.7	9.1	1.6

Source Company Data, Panmure Gordon

INVESTMENT CASE

Lufthansa's recent GDS surcharge decision reignited investor concerns about the disintermediation of the global distribution systems (GDS) platforms as the airline industry's dominant distribution channel, signalling the next wave of the travel industry's evolution requiring a business model shift away from a historic focus almost solely on reducing distribution channel costs and towards one that looks to drive financial returns by best serving travelling customer needs. Datalex should be a substantial beneficiary of such a shift. This, combined with the company's truly differentiated business model and attractive financial profile continues to make Datalex a highly compelling investment proposition.

- **Lufthansa's surcharge reignites investor concerns about GDS disintermediation –** Eager to obtain lower ticket distribution costs by redirecting travel agents (TA)/travel management companies (TMC) to connect directly with its reservations system for flight availability/ticket prices — thereby bypassing the more costly GDS— Lufthansa announced on June 2 a plan to apply a €16 surcharge to every ticket issued by a booking channel using a GDS from September 1 2015 This has triggered fears of airline industry-wide adoption of Lufthansa's measure.

All the three major GDS companies (the quoted Amadeus IT Group, Sabre Corp and Travelport Worldwide) have unsurprisingly used their most recent financial results to downplay (again) investor concerns about the potential impact of Lufthansa's initiative. They have all highlighted the convenience offered by GDS of providing to travellers, through the TA/TMCs, impartial comparisons of all available flights, allowing them to get the best value. We often hear, however, airlines stating the GDSs' technology is outdated and cannot keep pace with the airlines' own direct channel in terms of how their products are displayed and sold. We believe there is indisputably mounting evidence that the traditional supply chain technology (i.e. GDS) to support intermediaries (TA/TMCs) is diminishing in relevance due to the increasing sophistication and ever-changing demands of the digital consumer and advancements in digital commerce technologies.

Judging by the volatile stock price reaction of the three GDS operators since June 2, Lufthansa's move signals potential severe disruption to the GDSs' pivotal and highly lucrative role in the global airline industry distribution model. Investors are, at the very least, concerned about the possible disintermediation of the GDSs and uncertain about the GDSs' hitherto almost unassailable investment attractions (i.e. stable, uninterrupted long-term sales and profit growth, combined with strong cashflow generation).

We think that Lufthansa's current surcharge initiative has therefore created sufficient uncertainty and confusion amongst investors to prompt re-evaluation of how best to get investment exposure to the current powerful positive trends in the airline travel industry.

- **Make customers the strategic focus, not lowering cost of distribution channels –** We believe that the shift to low-cost direct sales connection away from the GDSs will remain a key industry trend, albeit a very highly protracted process, not least because of (1) the existing long-term commitments between TA/TMCs and the GDSs, (2) TA/TMCs value the aggregated service (i.e. single search and booking source for multiple-airline content) provided by the GDS, and (3) TA/TMCs value the additional ancillary services (e.g. desktop workflow, accounting and reporting products, travel expenses reconciliation etc.) provided by the GDS.

However, our conversations with travel industry operators highlight that the pace of change and evolution within the industry has dramatically and significantly accelerated in the past 18-24 months, not least triggered by the explosion in end-consumers/travellers' use of mobile devices. We frequently hear the view, and agree with it, that the travel sector has reached the next distinctive phase in its evolution. This, combined with a pick-up in world GDP feeding into the continued healthy recovery in global air traffic volumes (expected to grow c.7% -IATA forecast- in 2015) creates a significant opportunity for both incumbent and new operators who can define their place in such a fast-evolving, fast-growing industry.

continued

Consequently we believe that this next wave of the travel industry's evolution requires a complete change of mind-set with a business model shift away from a historic focus almost solely on reducing distribution channel costs and towards one that looks to drive financial returns by best serving customer needs and enhancing the customer experience, and delivering a highly personalised service.

- **Datalex: Well-placed to benefit from the shift to a more customer-centric approach –** If we are correct with our investment thesis, then we think this will prompt investors to look even more closely at Datalex.

We believe management continues to do an excellent job at explaining to investors the company's business model (i.e. Datelex's customer-centric rather than distribution channel-centric proposition and the supporting operating model) and the unique position the company enjoys at the intersection of travel retail and technology. On a very simplistic level, Datalex's provides innovative retailing solutions and differentiation for airlines (and other travel industry players) — its flexible and scalable open technology platform gives airlines complete control, flexibility and variability of pricing in the selling of their ancillary products, as well providing insight into their travelling customers' behaviour and preferences which gives airlines the opportunity to provide a personalised experience and tailored offers to those travellers.

Furthermore, we believe that several aspects of Datalex's approach fundamentally differentiate it from its competitors, including:

- Datalex has the only true omni-channel digital commerce platform in the market –across every touchpoint it provides a single view of the customer. For example, JetBlue (the US's 5th largest passenger carrier) can merchandise its products/services on its website using Datalex's software, as well as on a traveller customer's mobile device, the airline's call centre, the airport kiosk etc. The key takeway here is that it is a single engine underneath every customer touchpoint.
- Datalex's open architecture allows the integration of a wide range of partners —Datalex enables a digital ecosystem for the airline (i.e. extensibility and configurability). JetBlue is again a prime example – we understand JetBlue is using HP Autonomy for CSM, Possible Mobile to develop their mobile app, an Apple app on board, multiple payment services, an external loyalty company etc. All these partners' solutions sit on top of the Datalex platform.
- Datalex's flexibility and openness allow its airline customer to future proof its infrastructure for its retailing capabilities —i.e. the airline can change and evolve easily its infrastructure over time (plug out and plug in.)
- Datalex is a recognised industry leader in areas such as advanced pricing (Swiss signed with Datalex to develop an industry leading dynamic bundling and pricing capability).
- The componentised nature of Datalex's platform allows the airline to develop a 'best of breed' infrastructure —the airline can build some elements in house and bring in other components from third party technology suppliers. The airline then has the flexibility to replace the individual components with either an updated version or an alternative without breaking the system in which the component operates.
- The future of airline retailing will bring more distribution channels, more online communities etc. (e.g. Datalex's client Air China sells tickets through the mobile messaging app, WeChat, and the business-to-consumer online marketplace, T-Mall). Airlines need more flexibility in the future, not less.

This is why we believe the most innovative airlines like JetBlue, Swiss etc choose Datalex rather than Sabre and Amadeus who we think do not and cannot provide the above.

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21 August 2015

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Overall Global Distribution (Banking Client*)			**Buy**	Total return of >10% in next 12 months
Buy	**Hold**	**Sell**	**Hold**	Total return >-10% and <+10% in next 12 months
68% (38%)	24% (5%)	8% (0%)	**Sell**	Total return <-10% in next 12 months

* Indicates the percentage of each category in the overall distribution that were banking and/or corporate broking clients

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