

No material change

Bytes delivered a better-than-expected set of financials for 1H24, with management pointing to a good start to 2H. The 1H outperformance naturally lends upward pressure to the full-year number. However, we keep our forecasts unchanged in light of growing evidence that a weaker macro is affecting peers. We maintain our Buy rating, based on the significant runway to gain market share and the company's commitment to investment to capitalize on this opportunity.

Positive 1H24: Gross profit and adj. operating profit came in c2/6% ahead of cons. The reported double-digit growth was broad-based across all product segments. During the quarters, Bytes won a number of large public contracts. Initial margins for these contracts when they are first onboarded are typically lower, given the competitive tendering process and upfront work. However, management is positive about improving the economics as the contracts mature, citing c20 past instances in which Bytes has seen profitability improve by year 2. Additionally, existing customer uptake remains strong, with avg. GP per customer up 10% YoY and stable customer satisfaction of 77. Cash flow followed the seasonal pattern in 1H, with management now expecting FY cash conversion > 100% (vs at FY23 prelim results expectation of "targeted 100%").

Continued investments: Similar to Softcat, Bytes has been taking advantage of a less competitive labor market and increased headcount 15% YoY during the period. It is worth noting that this followed a 2H23 that saw c20% growth, indicating management's conviction around the future and being able to capitalize on the opportunity.

Limited change in commission: Management believes there will be little to no change to the economics of vendor commission, specifically with regard to upcoming launch of Microsoft's Co-pilot in November. We think this is similar to the messaging from Softcat that while Co-pilot's pricing is likely to change over time, the overall contribution to resellers is positive and "a real opportunity".

Forecast change and valuation: Despite the 1H beat, we keep our forecasts unchanged (GP, adj. EBIT basis while adj. EPS is up 7% for FY24 given interest income) and take a conservative stance on the 2H development given recent remarks from peers around the impact of the macro on decision cycles. On valuation, we continue valuing Bytes on a DCF basis to capture the multiyear runway for growth. Given unchanged forecasts, we retain our PT of 560p and stay at Buy.

Chart 1 - Summary of forecast changes

£m, ex. per share	FY24E			FY25E			FY26E		
	Old	New	diff.	Old	New	diff.	Old	New	diff.
Gross profit	148	149	0%	168	168	0%	189	188	0%
% growth	14%	15%		13%	13%		12%	12%	
Adj. EBIT	62	63	0%	70	70	0%	78	78	0%
As % of GP	42%	42%		42%	42%		41%	41%	
Adj. EPS	18.94	20.20	7%	21.22	21.25	0%	23.66	23.70	0%

Source: Jefferies, Company data

(FY Feb)	2023A	2024E	2025E	2026E
Gross Profit	129.6	148.6	167.7	188.3
EPS	18.83	21.15	22.34	24.88
EV/EBIT	20.5x	18.3x	16.0x	14.6x
FY P/E	24.1x	21.5x	20.3x	18.2x

ESTIMATE CHANGE

RATING	BUY
PRICE	454.00p*
PRICE TARGET % TO PT	560.00p +23%
52W HIGH-LOW	548p - 353p
FLOAT (%) ADV MM (USD)	87.8% 226.64
MARKET CAP	£1.1B \$1.4B
TICKER	BYIT LN

*Prior trading day's closing price unless otherwise noted.

	CHANGE TO JEF		JEF vs CONS	
	2024	2025	2024	2025
REV	NA	NA	NA	NA
EPS	+6%	NM	NA	NA

2024 (p)	1 Half	2 Half	FY
EPS	-	-	↑21.15
PREV			19.91

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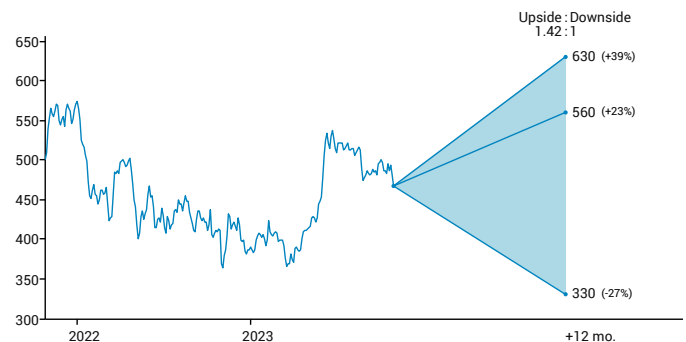
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The Long View: Bytes

Investment Thesis / Where We Differ

- We find supportive evidence that the quality and sustainability of Bytes's growth is improving as it continues focusing on increasing its share of customer wallet. Through vendor network expansion and further efficiency driven out of the salesforce, coupled with customers' priority on digitalization, Bytes is likely to lengthen its period of strong growth.
- Bytes's premium valuation is merited, in our view, given the opportunities for the company to sustain growth. We believe this is underpinned by its capital allocation policy, yielding a further step up in shareholders return.

Risk/Reward - 12 Month View



Base Case, 560p, +23%

- Bytes continues to increase its share of customer wallet, enabling it to increase gross profit per customer > 4% per annum over the next 3 years.
- Further improvement in productivity and lean cost structure allow Bytes to defend the current level of profitability, driving avg. 14% EBIT growth during the same period.
- 8.5% cost of capital, terminal growth 3%, implying a DCF-based PT of 560p.

Upside Scenario, 630p, +39%

- Initiatives to increase customer wallet share result in Bytes delivering faster than expected wallet share gains at > 6% over the next 3 years.
- Higher-than-expected wallet share gains drive better-than-expected salesforce efficiency, resulting in avg. EBIT growth of 20% during the same period.
- Terminal growth rate increases to 3.5%, cost of capital 8.5%, implying a DCF-based PT = 630p.

Downside Scenario, 330p, -27%

- UK IT investments go into a cyclical downturn, although partly offset by increased wallet share growth and gross invoiced income growth slows.
- To support future growth, Bytes continues to invest in headcount, resulting in downgrades to EBIT, growing < 10%.
- Terminal growth falls to 2% and the cost of capital increases to 10%, implying a DCF-based PT = 330p.

Sustainability Matters

Top ranked ESG issue: Employee engagement – Employees are the driving force of technology companies and, as a result, oversight of employee engagement, diversity, equality and the likes are a top focus.

Company target(s): 1) Foster an engaging work environment with two-way communication, 2) Increase talent diversity, equality and improve overall retention.

Questions to management:

1. What are the current policies in place to track the ongoing gender pay gap and to ensure gender equality across different levels of the company?
2. On diversity and inclusion, when Bytes sets out to hire people with beliefs that align with the company's vision, how do you avoid disqualifying people from different backgrounds?

Catalysts

- Major contract wins
- Major vendor partnerships

Income statement		2020		2021		2022		2023		2024E	
		1H	2H	1H	2H	1H	2H	1H	2H	1H	2H
Revenue	€mn	205.0	168.1	221.2	172.3	251.4	196.6	93.5	90.9	108.7	94.4
COGS	€mn	(165.1)	(128.8)	(174.8)	(129.2)	(198.5)	(142.1)	(28.0)	(26.8)	(33.4)	(21.2)
Gross profit	€mn	39.9	39.3	46.4	43.2	52.9	54.5	65.5	64.1	75.3	73.3
% margin		19%	23%	21%	25%	21%	28%	70%	69%	69%	77%
% growth				16%	10%	14%	26%	24%	18%	15%	14%
Admin expenses - adj.	€mn	(23.5)	(24.0)	(25.9)	(26.2)	(27.9)	(33.2)	(35.7)	(37.5)	(41.4)	(44.7)
As % of gross profit		59%	61%	56%	61%	53%	61%	54%	59%	55%	61%
Adj. operating profit		16.5	15.2	20.5	17.0	25.0	21.3	29.8	26.6	33.9	28.6
As % of gross profit		41%	39%	44%	39%	47%	39%	46%	41%	45%	39%
% growth				24%	11%	22%	26%	19%	25%	14%	8%
Share based payments	€mn			(0.2)	(0.8)	(1.0)	(1.5)	(1.7)	(2.5)	(2.9)	(2.9)
As % of gross profit				0.3%	1.9%	1.9%	2.8%	2.6%	3.9%	3.8%	4.0%
Intangible amortisation	€mn			(0.8)	(0.8)	(0.8)	(0.8)	(0.8)	(0.5)	(0.4)	(0.4)
Operating profit	€mn	16.5	15.2	19.5	7.3	23.2	19.0	27.3	23.6	30.6	25.2
As % of gross profit		41.3%	38.8%	42.1%	16.9%	43.8%	34.8%	41.7%	36.8%	40.6%	34.4%
% growth											
Finance income	€mn	0.1	0.1	0.0	(0.0)	0.0	(0.0)			2.9	
Finance cost	€mn	(0.0)	(0.0)	(0.0)	(0.2)	(0.3)	(0.3)	(0.3)	(0.2)	(0.2)	(0.3)
Net finance costs	€mn	0.0	0.0	(0.0)	(0.2)	(0.3)	(0.3)	(0.3)	(0.2)	2.6	(0.3)
Share of profit of associate										0.1	
Profit before taxes	€mn	16.5	15.3	19.5	7.1	22.9	18.7	27.0	23.4	33.3	24.9
% growth				18%	-53%	17%	162%	18%	25%	23%	7%
Reported tax expense	€mn	(3.1)	(2.7)	(3.8)	(3.0)	(4.6)	(4.2)	(5.3)	(4.6)	(8.0)	(6.2)
% tax rate		19%	18%	19%	42%	20%	22%	20%	20%	24%	25%
Deferred tax on intangibles + SBP									(0.8)		
Net income	€mn	13.5	12.6	15.8	4.2	18.3	14.5	21.7	18.7	25.4	18.7
Adj. net income	€mn			16.7	13.9	20.1	16.9	24.2	20.9	28.6	22.0
Average shares outstanding	mn			232.5	235.3	237.4	241.5	239.5	239.5	239.5	239.5
Diluted shares outstanding	mn			232.5	238.3	242.8	246.9	248.3	248.1	249.6	251.8
Basic EPS	p			6.78	1.77	7.71	6.02	9.06	7.81	10.60	7.80
Diluted EPS	p			6.78	1.75	7.54	5.89	8.74	7.54	10.17	7.42
Adj. basic EPS	p			7.19	5.89	8.48	6.99	10.11	8.72	11.95	9.21
Adj. diluted EPS	p			7.19	5.81	8.30	6.84	9.75	8.41	11.46	8.75

Source: Jefferies, Company data

Company Description

Bytes

Bytes is one of the UK's top 5 biggest value-added-resellers (VARs) of software, security, and cloud services. The company serves 5,000+ UK customers across a vendor base consisting of Microsoft (its biggest vendor), VMWare, Adobe, and Dell, among others. Growth delivered from FY19 until now has been all organic.

Company Valuation/Risks

Bytes

We value Bytes on a DCF basis, applying a 9% WACC and 3% terminal growth rate. Key risks: more-severe-than-expected macros, higher-than-expected competition, lower-than-expected returns on Bytes's growth initiatives, failure to develop a successful services offering, and term changes with vendors.

Adobe Inc.

Our \$660 price target is based on 26x EV/EBITDA (roughly at the historical average), applied to our estimates in 5-8 quarters. Risks include execution at scale, competitive marketing tech market, M&A integration, and subs not being immune to recessions.

Microsoft Corporation

Our Price Target of \$400 is based on a DCF. Key risks include the PC cycle and risks related to revenues and margins as MSFT transitions to the Cloud.

Softcat

Our DCF-based PT is based on a 8.5% WACC and 3.5% long-term growth rate. Key risks: lower-than-expected returns on Softcat's growth initiatives, failure to develop a successful services offering, and worse than expected macro.

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Investment Recommendation Record

(Article 3(1)e and Article 7 of MAR)

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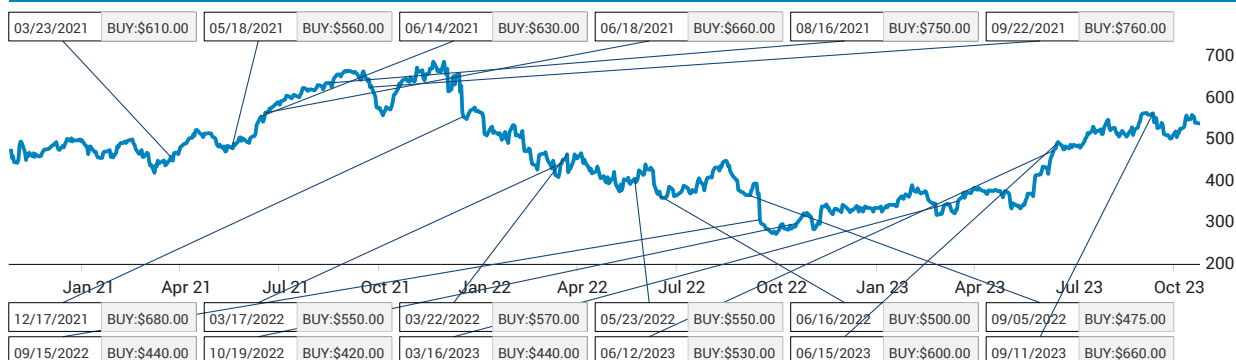
Other Companies Mentioned in This Report

- Adobe Inc. (ADBE: \$539.56, BUY)
- Microsoft Corporation (MSFT: \$330.53, BUY)
- Softcat (SCT LN: p1,238.00, BUY)

Rating and Price Target History for: Bytes Technology Group plc (BYIT LN) as of 10-24-2023



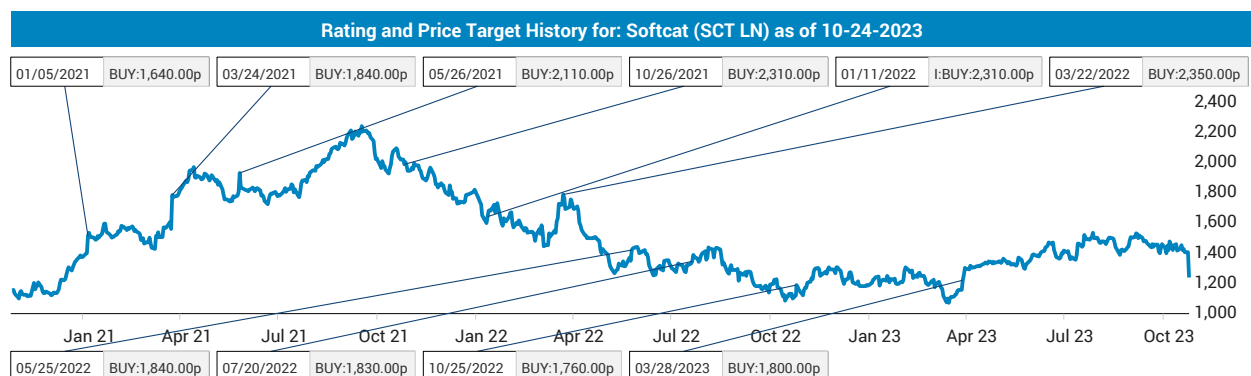
Rating and Price Target History for: Adobe Inc. (ADBE) as of 10-24-2023



Rating and Price Target History for: Microsoft Corporation (MSFT) as of 10-24-2023



Steven DeSanctis owns shares of Microsoft Inc. common shares.



Notes: Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

Distribution of Ratings

	IB Serv./Past12 Mos.		JIL Mkt Serv./Past12 Mos.	
	Count	Percent	Count	Percent
BUY	1892	58.78%	318	16.81%
HOLD	1182	36.72%	112	9.48%
UNDERPERFORM	145	4.50%	2	1.38%

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