

Stock Report

Stock of the Year 2024

Cerillion

London, U.K.

London Stock Exchange - CER.L



About

This question was by far the most asked question for all of January and is continuing well into February. As I am sure the majority of you are aware by now, the portfolio has been removed from within the MyWallSt App. It is now housed on its own separate web app, which is dynamic and runs very smoothly on both mobile and desktop browsers. You can find our reason for removing the portfolio in our help center.

Nutshell

The global telecommunications industry is estimated to be worth anywhere between \$1.5 to \$2 trillion. In 2023, Cerillion took in just shy of \$50 million in total sales. This should give you an inkling of the opportunity that lies in store for this specialist software provider. It is a pick-and-shovel play in one of the world's most lucrative markets, and we believe that it can continue to deliver high-margin growth for years to come as it wrests away market share from larger competitors and benefits from a tailwind of digital transformation amongst top telcos.

Cerillion earns 6/10 Nexus badges



10X

Potential for 10X growth.



Founding CEO

Led by their visionary founder.



Insider Ownership A-Lister: Gold

Over 30% Insider Ownership.



Pristine Financials

More cash than debt and a robust balance sheet.



Return on Equity

An exceptional return on equity spanning at least 3 of the last 5 years.

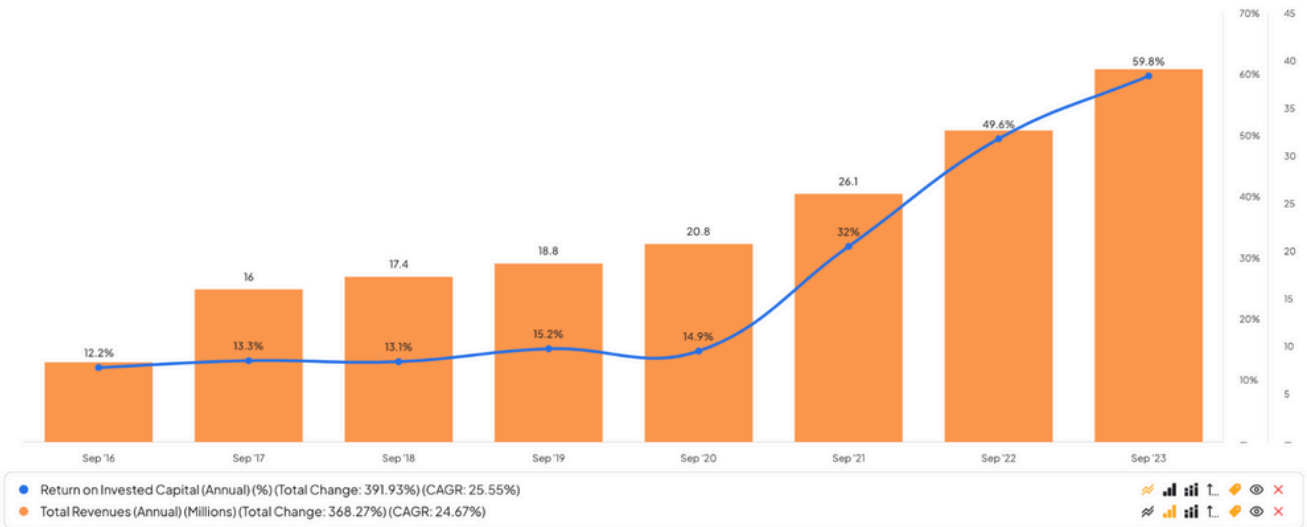


Risk Tamer: Medium

For investors seeking a balance between risk and reward, acknowledging moderate risk tolerance.

Cerillion Plc (CER)

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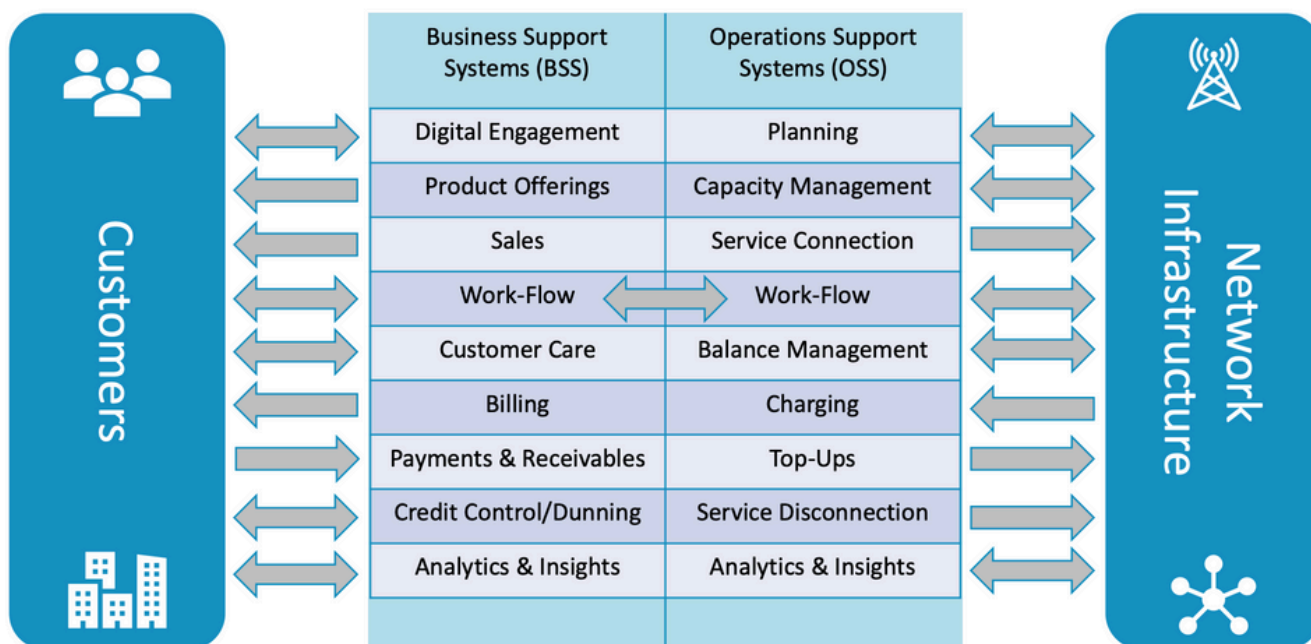
Key Takeaways

- **Revenue** (in orange) has really picked up in the last three years.
- **ROIC** (blue) has been wonderfully consistent and is currently sitting at best-in-class levels.

About

Cerillion was formed in 1999 when management bought out the Customer Care & Billing division of Logica. That management team identified an opportunity in the telecoms space for an end-to-end solution that would add value to its customers by being specifically tailored to their needs. While it has branched out to other markets since, the fact that it was custom-built for one particular vertical ensures that this specialist software company has a distinct competitive advantage.

So let's talk about the industry in question because it's no minnow. As stated in The Nutshell, depending on who you ask the telecoms market could be worth as much as \$2 trillion dollars and is made up of giants like Verizon, Vodafone, and Orange to name but a few. Obviously, businesses at this scale have a lot of moving parts, with one vital cog being a BSS (Business Support Systems) / OSS (Operating Support Systems) platform. While originally separate tools, they have been bundled together for years now and cover the entire ordering process, from order capture, CRM and billing to order management, inventory management and operations. Here's a snapshot:



With so many different operations being run on a platform like this, it really does become mission-critical software for its clients. This puts Cerillion in a great spot, as once its foot is in the door, it's awfully tough to get rid of them. These switching costs — just stop and imagine the hassle of changing an entire operating system for a business of 1,000+ employees — lead to added retention and steady revenue streams. This shows up in the numbers, with roughly 90% of revenue coming from existing customers. Not only that, but 80% of Cerillion's customer base has been with it for more than 5 years. In the fast-moving world of software, that is some seriously impressive retention. Add to this the growing tailwind of these telecoms investing in enterprise software to increase efficiency and cut costs and we're really getting somewhere.

But existing customers are not where we're going to see the explosive growth that could lead to a 10x investment. Cerillion has set its sights on bigger and better things, recently landing what it describes as a 'Tier 1 telco' contract with a global network, worth €12.4 million to the business. This deal indicates Cerillion's ability to expand its current reach and swim upstream to a pool of much larger customers. We've seen this strategy work wonders in similar industries. Paycom is a shining example in HR software, in which it originally set out to target clients industry incumbent ADP deemed too small, before moving upstream and slowly stealing away market share from its larger competitor. If Cerillion could follow this path, we'd be laughing.

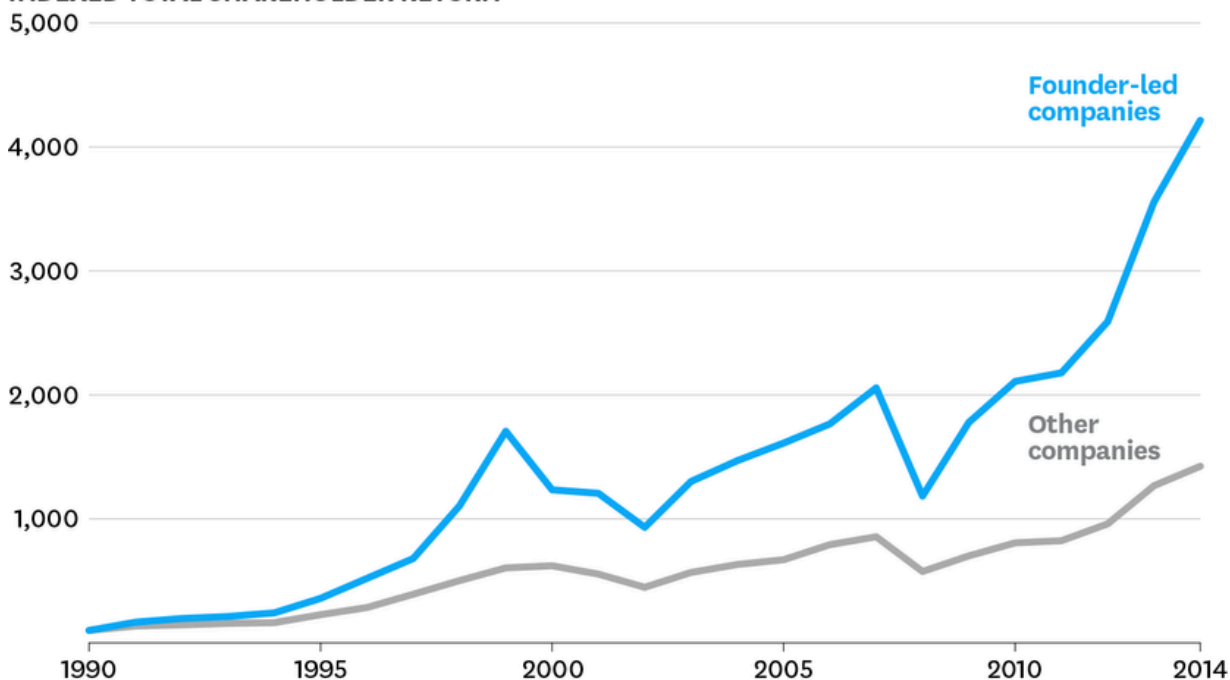
Founder/CEO

It is statistically proven that public companies with the founder as its CEO perform better on the stock market than those without. That is why it is a key element to our Nexus scoring system. Founder/CEOs are proven time and again to operate with a long-term vision in mind and to have their values closely aligned with those of shareholders because they're usually the largest shareholder themselves. This avoids the dreaded short-termism that is found with career CEOs whose incentive scheme may not be oriented for the long term. While there are no silver bullets in investing, finding high-quality businesses with a founder still at the helm is a bit of a cheat code.

Founder-Led Companies Outperform the Rest

Based on an analysis of S&P 500 firms in 2014.

INDEXED TOTAL SHAREHOLDER RETURN



SOURCE BAIN & COMPANY

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In Louis Hall, Cerillion is in good hands. He owns roughly 30% of the business and has led it since its inception in 1999. His tenure as a public CEO has brought nothing but success for the company and its investors and in spite of the quarter of a century he's spent at the top spot, he is continuing to innovate. Generative AI is the new hot topic across the board, and it is one being championed by Hall & Co. as Cerillion tries to make waves with larger clients.

A recent innovation, Cerillion just wowed the crowd at MWC Barcelona in March — the telecoms industry’s largest annual trade show — with its generative AI capabilities. Incorporating this technology into its BSS/OSS platform allows users to use natural language to create new workflows, product sets, and packages. This can vastly improve the company’s time-to-market for new product offerings and could be a big competitive advantage as Cerillion sets its eyes on clinching more Tier 1 clients.

Checking In on the Financials

We’ve talked about what makes the business tick, but let’s look under the hood. Numbers-wise, there’s an awful lot to like about Cerillion. As with any high-quality software business, we can expect high gross margins — just shy of 80% in this case — but it manages its bottom line exceptionally to deliver an EBITDA margin of 42% and a net margin of 33% in 2023. Returns on capital are best-in-class — ROE 40% and ROIC 60% — and it boasts plenty more cash than debt on its balance sheet. It also has a consistently growing dividend to boot.

In its most recent shareholder update, management gave us an insight into performance for H1 in fiscal 2024. Revenue and profits both grew 10% year-on-year with the team confident that it will meet market expectations thanks to the favourable trading environment brought on by telcos shifting to SaaS options and embracing their digital transformations to increase efficiency.

Nexus Factor

Cerillion’s returns on capital are exemplary, as is its insider ownership, which is unsurprising given Louis Hall’s presence as CEO. It is right on the edge of being overvalued, however, the rate at which it has grown earnings in the past can go some way to validating its premium price. Historically, revenue growth has been a bit choppy which has led to a few marks falling by the wayside, but with an 86 on the Nexus Score, this is clearly a high-quality business.

Concerns & Risks

Customer concentration

This is a major concern for Cerillion, with its top customer contributing 20% of total revenues in 2023 and its top 5 contributing 60%. Any disruption to those contracts could lead to a serious hit to the business. Of course, we’ve discussed at length the scale of its clients and it only has a customer base of 80 in total so these numbers might seem more sensational than they really are, but there is a clear over-reliance on its top customers.

Buyer power

Because Cerillion relies so heavily on its top clients, it does put it on the hind foot when it comes to negotiations. It is one of Michael Porter's Five Forces and leads to its large, influential customers being able to garner discounts or additional services much easier than we would like.

Valuation

Cerillion is an expensive stock on a price/earnings basis. When we take into account how fast it continues to grow earnings it becomes more palatable, but any deceleration will exacerbate the sell-off. Its premium valuation means expectations are elevated.

Competition

As the company eyes up larger clients, it will go up against much heavier hitters in the likes of Ericsson, Nokia, Huawei, and Oracle. Resource-wise, Cerillion can't compete. However, it is more agile and the telecom industry is its core vertical, which could be enough to give it an edge and make it a niche player in this huge market.

Discovery and Research

This stock was first discovered through research conducted for our Charging & Fearless newsletter. It then passed all the checks from our Nexus screener. We assigned it a 10x badge which may be ambitious, but if it continues to execute as it has been, the sky's the limit. It was assessed using the Nexus weighting algorithm, scoring 86 out of 100. The MyWallSt analyst team produced this write-up.

Exchange rate used: £1.00 = \$1.25