

**DATALEX**

Whenever I meet a company for the first time my main priority is to try to work out whether or not that company has some sort of competitive advantage. If I am unable to get my head around that particular issue, I tend to give that company no more of my time and move on to giving time to a company where I can answer that question. When Datalex was launched on the stock market back in October 2000 I attended a presentation given by their management at the offices of Goodbody Stockbrokers and naturally enough I was trying to answer that critical question and work out if they had some sort of competitive advantage. Whatever was said that day or whatever was in the presentation meant that I felt I was unable to identify if they had anything that could keep the competitors at bay. I therefore did not take things any further. I did not go on and do any detailed analysis and I did not consider investing. I just moved on to the next company.

In the years between that initial meeting in 2000 and the autumn of 2018 I did not give Datalex any real attention. It was only in late 2018 when I was asked by a Datalex shareholder (a good friend of a good friend) if I had an opinion as to whether it was a good investment, that I gave it some consideration.

They said that Dermot Desmond being a major shareholder had been a significant part of their decision to invest. In other words, they had not identified any competitive advantage from doing any analysis themselves. They hoped that following Dermot would be a successful strategy.

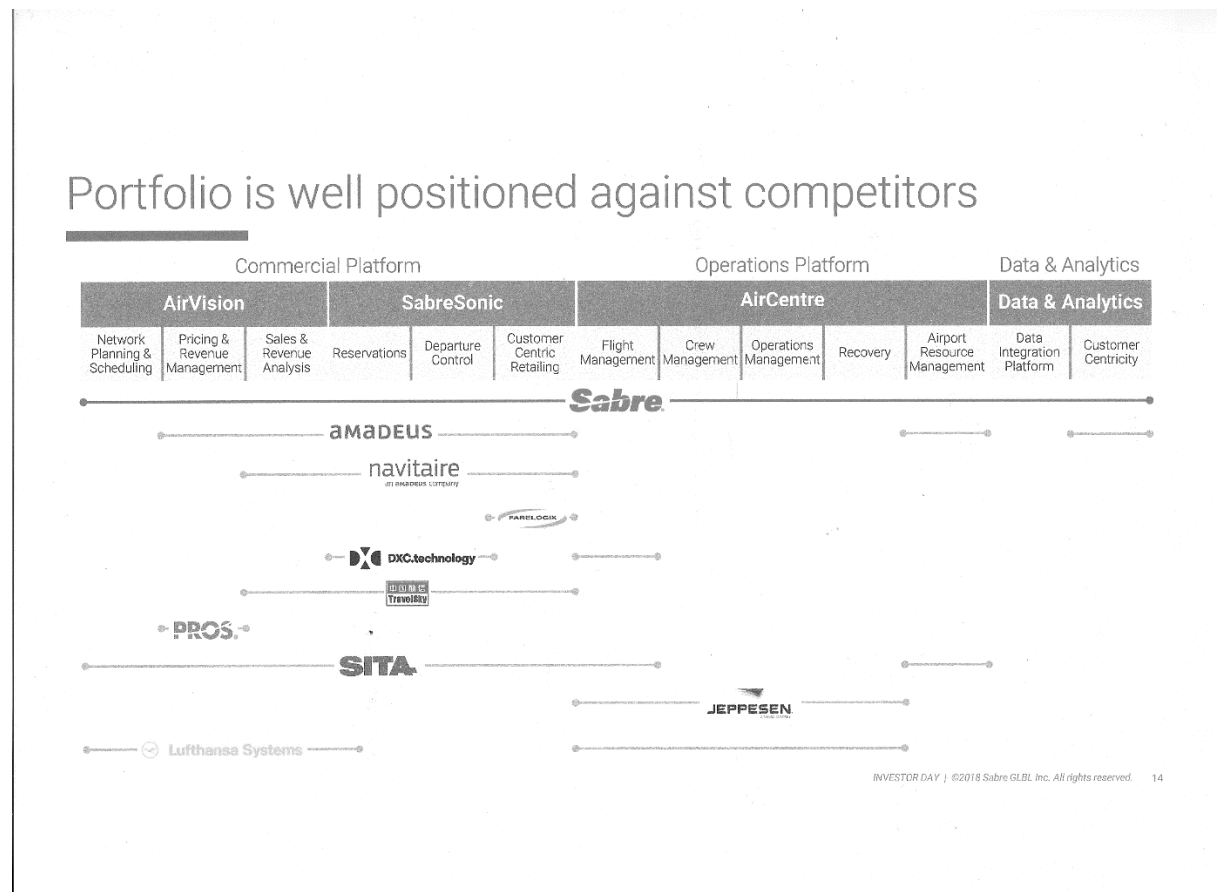
I said that I would do an initial look and report back on my findings but I emphasised that I might not be in a position to give any opinion let alone a strong opinion because there are plenty of times where I have to say to people that I do not know.

An initial look involved reading the Datalex annual report and looking at company presentations as well as looking at the information that was available on their major competitors. The major competitors being Sabre and Amadeus.

I immediately realised that I would normally put these companies in the “too hard to understand” category because I really could not understand what was going on but I decided to do a little bit of work because I felt obliged to try to have something useful to say. The only thing I could think of was to do a simple comparison of the three companies and this is what I came up with:

2017	DATALEX	SABRE	AMADEUS
Revenue \$m	64	3600	5000
Employees	300	9000	16800
R&D spending \$m	13	370	400
Market Cap \$bn	0.35	6	30

The only thing that this analysis showed was that Datalex was tiny in comparison to the major competitors. Smaller revenues, fewer employees and much less spending on research. How could Datalex possibly compete? In such a situation a small company generally tries to find a niche that the big competitors do not do well. I tried to find some evidence of such a niche from the Datalex material but to be honest I could not reach any conclusion as to whether they dominated any particular sub sector. This is where I was hitting a wall. I was unable to understand exactly what was going on. I did however find the following chart on the Sabre website from their 2018 investor day:



I looked at the above chart expecting to see Datalex identified as being a competitor in one or two of the areas mentioned (for example, pricing and revenue management) but it appears as if Sabre don't identify them as a competitor. This added to my confusion as to whether Datalex had managed to find a niche. (It also highlighted that there are other small players that Sabre does identify as being competitors and that I haven't even heard of.)

As I had once again reached the point where I wanted to put Datalex in the "too difficult to analyse" category I decided to report my findings back to the shareholder. I told him I was worried because I could not identify anything where Datalex was a clear leader and I was also worried by the sheer size of the leading players. I also acknowledged that this was such a short and superficial analysis that I might be missing something. I said that what was really needed was to find somebody with industry expertise. Perhaps a former employee of Datalex or one of the competitors, or an employee in one of their customers like Aer Lingus, or somebody writing for a trade magazine.

The shareholder listened to what I had to say and thanked me for having even done that amount of research and he then said that there was no need to take it any further. I was relieved to hear him say this because I guessed it would be really difficult to find somebody with the necessary industry expertise.

We therefore left it at that and I honestly thought that it might be another eighteen years before I had reason to look at Datalex again so I have to admit that I was taken aback when the news of accounting irregularities in Datalex hit the market earlier this year. It felt a bit weird that I hadn't looked at the company for eighteen years and then a few months after I had a quick look, they ended up hitting the headlines for all the wrong reasons.

From what I have read it seems as if a major project they were working on for Lufthansa ran into difficulties. This project was a multi-year project and was supposed to be delivered in stages. Revenue was recognised before any of the stages had been completed and delivered to Lufthansa.

I can only imagine the atmosphere in the company as the realisation dawned on everyone that the project was not going to plan. What I don't know is who knew what and when. As there is potentially a legal action being taken, we might get to hear everything if it ends up in court but there is a good chance it might remain a mystery.

I decided to go back and have a quick look at the 2017 annual report to see what was said at the time. From reading the audit committee report it became clear that they were aware of the importance of this particular project:

The Committee has given consideration to the fact that for fixed fee large deployment projects, which extend over long periods, the determination of stage of completion can be complex. The Group's management team has exercised their judgement on the stage of completion of certain large projects based on the time incurred, the work performed and project stages achieved at yearend, as well as the estimate of effort and hours to completion. The Committee has discussed the underlying significant judgements and estimates supporting the accrued income calculation with management and concur with management's assessment thereof.

The Audit Committee has also discussed the increase in the balance of accrued income at year-end with a focus on one large balance which accounts for 66% of the total unbilled balance at year-end and developed an understanding of the underlying reasons and projects underpinning this increase in accrued income.

Having read the above I believe that there was no possible way that an ordinary shareholder could have had any reason for concern beyond the normal concerns related to any big project. The audit committee were on top of the issue and they were satisfied, so there was no way that I could have seen a problem.

Conclusion

Any shareholders that bought Datalex shares in recent years have in all likelihood suffered a permanent loss on their investment. This is the real definition of stock market risk and is the reason why a prudent level of diversification is so important for all investors.