

Sage Group

Price 610.00p

Q1 FY16 conference call feedback: with the help of currencies

Fair Value 570p vs. 550p (-7%)

NEUTRAL

Bloomberg	SGE L
Reuters	SGE.LN
12-month High / Low (p)	614.0 / 461.9
Market Cap (GBP)	6,582
Ev (BG Estimates) (GBP)	6,727
Avg. 6m daily volume (000)	2 258
3y EPS CAGR	8.1%

We are reiterating our Neutral recommendation have raised our DCF-derived Fair Value to 570p from 550p after updating our forward fx assumptions (GBP/EUR: 1.31 vs. 1.36; GBP/USD: 1.42 vs. 1.48) to increase our revenue and adj. EPS forecasts by 2% (+10p/share) and making some adjustments to our WCR ests. (+10p). Besides fx tailwinds, Q1 FY16 was helped by easy comps and we doubt lfl revenue growth will accelerate at least during the next two quarters given the faster switch to subscriptions.

ANALYSIS

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.3%	13.8%	17.2%	1.1%
Softw. & Comp.	-1.4%	3.4%	5.6%	-2.3%
DJ Stoxx 600	-7.1%	-8.5%	-11.8%	-7.0%

YEnd Sept. (£m)	09/15	09/16e	09/17e	09/18e
Sales	1,436	1,525	1,635	1,752
% change		6.2%	7.2%	7.2%
EBITDA	418	444	480	520
EBIT	297.2	295.8	431.5	472.1
% change		-0.5%	45.9%	9.4%
Net income	283.9	295.6	326.6	358.4
% change		4.1%	10.5%	9.7%

	09/15	09/16e	09/17e	09/18e
Operating margin	27.1	27.6	27.9	28.4
Net margin	13.5	13.2	18.6	19.1
ROE	22.5	22.2	28.9	27.5
ROCE	25.2	32.5	34.0	39.2
Gearing	39.6	15.9	-4.9	-22.5

(p)	09/15	09/16e	09/17e	09/18e
EPS	25.29	26.32	29.07	31.91
% change	-	4.1%	10.5%	9.7%
P/E	24.1x	23.2x	21.0x	19.1x
FCF yield (%)	4.3%	4.7%	5.2%	5.7%
Dividends (p)	13.10	13.76	14.44	15.16
Div yield (%)	2.1%	2.3%	2.4%	2.5%
EV/Sales	4.8x	4.4x	4.0x	3.6x
EV/EBITDA	16.6x	15.1x	13.6x	12.1x
EV/EBIT	17.8x	16.0x	14.3x	12.7x

- Q1 growth helped by easy comps.** The 6.6% lfl revenue growth in Q1 FY16 was driven by the switch to subscriptions (+35.7% lfl) at the expense of SSRS (-5.5% lfl). From a geographical standpoint, France and the UK led growth followed by Africa, North America was in line with the FY15 trend, Brazil continued to grow double-digit in software but slowed down in content, while Asia Pacific slowed. Now one third of the 10.4% lfl recurring revenue growth stems from price increases (vs. 50% previously): it is becoming driven by the move to subscriptions for contract reactivation with existing customers, while new customer acquisition is unlikely to become a significant driver before next year or beyond. Subscription growth was primarily driven in the UK and the US on Sage 50 (small business). On Sage One (entry level), momentum is pretty similar to that of FY15, and improving in the US but from very small numbers.
- Tougher comps in Q2 FY16 for SSRS.** 6.6% lfl revenue growth in Q1 seemed to be at the high-end of the range expected for the full-year (at least +6%) given easy comps in Q1 FY15 but which are set to become more difficult in coming quarters (+5.3% lfl in Q1 FY15, +7.1% lfl in Q2, +7.5% in Q3 and +7% in Q4). In addition, Q2 FY15 was inflated by GBP4m in regulatory licence sales in Malaysia, with management acknowledging that the SSRS revenue decline is likely to be bigger in Q2 FY16 than it was in Q1. The 5.4% lfl growth in Processing for Q1 remains below Sage's medium-term ambition, despite the fact that Payments in the US returned to growth and may reach high-single digit growth by the end of H1 and double-digit growth over the longer term.
- Confident in an organic operating margin of 27% for FY16.** The fixed cost base has been set for 6% lfl sales growth, while variable costs depend on the prospect of accelerating above 6%. Sage did not comment on the plan to save GBP50m in costs for FY16, but is investing in sales channels and this could burden the margin somewhat in H1. At this stage: 1) In digital marketing, Sage has invested in two customer business centres (Atlanta and Dublin), first for the launch of Sage Live (business management software based on the Salesforce1 platform), with Sage One likely to be next, while it is looking at opening another centre in the International region; 2) the group has invested in the regions in order to drive local products, Sage Live, and building up the pipeline on Sage ERP X3 for the mid-market - which looks to be a bit below expectations due to a lengthening of sales cycles on licences probably due to the general economic environment.
- Small acquisitions or returning cash to shareholders.** Concerning cash usage, management remains focused on small 'bolt-on' acquisitions rather than big ones. However, if no M&A prospects emerge as Sage approaches the fiscal year end, there could be some scope for launching a share buy-back programme or increasing the dividend.

VALUATION

- Sage's shares are trading at est. 16.0x FY16 and 14.3x FY17 EV/EBIT multiples.
- Net debt on 30th September 2015 was GBP341.6m (net gearing: 40%).

NEXT CATALYSTS

AGM on 1st March. H1 FY16 results on 5th May before markets open.

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