

Software AG

Price EUR33.14

From value to growth (FOCUS report released today)

Fair Value EUR38 vs. EUR34 (+15%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	33.5 / 23.8
Market Cap (EURm)	2,618
Ev (BG Estimates) (EURm)	2,490
Avg. 6m daily volume (000)	254.5
3y EPS CAGR	3.7%

We raise our DCF-derived fair value to EUR38 from EUR34 on an increase to our medium-term adj. EBIT margin assumption (to 35% from 33% = +EUR2/share) and an update to our WCR ests. (+EUR2/share). The meetings held at our TMT conference confirmed that the sales transformation led by Eric Duffaut has started to bear fruit, gradually raising Software AG's stock market status to "growth" from "value".

ANALYSIS

- Digital Business Platform (DBP) starting the upturn.** Q4 15 has been the first quarter with double-digit lfl DBP licence sales growth since 2013. Software AG reaps the benefits of the sales transformation it underwent a year ago under the management of Eric Duffaut. All the performance indicators speak for themselves. Software AG now boasts a win rate of 1:1 by selling use cases instead of 1:3 by selling products, although there is a lot to be done as use cases only account for 20% of deals.
- Adabas & Natural still to be there for long.** The resilience of A&N revenues is no longer surprising as Software AG focuses a lot on customer retention. Customers in the installed base are not left behind. Management is confident A&N will deliver for 2016 a business line margin close to the 70% reported for 2015.
- Reiterated confidence in 2020 targets.** FY16 company guidance (DBP sales up 5-10%, A&N sales down 4-8%, non-IFRS operating margin of 30-31%) brings more confidence to be on track for achieving the 32-35% target set a year ago for 2020: 1). Most of the non-IFRS operating margin increase for 2020 is expected to stem from DBP maintenance; 2). R&D costs will continue to increase at a lower rate than R&D headcount; and 3). In the medium-term, A&N could still have a margin in the high 60s.
- Always prepared for acquisitions.** Over the past two years, Software AG made no acquisitions as prices were too high. However, management estimates there are signs that prices are coming down for unlisted companies. Software AG is prepared and is working with banks to increase financial flexibility to buy using cash, not shares. If no acquisition occurs, share buy-backs (3.5% up to now, potential: 10%) will resume.

VALUATION

- Software AG's shares are trading at est. 9.1x 2016 and 8.1x 2017 EV/EBIT multiples.
- Net debt on 31st December 2015 was EUR13.9m (net gearing: 1%).

NEXT CATALYSTS

Q1 16 results on 26th April before markets open.

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Analyst :
 Gregory Ramirez
 33(0) 1 56 68 75 91
gramirez@bryangarnier.com

Sector Team :
 Richard-Maxime Beaudoux
 Thomas Coudry
 Dorian Terral

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London	Paris	New York	Geneva	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	rue de Grenus 7	The Imperial Hotel
15 St. Botolph Street	75008 Paris	New York, NY 10022	CP 2113	Janpath
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Genève 1, CH 1211	New Delhi 110 001
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	Tel +4122 731 3263	Tel +91 11 4132 6062
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member	Fax+4122731 3243	+91 98 1111 5119
Authorised and regulated by the	Financial Conduct Authority (FCA) and		Regulated by the	Fax +91 11 2621 9062
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