

Software AG

Price EUR34.05

Q1 16 conference call feedback: leeway for upward revisions

Fair Value EUR40 vs. EUR39 (+17%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	34.9 / 23.8
Market Cap (EUR)	2,690
Ev (BG Estimates) (EUR)	2,555
Avg. 6m daily volume (000)	262.8
3y EPS CAGR	4.7%

We reiterate our Buy rating and increase our DCF-derived fair value to EUR40 from EUR39 following the conference call held yesterday. We raise our non-IFRS operating margin forecasts to 31.4% from 30.7% for 2016, to 31.9% from 31.6% for 2017, and to 32.5% from 32.2% for 2018. We are now convinced Software AG will raise FY16 non-IFRS operating margin guidance (currently 30-31%) in the course of the year, as Q1 A&N sales exceeded expectations and DBP sales productivity surged.

ANALYSIS

- Digital Business Platform (DBP): confident of 5-10% lfl product revenue growth.** The sales pipeline remains strong, including +20% on the deals above EUR1m, and bigger mid-sized deals, while cloud order entry was up 155%. The c. EUR3m shortfall on DBP sales is not a concern as it is related to a large deal with a South African firm which slipped and was replaced by a deal of similar value on Adabas & Natural. Excluding this deal, DBP product revenues would have been up an est. 9% lfl (o/w an est. +17% lfl on licence sales). The EUR3m DBP deal is still in the pipeline and planned to close in Q2. Software AG delivered a tremendous quarter on DBP licence sales in the US (+14% lfl), Germany (+19% lfl) and the UK (+17% lfl), and Iberia, Eastern Europe, Asia, South Africa and even Brazil delivered 2-digit growth. France, Italy and the Middle East underperformed in Q1, but more due to a weak pipeline after a strong Q4 15 than to economic concerns - Australia as well due to execution issues, but leadership changes should help for a turnaround.
- A&N (Adabas & Natural) sales trends clearly ahead of full-year guidance.** Excluding the EUR3m deal closed earlier than expected in South Africa, we estimate A&N product revenues in Q1 16 would have been up c. 15% lfl instead of the 20% lfl reported. That said, if Software AG looks to have actually benefited from its announcement to support A&N products beyond 2050, the trend looks ahead of schedule while company guidance for A&N product revenues for 2016 is -8%/-4% lfl. Management recognised during the call that if the trend remains ahead of company guidance after Q2 16 results, that full-year guidance may prove to be conservative.
- Room for upward revision for non-IFRS operating margin.** Management acknowledges that, given the advance taken in Q1 16 on the non-IFRS operating margin (+3.9ppt) while FY16 guidance is 30-31% (+0.3ppt/+1.3ppt vs. 2015), the latter could be reviewed if the trend is confirmed in Q2. Cost optimisation on sales & marketing is visible (-11% lfl in Q1 16 on DBP, while sales productivity surged by 30%), the restructurings initiated in Q3 15 will provide strong leverage on the margin until Q3 16. In addition, the 4ppt decline of the Consulting margin to 4% in Q1 16 is due to restructurings (EUR2m out of the EUR4m reported in the quarter). Instead, we estimate the Consulting business line margin would have been flat or slightly growing at c. 8%.
- Update on M&A.** Software AG is still committed on its use of cash: M&A, dividends, and/or share buy-backs. Even if there is no deal on the table immediately, M&A priorities remain oriented towards technology extension (real-time analytics, Internet of Things, Industry 4.0), new adjacent areas, and/or bigger targets in order to complete the solutions portfolio. Management confirms that there are signs of prices coming down (some companies struggle to leverage their buyouts, stock markets down) for unlisted companies, which may provide M&A opportunities.

	1 M	3 M	6 M	31/12/15
Absolute perf.	5.4%	26.7%	33.3%	28.9%
Softw. & Comp.	1.1%	-1.3%	9.2%	-3.7%
DJ Stoxx 600	0.2%	-0.5%	-4.3%	-6.2%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	873.1	889.5	915.1	956.2
% change		1.9%	2.9%	4.5%
EBITDA	278	290	305	323
EBIT	209.4	234.6	254.2	274.5
% change		12.0%	8.4%	8.0%
Net income	188.0	192.0	202.3	215.8
% change		2.1%	5.4%	6.7%

	2015	2016e	2017e	2018e
Operating margin	30.2	30.9	31.7	32.3
Net margin	16.0	17.4	18.6	19.3
ROE	12.8	12.9	12.8	12.2
ROCE	17.7	18.7	20.1	21.9
Gearing	1.3	-11.2	-22.0	-33.7

(€)	2015	2016e	2017e	2018e
EPS	2.33	2.38	2.51	2.67
% change	-	2.1%	5.4%	6.7%
P/E	14.6x	14.3x	13.6x	12.7x
FCF yield (%)	6.4%	7.1%	7.7%	8.1%
Dividends (€)	0.55	0.60	0.65	0.70
Div yield (%)	1.6%	1.8%	1.9%	2.1%
EV/Sales	3.1x	2.9x	2.6x	2.3x
EV/EBITDA	9.7x	8.8x	7.9x	6.7x
EV/EBIT	10.3x	9.3x	8.3x	7.1x



VALUATION

- Software AG's shares are trading at est. 9.3x 2016 and 8.3x 2017 EV/EBIT multiples.
- Net debt on 31st December 2015 was EUR13.9m (net gearing: 1%).

NEXT CATALYSTS

Final 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	Munich	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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