

10th May 2016

TMT

Software AG

Price EUR33.76

French Flair at work (full report released today)

Fair Value EUR40 (+19%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	34.9 / 23.8
Market Cap (EUR)	2,667
Ev (BG Estimates) (EUR)	2,548
Avg. 6m daily volume (000)	246.6
3y EPS CAGR	4.6%

We are reiterating our Buy rating and DCF-derived Fair Value of EUR40. We estimate that the positive momentum generated over the past 18 months by the new Chief Customer Officer, Eric Duffaut, is gradually changing Software AG's status from a value stock to a growth stock, with the target of delivering a margin of 32-35% in 2020.

ANALYSIS

- Positive momentum.** The arrival of Eric Duffaut as Chief Customer Officer at the end of 2014 (previously at SAP and Oracle) has so far enabled Software AG to improve its sales productivity by 30%. The strategy rolled out since early 2015 has delivered convincing results with a return to growth in the Digital Business Platform business (DBP), a 2015 non-IFRS operating margin of 29.7% well above the initial target, and five quarters in a row of higher than consensus earnings.
- Transformation far from complete.** The second part of the strategy consists of transforming the sales approach in order to step up growth by 2018: sales of business solutions, expanding the ecosystem of partners and extending sales coverage. In our view, this should lift organic growth to almost 6% in 2020 thanks to an acceleration in sales growth from the digital business platform.
- 2016 has started out ahead of targets.** Software AG reported Q1 2016 sales up 8.8% lfl and non-IFRS EBIT margin up 3.9 points. We estimate that 2016 margin guidance for 30-31% is cautious since it now implies a stable level for the last three quarters of the year. As such, if guidance is exceeded in 2016, we would be confident in the group's ability to deliver the top end of the 32-35% range in 2020

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.4%	16.2%	26.8%	27.8%
Softw. & Comp.	0.7%	7.3%	-2.6%	-4.9%
DJ Stoxx 600	0.4%	7.7%	-11.3%	-8.9%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	873.1	887.7	917.6	959.8
% change		1.7%	3.4%	4.6%
EBITDA	278	286	302	322
EBIT	209.4	233.3	255.2	277.2
% change		11.4%	9.4%	8.6%
Net income	188.0	189.7	200.1	214.9
% change		0.9%	5.5%	7.4%

	2015	2016e	2017e	2018e
Operating margin	30.2	30.6	31.3	32.0
Net margin	16.0	17.3	18.6	19.4
ROE	12.8	12.8	12.9	12.8
ROCE	17.7	18.2	19.5	21.4
Gearing	1.3	-9.9	-20.9	-30.6

(€)	2015	2016e	2017e	2018e
EPS	2.33	2.35	2.48	2.66
% change	-	0.9%	5.5%	7.4%
P/E	14.5x	14.4x	13.6x	12.7x
FCF yield (%)	6.5%	7.1%	7.6%	8.3%
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	9.6x	8.9x	7.9x	6.9x
EV/EBIT	10.2x	9.4x	8.3x	7.2x

VALUATION

- Still attractively valued.** Despite a rebound of more than 80% since October 2014, Software AG is trading on 2016e and 2017e EV/EBIT multiples of 9.4x and 8.3x respectively, implying a discount of around 40% relative to the average of major European software publishers
- Net cash position on 31st March 2016 was EUR49.1m (net gearing: -4%).

NEXT CATALYSTS

- AGM on 31st May.
- Q2 16 results on 20th July 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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