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14th July 2016

BG's Wake Up Call

SOFTWARE AG

BUY, Fair Value EUR40 (+28%)

Preliminary Q2 16 results way above expectations, FY16 guidance raised

Yesterday evening Software AG pre-announced Q2 16 results way above expectations with a non-IFRS operating margin of 27.4% (+3.8ppt) while we expected 24.1% and the consensus was at 24.8%, thanks to higher sales efficiency - sales and marketing costs fell 11% lfl (o/w -15% lfl for the Digital Business Platform division). While DBP revenue growth expectations are left unchanged, FY16 company guidance is upped for A&N revenue growth (to -6%/-2% lfl from -8%/-4% lfl) and non-IFRS operating margin (to 30.5-31.5% from 30-31%). We expect the share price to react positively.

	Last close	Daily chg (%)	Chg YTD (%)
Indices			
Dow Jones	18347.67	+0.66%	+5.29%
S&P 500	2152.14	+0.70%	+5.29%
Nasdaq	5022.82	+0.69%	+0.31%
Nikkei	16095.65	+2.46%	-15.44%
Stoxx 600	336.262	+1.07%	-8.08%
CAC 40	4331.38	+1.57%	-6.59%
Oil /Gold			
Crude WTI	46.8	+4.56%	+25.81%
Gold (once)	1342.44	-1.26%	+26.36%
Currencies/Rates			
EUR/USD	1.10695	+0.21%	+1.90%
EUR/CHF	1.09335	+0.69%	+0.55%
German 10 years	-0.092	-44.38%	-114.55%
French 10 years	0.188	+46.73%	-80.80%

Economic releases :

Date	
14th-Jul	GB - BoE rate Decision
	US - Continuing claims (2140K E)
	US - Initial Jobless claims

Upcoming BG events :

Date	
1st-Sept	L'OREAL (BG Paris roadshow with CFO)
8th-Sept	ACCOR (BG Roadshow with CFO)
13th-Sept	Thematic Breakfast with ARCEP
14th-Sept	SAINT GOBAIN (BG Luxembourg roadshow)
22nd-Sept	Thematic Lunch with HC specialist
28th-Oct	IMERYS (Paris roadshow)

Recent reports :

Date	
13th-Jul	Oncology is an increased focus
12th-Jul	DANONE No redemption
1st-Jul	UBISOFT Same player shoot again?
29th-Jun	ORANGE : Lights are turning green.
24th-Jun	Back from ADA 2016: Update on T2D treatments
22nd-Jun	AXA Ready for the next run

List of our Reco & Fair Value : Please click here to download



TMT

Software AG

Price EUR31.13

Preliminary Q2 16 results way above expectations, FY16 guidance raised

Fair Value EUR40 (+28%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	34.9 / 23.8
Market Cap (EURm)	2,459
Ev (BG Estimates) (EURm)	2,339
Avg. 6m daily volume (000)	249.8
3y EPS CAGR	5.1%

Yesterday evening Software AG pre-announced Q2 16 results way above expectations with a non-IFRS operating margin of 27.4% (+3.8ppt) while we expected 24.1% and the consensus was at 24.8%, thanks to higher sales efficiency - sales and marketing costs fell 11% lfl (o/w -15% lfl for the Digital Business Platform division). While DBP revenue growth expectations are left unchanged, FY16 company guidance is upped for A&N revenue growth (to -6%/-2% lfl from -8%/-4% lfl) and non-IFRS operating margin (to 30.5-31.5% from 30-31%). We expect the share price to react positively.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.0%	-7.5%	19.3%	17.8%
Softw. & Comp.	-0.6%	0.5%	-2.8%	-4.8%
DJ Stoxx 600	1.0%	0.5%	-2.0%	-8.1%

ANALYSIS

Q2 16 results way above expectations. Based on preliminary figures, Q2 16 sales were down 1.1% (+2.1% lfl) to EUR203.4m, or 1% above our forecast (EUR203.1m) and in line with the consensus (EUR202.9m). Non-IFRS operating profit was up 14.8% to EUR55.8m or 27.4% of sales (+3.8ppt) or 15% above our estimate (EUR48.7m or 24.1%) and 11% ahead of the consensus (EUR50.4m or 24.8%). IFRS EBIT was up 30.4% to EUR43.3m (BG est.: EUR38m; consensus: EUR39.6m), and net profit was up 41.7% to EUR28.2m (BG est.: EUR24.8m; consensus: EUR25.6m). Licence sales were down 6% lfl to EUR49.6m or 6% below our est. (EUR52.7m) and the consensus (EUR53m), while maintenance was up 3.9% lfl to EUR103.1m (BG est.: EUR101.9m; consensus: EUR101.2m). Finally, in the press release the management mentions a record free cash flow.

Details by division. 1). For the Digital Business Platform (DBP) division, Product sales were up 0.7% (+4% lfl) to EUR100.5m (BG est.: EUR105.1m, consensus: EUR103.3m), of which EUR38m (+4% lfl) in licences and +3% lfl on maintenance, while the business line margin was up 9.1ppt to 28.5% (BG est.: 25.9%) thanks to sales and marketing costs down 15% lfl - demonstrating once again a sharp improvement in sales productivity; **2). For the A&N (Adabas & Natural) division,** Product sales were down 9% (-5% lfl) to EUR52.3m (BG est.: EUR49.6m; consensus: EUR50.9m), of which EUR11.6m (-28% lfl) in licences following early contract closings in Q1 16 and a strong +5% lfl on maintenance, while the business line margin was down 3.7ppt to 66.9% (BG est.: 67.2%); **3). For Consulting,** sales were up 4.3% (+7% lfl) to EUR50.5m (BG est.: EUR47.5m; consensus: EUR48.7m) with a business line margin up 1.4ppt to 9.3% (BG est.: 9.5%) despite a gross margin down 0.8ppt to 17.6% thanks to sales and marketing costs down 14% lfl.

FY16 guidance raised. For FY16, Software AG still expects DBP Product sales up 5-10% at cc, but raised guidance for A&N Product sales to -6%/-2% at cc from -8%/-4% at cc and for non-IFRS operating margin to 30.5-31.5% from 30-31%. These figures are in line with our forecasts, as we expect +8% for DBP, -3% for A&N, and a non-IFRS operating margin of 31.3% (consensus: 31.1%). DBP revenues in H1 16, up 5% lfl, are at the low-end of the guidance range, but the management in the press release talks about a strong pipeline, yet it is too early to anticipate a better performance in H2 16. On their side, A&N revenues were up 7% lfl in H1 16, so even though we could expect a decline over H2 16 we think the high-end of company guidance for this division is not very challenging to achieve.

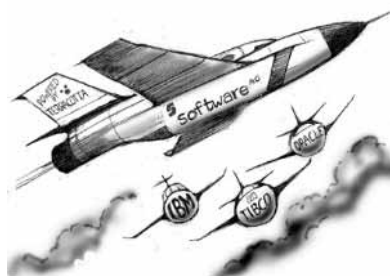
VALUATION

- Software AG's shares are trading at est. 8.5x 2016 and 7.4x 2017 EV/EBIT multiples.
- Net cash position on 31st March 2016 was EUR49.1m (net gearing: -4%).

NEXT CATALYSTS

Conference call today at 9.30am CET / 8.30am BST / 3.30am EDT (UK: +44 20 30 59 81 28; USA: +1 631 302 65 47).

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BG's Wake Up Call

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BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56.8%

NEUTRAL ratings 33.8%

SELL ratings 9.5%

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