

14th July 2016

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%

	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%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	873.1	890.4	923.4	965.5
% change		2.0%	3.7%	4.6%
EBITDA	278	289	307	327
EBIT	209.4	235.8	260.5	282.5
% change		12.6%	10.5%	8.5%
Net income	188.0	191.4	203.7	218.5
% change		1.8%	6.4%	7.2%

	2015	2016e	2017e	2018e
Operating margin	30.2	30.8	31.7	32.4
Net margin	16.0	17.5	18.9	19.7
ROE	12.8	13.0	13.1	13.0
ROCE	17.7	18.3	19.8	21.8
Gearing	1.3	-10.0	-21.2	-31.0

(€)	2015	2016e	2017e	2018e
EPS	2.33	2.37	2.53	2.71
% change	-	1.8%	6.4%	7.2%
P/E	13.4x	13.1x	12.3x	11.5x
FCF yield (%)	7.0%	7.8%	8.4%	9.1%
Dividends (€)	0.55	0.60	0.65	0.70
Div yield (%)	1.8%	1.9%	2.1%	2.2%
EV/Sales	2.8x	2.6x	2.4x	2.1x
EV/EBITDA	8.9x	8.1x	7.1x	6.1x
EV/EBIT	9.4x	8.5x	7.4x	6.4x

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.

## 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 31<sup>st</sup> 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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