

15th July 2016

TMT

Software AG

Price EUR33.36

Q2 16 conference call feedback: and six!

Fair Value EUR40 (+20%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	34.9 / 23.8
Market Cap (EUR)	2,635
Ev (BG Estimates) (EUR)	2,514
Avg. 6m daily volume (000)	251.3
3y EPS CAGR	5.2%

We reiterate our Buy rating following Software AG's sixth consecutive quarter of results that exceed consensus expectations. We raise our non-IFRS operating margin forecast to 31.5% from 31.3% for 2016 in order to reflect the company guidance upgrade (30.5-31.5% vs. 30-31%): 1). Management seems confident growth will accelerate for the Digital Business Platform in H2 16; 2). While additional upside is possible, the company refrains from being bullish on H2 margins - basically flattish given fading benefits from restructuring undertaken in H2 15. NB. Brexit had no impact so far.

	1 M	3 M	6 M	31/12/15
Absolute perf.	3.8%	-0.4%	26.0%	26.2%
Softw. & Comp.	4.1%	0.1%	0.6%	-3.2%
DJ Stoxx 600	5.6%	-1.6%	-0.3%	-7.5%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	873.1	889.7	922.4	964.7
% change		1.9%	3.7%	4.6%
EBITDA	278	291	307	328
EBIT	209.4	239.2	261.6	283.3
% change		14.2%	9.4%	8.3%
Net income	188.0	192.7	203.8	219.0
% change		2.5%	5.8%	7.5%

	2015	2016e	2017e	2018e
Operating margin	30.2	31.1	31.7	32.5
Net margin	16.0	17.8	19.0	19.8
ROE	12.8	13.1	13.1	13.0
ROCE	17.7	18.4	19.8	21.8
Gearing	1.3	-10.1	-21.2	-31.0

(€)	2015	2016e	2017e	2018e
EPS	2.33	2.39	2.53	2.71
% change	-	2.5%	5.8%	7.5%
P/E	14.3x	14.0x	13.2x	12.3x
FCF yield (%)	6.5%	7.3%	7.9%	8.6%
Dividends (€)	0.55	0.60	0.65	0.70
Div yield (%)	1.6%	1.8%	1.9%	2.1%
EV/Sales	3.0x	2.8x	2.6x	2.3x
EV/EBITDA	9.5x	8.6x	7.7x	6.6x
EV/EBIT	10.1x	9.1x	8.0x	7.0x

ANALYSIS

- KPIs continue to improve, Digital may accelerate over H2.** The transformation of the sales approach continues to pay off, yet Q2 16 was not as strong as we expected due to the slippage of 1-2 deals in North America. However, management appears confident DBP's sales growth will accelerate in H2 15, from the +5% lfl reported for H1. The DBP licence pipeline for deals above EUR3m is twice as big as that of one year ago (1.2x bigger for deals above EUR1m), sales productivity surged by 28% in Q2 16, the conversion rate of the pipeline into deals continues to improve, the average deal size was up only 5% in Q2 but rose by 11% for deals above EUR1m – which reflects Software AG's increased emphasis on large complex deals rather than smaller feature-oriented deals. By geography, in Q2 16, DBP licence sales were up 19% with +79% for Germany, +26% for the UK, +39% for France, and a solid performance in Spain, while the US was flat after a stronger Q1 (+11%) due to the slippage of 1-2 deals onto Q3 16, Latin America was still down, and Asia Pacific surged by 56%. The partner ecosystem is progressing well, with 35% more active partners than in Q1 16. On its side, A&N is expected to deliver declining licence revenues over H2 16 as expected, with a trend of flattish maintenance revenues.
- Are non-IFRS operating margin targets conservative?** We increase our non-IFRS operating margin forecast to 31.5% from 31.3% for 2016. With FY16 guidance upped to 30.5-31.5% from 30-31%, Software AG is now very close to the low-end of its 2020 target, i.e. 32-35%. Management has refrained from being bullish as some investment may be needed to fuel growth acceleration, i.e. increasing the sales coverage on geographies and channels, as the benefit of sales productivity measures implemented for the last 18 months will slow down over time, but it considers sales and marketing costs will grow at a slower pace than revenues. For FY16, while the non-IFRS operating margin was up 3.9ppt in H1 16, company guidance for the full-year (+0.8ppt/+1.8ppt) may be seen as conservative as it would imply a flattish margin for H2 16. However, this has to be analysed in the light of 3 elements: A&N licence sales are planned to be down in H2, the benefit of the sales force restructuring undertaken in H2 15 will fade, and the gross margin of Consulting will be hit by tough comps - positive one-offs in Q3 15 due to the closing of an overdue payment.
- Reiterated comments on M&A.** Software AG reiterates its commitment on its use of cash, through M&A, dividends and/or share buy-backs. There is still no deal on the table immediately, but management remains opportunistic on M&A as its confirms prices are coming down for unlisted companies, and banks are more than ever willing to lend money to corporates.

VALUATION

- Software AG's shares are trading at est. 9.1x 2016 and 8.0x 2017 EV/EBIT multiples.
- Net cash position on 31st March 2016 was EUR49.1m (net gearing: -4%).

NEXT CATALYSTS

Final Q2 16 results on 20th July before markets open.

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