

Software AG

Price EUR35.62

Announcing the Adabas & Natural 2050 agenda and acquisition of Connx Solutions

Fair Value EUR40 (+12%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	36.7 / 23.8
Market Cap (EURm)	2,814
Ev (BG Estimates) (EURm)	2,682
Avg. 6m daily volume (000)	201.8
3y EPS CAGR	5.2%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-1.2%	2.1%	9.4%	34.8%
Softw. & Comp.	1.0%	5.5%	11.4%	5.3%
DJ Stoxx 600	0.5%	-1.1%	2.9%	-6.1%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	873.1	889.8	922.4	964.7
% change		1.9%	3.7%	4.6%
EBITDA	278	291	307	328
EBIT	209.4	239.1	261.5	283.2
% change		14.2%	9.3%	8.3%
Net income	188.0	192.7	203.7	218.9
% change		2.5%	5.7%	7.5%

	2015	2016e	2017e	2018e
Operating margin	30.2	31.0	31.7	32.5
Net margin	16.0	17.7	19.0	19.8
ROE	12.8	13.1	13.1	13.0
ROCE	17.7	18.5	20.0	22.0
Gearing	1.3	-11.0	-22.0	-31.7

(€)	2015	2016e	2017e	2018e
EPS	2.33	2.39	2.53	2.71
% change	-	2.5%	5.8%	7.5%
P/E	15.3x	14.9x	14.1x	13.1x
FCF yield (%)	6.1%	6.8%	7.4%	8.0%
Dividends (€)	0.55	0.60	0.65	0.70
Div yield (%)	1.5%	1.7%	1.8%	2.0%
EV/Sales	3.2x	3.0x	2.7x	2.4x
EV/EBITDA	10.2x	9.2x	8.2x	7.2x
EV/EBIT	10.7x	9.7x	8.6x	7.5x

Yesterday Software AG made its Adabas & Natural (A&N) 2050 roadmap official, launching an extended services portfolio and the integration of Mobile, Big Data and DevOps capabilities. It also announced the acquisition of Connx Solutions, a software vendor specialised in data integration and replication, which has been a partner in A&N for over 10 years. While the contribution of both is difficult to quantify, we consider these two moves will help Software AG soften the decline in the A&N business (est. 27% of sales and a 68% margin) over the medium-term.

ANALYSIS

- Announcing the Adabas & Natural roadmap.** Software AG yesterday released details of its agenda to support and further develop its Adabas & Natural product portfolio until beyond 2050. In order to leverage its digitisation capabilities to Adabas & Natural enterprise applications, Software AG is launching an extended services portfolio named "A&N Managed Services", which provides staff training, and application modernisation, management and operations to protect the investments made by customers and extend the life-cycle of their mission-critical applications. New A&N product releases and capabilities, as underlined in a recent statement of direction for 2015-2020, include: 1) Mobile, by adding capabilities to develop mobile-optimised applications with Natural; 2) Big Data, by replicating Adabas data in real-time into Terracotta In-memory to enable internet scale applications and services, and through the integration with Apama Streaming Analytics to develop analytic solutions with real-time insights and decisions; 3) DevOps, by extending capabilities to improve DevOps tasks in the Eclipse-based NaturalOne (support, profiling, testing).
- Acquisition of Connx Solutions.** Founded in 1989 and based in Redmond (USA), Connx Solutions provides API-based data integration/replication technology for Adabas & Natural customers. The company has been an OEM partner of Software AG for over 10 years with broad adoption within the Adabas & Natural customer base. The rationale of the acquisition for Software AG is to secure access to this technology in the light of the 2050 agenda. In addition, Software AG customers gain access to the full range of Connx Solutions technologies (SQL data access, ETL, data sync, desktop query and reporting, cloud integration, integration with Excel...). The acquisition closed on 31st July. We have no details regarding the acquisition price and the revenues Connx generates, but at first glance we doubt the company will have a significant contribution to Software AG's P&L.
- Efforts to soften the decline in A&N revenues.** We estimate that Adabas & Natural products, before the contribution of Connx Solutions, will account for 27% of revenues to EUR240m (-3% vs. 2015) vs. company guidance of -6%/-2% at cc) with a margin of 68% (70% in 2015) before G&A and central costs. For H1 2016, the A&N division was up 7% lfl with +20% lfl in Q1 especially on the back of a large deal which was booked ahead of schedule. While the impact of the roadmap and Connx are challenging to evaluate, we expect A&N revenues to fall 6-7% lfl by 2019-2020, but we cannot rule out the prospect of this decline being softened in the medium-term by a sustained software renewal rate (currently 98%) and Connx products. In addition, the addition of A&N Managed Services could enhance services revenue growth (est. +4.5% for 2020).

VALUATION

- Software AG's shares are trading at est. 9.7x 2016 and 8.6x 2017 EV/EBIT multiples.
- Net cash position on 30th June 2016 was EUR65.8m (net gearing: -6%).

NEXT CATALYSTS

Q3 2016 results on 20th October before markets open.

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Distribution of stock ratings

BUY ratings 72%

NEUTRAL ratings 0%

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