

Software AG

Price EUR37.03

Preliminary Q3 2016 results below estimates due to late deals; FY16 guidance reiterated

Fair Value EUR40 (+8%)

BUY

Bloomberg	SOW GR
Reuters	SOWG.DE
12-month High / Low (EUR)	38.9 / 23.8
Market Cap (EUR)	2,925
Ev (BG Estimates) (EUR)	2,794
Avg. 6m daily volume (000)	188.0
3y EPS CAGR	4.9%

This morning, Software AG pre-announced Q3 2016 results with revenues 7% below the consensus average and non-IFRS operating profit only 2% below thanks to a non-IFRS op. margin up 1.2ppt to 33.7% vs BGe 31.7% (consensus: 32%), while EUR7.3m of DBP licence sales slipped to early October. Management considers that the sales pipeline remains promising, and reiterates FY16 guidance. As Software AG reports its first quarterly miss after 6 consecutive quarters above consensus, we expect the share price to react negatively short-term.

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.6%	18.7%	8.8%	40.1%
Softw. & Comp.	-0.5%	10.7%	9.3%	5.3%
DJ Stoxx 600	-0.9%	-0.1%	-2.2%	-8.3%

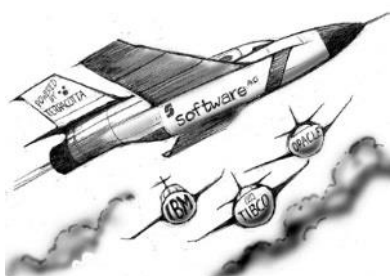
ANALYSIS

- Q3 2016 results below expectations due to late deal closings.** Based on preliminary figures, Q3 2016 sales were down 8.1% (-7.1% lfl) to EUR198.3m, or 8% below our forecast (EUR215.3) and 7% behind the consensus (EUR212.6m), due to EUR7.3m of DBP licence sales that slipped from Q3 to the first days of October. Non-IFRS operating profit was down 4.8% to EUR66.8m or 33.7% of sales (+1.2ppt) or only 2% below our estimate (EUR68.3m or 31.7%) and the consensus (EUR68m or 32%). IFRS EBIT was down 25% to EUR50.1m (BG est.: EUR57.1m; consensus: EUR56.4m) after a EUR5.4m one-time charge related to a lawsuit in the US. Licence sales were down an est. 32% lfl to EUR46.9m or 27% below our est. (EUR64.6m) and 25% behind the consensus (EUR62.5m), while maintenance was up 4% lfl to EUR104m (BG est.: EUR104.2m; consensus: EUR102.9m). Finally, the management estimates that free cash flow was up 25-35% in Q3 2016 (up 10-13% year-to-date). Restated from the EUR7.3m that slipped, pro forma Q3 revenues would have been down 4% lfl to EUR205.5m, or 3% below consensus however due to a weak quarter for Adabas & Natural (A&N) on licence sales - probably in relation with licence revenue seasonality.
- Details by division.** 1). **For the Digital Business Platform (DBP) division**, Product sales were down 1.2% (est. +1% lfl) to EUR101.9m (BG est.: EUR110.8m, consensus: EUR109.9m), of which EUR37.5m (est. -8% lfl) in licences and +6% lfl on maintenance, while the business line margin was up 7.3ppt to 35.4% (BG est.: 32.7%) thanks to sales and marketing costs down 20%; 2). **For the A&N (Adabas & Natural) division**, Product sales were down 26.6% (-26% lfl) to EUR49.1m (BG est.: EUR58.2m; consensus: EUR55.5m), of which EUR9.3m (-66% lfl) in licences and +1% lfl on maintenance, while the business line margin was down 2.5ppt to 73.7% (BG est.: 71.1%); 3). **For Consulting**, sales were up 3.2% (+5% lfl) to EUR447.3m (BG est.: EUR46.3m; consensus: EUR47.2m) with a business line margin 1.4ppt to 15.5% (BG est.: 9.4%) with a gross margin up 0.7ppt to 25.8%.
- FY16 guidance reiterated.** For FY16, Software AG still expects DBP Product sales up 5-10% at cc, A&N Product sales down 2-6% at cc, and a non-IFRS operating margin of 30.5-31.5%. These figures are roughly in line with our forecasts, as we expect +6.3% for DBP, -1.5% for A&N, and a non-IFRS operating margin of 31.5% (consensus: 31.9%). DBP revenues year-to-date as of 11th October, up 5% lfl, are at the low-end of the guidance range, but the management in the press release talks about a promising project pipeline. On their side, A&N revenues were down 5% lfl year-to-date, or at the low-end of full-year guidance, but Q4 2015 was down 15% lfl.

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	873.1	887.6	916.7	958.8
% change		1.7%	3.3%	4.6%
EBITDA	278	289	304	325
EBIT	209.4	237.7	258.2	280.4
% change		13.5%	8.6%	8.6%
Net income	188.0	191.7	201.5	217.0
% change		1.9%	5.1%	7.7%

	2015	2016e	2017e	2018e
Operating margin	30.2	31.0	31.5	32.4
Net margin	16.0	17.7	18.8	19.7
ROE	12.8	13.0	13.0	12.9
ROCE	17.7	18.4	19.7	21.8
Gearing	1.3	-10.9	-21.8	-31.5

(€)	2015	2016e	2017e	2018e
EPS	2.33	2.38	2.50	2.69
% change	-	1.9%	5.1%	7.7%
P/E	15.9x	15.6x	14.8x	13.8x
FCF yield (%)	5.9%	6.6%	7.0%	7.6%
Dividends (€)	0.55	0.60	0.65	0.70
Div yield (%)	1.5%	1.6%	1.8%	1.9%
EV/Sales	3.4x	3.1x	2.9x	2.6x
EV/EBITDA	10.6x	9.7x	8.7x	7.6x
EV/EBIT	11.2x	10.2x	9.1x	7.9x



VALUATION

- Software AG's shares are trading at est. 10.2x 2016 and 9.1x 2017 EV/EBIT multiples.
- Net cash position on 30th June 2016 was EUR65.8m (net gearing: -6%).

NEXT CATALYSTS

Conference call today at 10am CET / 9am BST / 10am EDT (UK: +44 20 30 59 81 28; USA: +1 631 302 65 47).

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