22 August 2019

SOPHEON

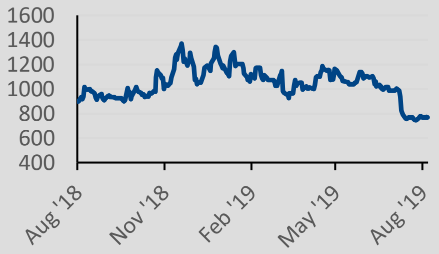
SOFTWARE & COMPUTER SERVICES

SPE.L

770p

Market Cap: £82m

SHARE PRICE (p)



12m high/low	1,370p/745p

Source: LSE Data

KEY INFORMATION

Enterprise value	£68.2m
Index/market	AIM
Next news	Trading update, Jan '20
Gearing	N/A
Interest cover	N/A

SOPHEON IS A RESEARCH CLIENT OF PROGRESSIVE

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Interims in line with recent update

Strong pipeline drives confidence for the future

Sopheon's interim results reflect a return to a stronger second half weighting, as flagged in July's trading update – although EBITDA is $0.5m ahead of the number in that announcement. Alongside the delays in closing some license contracts in the first half, management reiterates the strength of the new business pipeline and the supportive underlying market conditions, and notes customers apparently reverting to a year-end buying pattern. With a sharp increase in the proportion of SaaS business in the pipeline – reflective of industry procurement trends - we expect to see higher recurring revenues over time (bringing greater visibility) and enhanced lifetime customer revenue. Chairman Barry Mence comments that the future prospects for Sopheon 'have never been brighter' when highlighting the positive trends for the Group in the outlook statement – and we note the pipeline and the long-term value being built within the growing SaaS business.

- Sopheon's experience of a step up in the proportion of SaaS contracts in its pipeline is in line with broader, longer term market trends. Whereas its business model has historically featured predominantly perpetual licences, this previously-flagged migration towards a SaaS model is now accelerating.
- In addition to customer behaviours driving a more H2 bias for deal closings, the Group highlights unexpected client personnel changes, customer scope expanding from point to enterprise solutions and ramp-up time of its newer sales resources as contributory factors to the H1 delays previously highlighted in July's trading update.
- Having closed further new business post the half year end, current revenue visibility is stated as $25.4m compared to just over $27m a year ago following the very strong Q2 2018.

Today's results are in line with (or a little ahead of) the figures expected following the recent update. From management's tone, it appears that the momentum within the business remains very strong, and there is still confidence around the pickup required in H2 to deliver full-year forecasts. This would clearly bode well for 2020 and beyond, and we look forward to further newsflow across coming months.

FYE DEC ($M)	2016	2017	2018	2019E	2020E
Revenue	23.2	28.5	33.9	33.5	39.5
Adj EBITDA	5.3	8.2	9.4	7.5	9.5
Fully adj PBT	2.7	5.3	6.9	4.5	6.3
Fully adj dil EPS (c)	28.1	50.9	59.8	39.0	54.4
EV/Sales (x)	3.6x	2.9x	2.4x	2.5x	2.1x
EV/EBITDA (x)	15.5x	10.0x	8.8x	11.0x	8.6x
PER (x)	33.1x	18.3x	15.6x	23.9x	17.1x

Source: Company Information and Progressive Equity Research estimates

H1 2019 results

Headwinds in H1 mitigated by a strong forward pipeline

This year's interim results followed a strong performance in 2018 when Sopheon's blue chip customer base featured increasingly enterprise-focused customer relationships. Last year, Accolade was sold predominantly on perpetual licences with annual maintenance and hosting fees. Few deals were pure SaaS, although there was a good level of recurring income with further increases in maintenance and hosting. Sopheon ended 2018 with a total recurring revenue run rate of $15m of which approximately $3m was SaaS and hosting. The Group is now seeing an increasing proportion of licence opportunities in the pipeline opting for a SaaS model rather than perpetual. The first half of 2019 also featured the effects of delays in closing contracts that were highlighted in July's trading update and which prompted downgrades for the full year at the time.

Sopheon closed 18 software transactions in the first half of 2019 with 7 from new customers (2018: 29 and 9 respectively). The 'unprecedented' pipeline growth of 48% during H1 2019 included an increase in the number of opportunities above $500,000 in deal value of 29%. New customers included wins in Thailand, the UK, USA, Canada and Benelux and management states that it continues to see 'tremendous potential' in Asia. In addition to customers looking to a more H2 bias for deal closings, the Group highlights unexpected client personnel changes, customer scope expanding from point to enterprise solutions and ramp-up time of its newer sales resources as contributory factors.

While our FY 2019E estimates assume that the Group will not recover all the lost ground in the second half, it is seeing good levels of demand and reports a very strong pipeline. The increased proportion of SaaS deals, however, means that new business won will not assist reported H2 2019 revenues anything like as much as equivalent perpetual licences. However, Sopheon will receive the more-valuable longer term benefits of those SaaS contracts in ensuing periods.

Strategy remains clear

Sopheon released Accolade version 12.3 in June 2018 and expects to release version 13.0 in the final quarter of this year. The latest software releases introduced more localized flexibility and continued to enhance the user experience and time savings through smart automation. The Group has broadened its offering to one that helps major enterprises achieve their strategic goals. Extending Accolade's application has expanded its potential to a substantial addressable market. The Group continues to focus on and refine its three core growth strategies.

Firstly, Sopheon will seek to extend its footprint with existing customers by expanding the business scope of its enterprise platform with different use cases that leverage the Accolade platform beyond product innovation and identify it as the digital platform of choice to digitalize corporate strategy and operational execution. Management has identified fourteen different use cases that have already been deployed by its customers. In 2019, management planned to introduce and actively market three of the fourteen to generate additional growth: Strategic Initiative Management was introduced in the first half of the year, and the remaining two will be introduced in the second half.

Secondly, it will continue to target new business acquisition with a clear vertical focus through deeper specialisation and domain-specific expertise – something which has been key to its historical success. In 2018, all new customer wins were in one of those verticals – chemicals, aerospace, technology, consumer, food, industrial manufacturing and more recently, automotive and transportation. The pipeline now includes a number of opportunities in the automotive space.

Thirdly, Sopheon will also look to develop and monetise an Accolade ecosystem of channel, strategic and geographical distribution partnerships. That includes, for instance, increasing activity with Sopheon's reseller network in Asia-Pacific where the announcement of wins has provided early evidence of traction in the region. It will also deepen and formalise relationships with major consulting firms that have already recommended Accolade.

Revenue

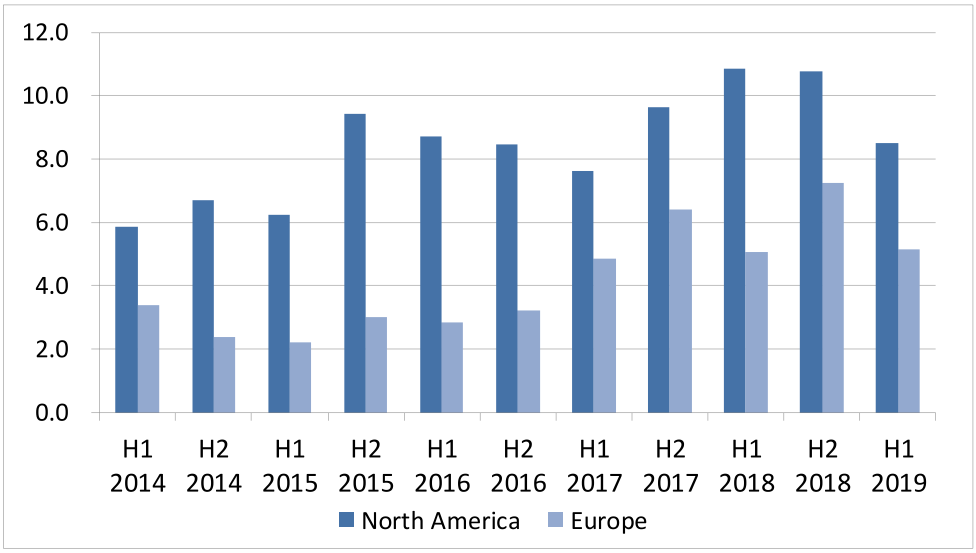
Revenue visibility

Having closed further new business post the half year end, current revenue visibility is stated as $25.4m compared to just over $27m a year ago following the very strong Q2 2018.

H1 2019 revenue

H1 2019 revenue was $13.7m compared to $15.9m in H1 2018 which had included a particularly strong Q2 performance. The announcement reiterates management's expectation that the full year results will return to being H2 weighted – in particular Q4 weighted – given the strong pipeline growth. US dollar strength produced a c. 2% headwind for reported revenues in the first half which would have been around $14m on a constant currency basis. The effects of the delays in contract signings can be seen in the chart below which shows the revenues under the segmental split.

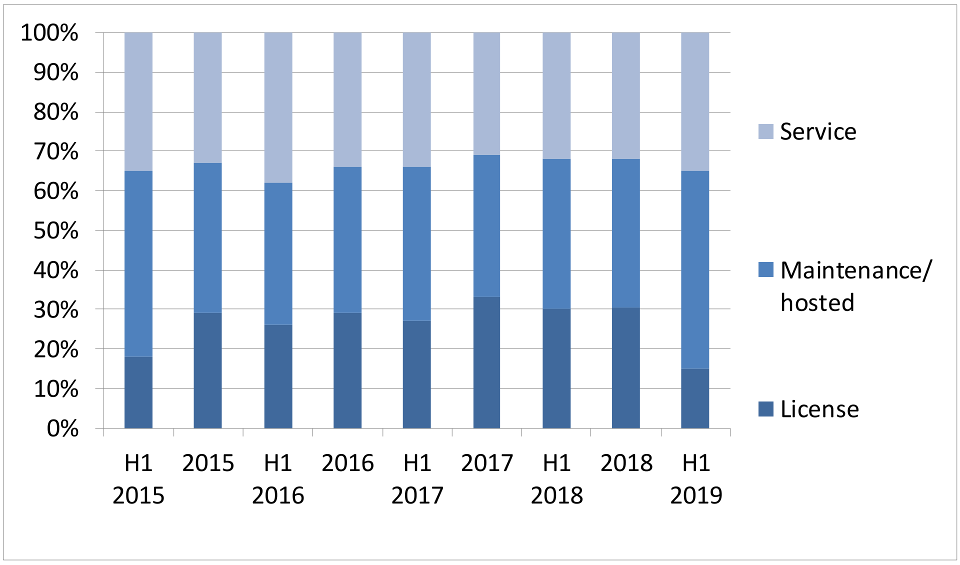
Revenue by segment (US$m)



Source: Sopheon information

With a mix of perpetual and SaaS deals, the recurring revenue base rose to $15.3m at the end of June 2019 from $13.7m a year ago. The Group also continued to sign 'substantial' service extensions alongside implementation and upgrade projects. The revenue mix between licence, service and maintenance/hosting reflected the licence sale delays in H1 2019 at 15:35:50 compared to 30:32:38 respectively in H1 2018.

Revenue by type (%)



Source: Sopheon information

Costs, margin and profitability

Sales and marketing costs were up slightly at $4.3m from $4.1m last year, with higher staff costs mitigated by lower revenue-associated commissions and incentives. Sopheon continues to recruit and ended the period with 161 staff compared to 147 at the end of 2018 with new hires across its commercial, deployment and development areas. There is a continuing recruitment focus on developing Sopheon's expanded business strategy and partnership programs. Net R&D expense of just over $2.4m increased by $0.3m while administrative expenses were similar to those of the prior year at $2m compared to $1.9m in H1 2018. Sopheon's adoption of IFRS 16 has resulted in a reduction in leases expense of $370,000, offset by increases in depreciation and interest of $350,000 and $35,000 respectively. We reflect the IFRS 16 changes in our forecasts with modest increases to the EBITDA estimates for 2019E and 2020E.

Gross margin for the period was 69% compared to 71% in H1 2018 as the main direct cost component - delivery teams and associated subcontractors - remained 'fairly steady', as did all Sopheon's major cost categories. EBITDA for H1 2019 was $2.5m (2018: $4.1m) while H1 2019 PBT was $0.9m (2018: $2.8m) after net interest, depreciation and amortization costs amounting to $1.6m (2018: $1.3m).

The announcement states that no adjustment has been recorded to the deferred tax asset, although provision has been made for approximately $0.2m in current tax for US state taxes and German corporation tax, resulting in a final profit after tax of $0.6m compared to $2.6m the year before. Basic and diluted H1 2019 EPS were respectively 6.33 cents and 5.98 cents (H1 2018: 26.34 and 24.99).

Cash and credit facilities

The Group continues to present a strong Balance Sheet with growth in net assets to $26.2m from $21.2m a year earlier. Sopheon also ended the half year with an improved net cash position of $18.7m from $16.7m at the 2018 year end (30 June 2018: $15.5m) reflecting further positive cash generation in the business. The Group's $3m revolving line of credit facility with Silicon Valley Bank was renewed through February 2020 with an improved interest rate of 3.75%, down from 7.25% and a rolling annual renewal is anticipated. As at 30 June 2019 there were no funds drawn (30 June 2018: $0.4m).

Financial Summary: Sopheon

Year end: December ($m unless shown)

PROFIT & LOSS	**2016**	**2017**	**2018**	**2019E**	**2020E**
Revenue	23.2	28.5	33.9	33.5	39.5
Adj EBITDA	5.3	8.2	9.4	7.5	9.5
Adj EBIT	3.1	5.8	6.9	4.3	6.2
Reported PBT	3.1	5.1	6.4	4.0	5.8
Fully adj PBT	2.7	5.3	6.9	4.5	6.3
NOPAT	3.0	5.3	6.3	4.0	5.7
Reported Dil EPS (c)	42.8	55.9	65.0	37.8	54.5
Fully adj dil EPS (c)	28.1	50.9	59.8	39.0	54.4
Dividend per share (p)	0.0	2.5	3.3	3.9	4.6
CASH FLOW & BALANCE SHEET	**2016**	**2017**	**2018**	**2019E**	**2020E**
Operating cash flow	5.5	6.0	10.4	6.5	7.3
Free Cash flow	3.0	2.8	7.6	3.3	4.1
FCF per share (c)	29.5	27.1	71.1	30.8	37.9
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.1	0.0	0.2	0.0	0.0
Net cash flow	2.9	3.1	7.8	3.3	4.1
Overdrafts / borrowings	(5.8)	(3.2)	(0.4)	(0.4)	(0.4)
Cash & equivalents	10.1	12.7	17.1	20.4	24.4
Net (Debt)/Cash	4.2	9.5	16.7	20.0	24.1
NAV AND RETURNS	**2016**	**2017**	**2018**	**2019E**	**2020E**
Net asset value	10.4	18.6	25.6	29.3	34.8
NAV/share (c)	142.3	186.0	252.2	288.8	342.4
Net Tangible Asset Value	0.2	0.4	0.5	0.8	0.9
NTAV/share (c)	3.3	4.1	5.2	7.5	8.4
Average equity	7.9	14.5	22.1	27.5	32.0
Post-tax ROE (%)	37.7%	36.5%	28.7%	14.6%	17.7%
METRICS	**2016**	**2017**	**2018**	**2019E**	**2020E**
Revenue growth	11.1%	23.0%	18.9%	(1.2%)	18.0%
Adj EBITDA growth	28.9%	54.8%	14.7%	(20.5%)	27.3%
Adj EBIT growth	98.8%	87.5%	19.6%	(36.9%)	42.0%
Adj PBT growth	88.5%	95.1%	30.5%	(34.3%)	39.4%
Adj EPS growth	102.4%	80.7%	17.5%	(34.7%)	39.4%
Dividend growth	N/A	N/A	30.0%	18.5%	18.2%
Adj EBIT margins	13.2%	20.2%	20.3%	13.0%	15.6%
VALUATION	**2016**	**2017**	**2018**	**2019E**	**2020E**
EV/Sales (x)	3.6	2.9	2.4	2.5	2.1
EV/EBITDA (x)	15.5	10.0	8.8	11.0	8.6
EV/NOPAT (x)	27.5	15.6	13.0	20.6	14.5
PER (x)	33.1	18.3	15.6	23.9	17.1
Dividend yield	N/A	0.3%	0.3%	0.4%	0.5%
FCF yield	3.2%	2.9%	7.6%	3.3%	4.1%

Source: Company information and Progressive Equity Research estimates

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